Njuguna Ndung'u: Strengthening regulatory frameworks in the finance industry – a key enabler for private sector development

Keynote speech by Prof Njuguna Ndung'u, Governor of the Central Bank of Kenya, at the 1st Annual Africa Banking and Finance Conference, Nairobi, 21 February 2011.

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Distinguished Speakers,
Distinguished Guests,
Ladies and Gentlemen:

It gives me great pleasure to be here today at this inaugural African Banking and Finance Conference. This is an appropriate forum for the financial sector in Africa to reflect on pertinent developments affecting the sector globally and share experiences. But more importantly dwell on solutions to structural constraints that hinder its' development.

To start with, let me extend my profound appreciation to the organisers for putting together this forum, and to all participants for the honour of your presence. I take this opportunity to welcome all those visiting Kenya for this Conference, and wish you all a delightful stay during and after the conference.

Ladies and Gentlemen: My task this morning is to share with you some thoughts on strengthening regulatory frameworks in the financial sector as a key enabler to private sector development. The Financial Sector supports the development of the country through:

- Resource mobilization and their allocation.
- Collating savings from savers and delivering them to investors.
- The intermediation process.

The traditional regulatory environment delivered the appropriate structures for the financial sector. But it was tried during the global financial crisis.

The global financial crisis brought out some very important lessons. We should not think of more regulation but better regulation. What does better regulation entail?

- A regulatory regime that can readily identify weaknesses and emerging vulnerabilities.
- A regulatory regime capable of analyzing risks and so adequately pricing risks.
- A regulatory regime that provides appropriate incentives (penalties) to induce prudent behavior in the market place.
- A regulatory regime that encourages innovations and strong institutions to develop. Where the regulator has the role to develop the market in the African countries we live in.

The efficiency through which these roles are performed depends very much on the sector and the regulatory technology in place.

Ladies and Gentlemen: The theme of this forum *"Achieving Innovative Solutions Relevant for Africa's Banking & Finance Industry – Key Issues"* is timely and weighty because it is only through innovative solutions that African economies can move to the next level of development frontiers. It is therefore my expectation that the diversity of the participants in this forum will enable you to identify the various relevant innovations in the financial sector that are consistent with the African Landscape and to drive development in the sector.

Ladies and Gentlemen: Allow me now to briefly share with you Kenya's experience on innovations in the banking sector. In pursuit of the financial sector's vision in the Kenya's development blueprint, Vision 2030, CBK and the players have embraced a partnership approach. Consequently, several initiatives have been undertaken over the last 4 years aimed at the three envisaged goals of stability, efficiency and financial inclusion. These initiatives include:-

- ***Rollout of mobile phone financial services*** – Approval for banks to leverage on mobile phone technology to present convenience and lower costs for their customers without compromising quality of service. Through mobile banking, customers are now able to perform their transactions "anytime anywhere". Mobile money transfer has evolved from the initial concept of transferring money from one individual to another to include other functions such as payment of utility bills, loans, salaries and for deposits mobilization.
- ***Introduction of agent banking mechanism in May 2010*** where banks are allowed to engage third parties to provide certain banking services. The aim is increased outreach of banks to the vast under-banked and unbanked Kenyan populace by introducing "banking beyond branches". It also enables banks to leverage on additional cost effective distribution channels to offer financial services. Agency banking takes banking to the people unlike previously when people had to go to the banks.
- ***Licensing of credit reference bureaus*** to collect, collate, analyse and disseminate credit information among credit providers. Credit information sharing provides an opportunity for individuals and businesses to rely on their credit history (information capital) as an alternative form of collateral to the traditional physical collateral, to secure credit facilities from banks. Individuals will also be able to use their positive credit history to negotiate for better terms and conditions from their banks. On the other hand, banks will benefit from the mechanism since it will address the problem of information asymmetry and by extension the problem of non-performing loans which has in the past threatened the stability of the banking sector. The traditional challenges of the moral hazard and adverse selections can hinder financial sector growth.
- ***Licensing of deposit taking microfinance institutions (DTMs)***, whose focus is the lower end of the market, which is concentrated in the rural and periurban areas. The Microfinance Act, 2006, which empowers CBK to licence and supervise DTMs, was operationalised in 2008. Formalizing the operations of DTMs is expected to bring more people, especially those previously unbanked or under banked, into the realm of the formal financial sector not only through their lending activities but also savings mobilization.
- ***Lowering the cost of doing business:*** Several modalities including establishment of three currency centers in towns outside the key Kenyan cities to lower cash in transit costs for banks. CBK is also actively pursuing modalities of reducing the cost of establishing branch networks for Deposit Taking Microfinance Institutions, in addition to agency mechanism.

Ladies and Gentlemen: As a result of CBK's adoption of a new approach to regulating the financial sector through dialogue with the players and acting as a development agent, the Kenyan financial sector has experienced a structural transformation. This transformation is evidenced by the following achievements:

- Exponential growth of bank branches from 740 in 2007 to 1,063 as at end of 2010.
- Increase in the number of deposit accounts from 4.7 million in 2007 to 12.8 million as at end of 2010.
- Increase in the number of loan accounts from 1.2 million in 2007 to 1.8 million as at 2010.

- Licensing of five deposit taking microfinance institutions with 41 branches as at 31st December 2010, which had opened 1.01 million deposit accounts with deposits worth Kshs. 7.90 billion(USD 99m).
- Increase in the automated teller machines from 1,012 in 2007 to 1,940 as at 31st December 2010.
- Banks contracting 8,809 agents by December 2010.
- Mobile money transfers increased their total transactions to Kshs. 2.3 bn or USD 29 m per day. Well over 15 million Kenyans have subscribed to mobile money transfers since their roll out in 2007. This is expected to increase especially with the confidence to be generated by the draft E-Money Regulations recently issued by CBK.
- Mobile phone financial services have generated micro-savings accounts (MKESHO) to the tune of over 700,000 accounts with Kshs. 678m in deposits.

Ladies and Gentlemen: The structural transformation of Kenya’s financial sector has not been achieved on a silver platter. There has always been the task of surmounting prevalent challenges. Key among these is the need to balance the goals of financial efficiency, stability and integrity on one side with financial inclusion on the other. The pursuit of these goals requires delicate balancing given their importance. However, as already alluded, balancing of these goals is made easier when regulators embrace their new role of being a market developer in addition to their traditional regulatory role. A developing financial sector increases efficiency and the regulator ensures stability.

Ladies and Gentlemen: The structural transformation experienced thus far is just but the beginning. CBK and other players have earmarked several other reforms which are expected to take the development of the financial sector to new frontiers. CBK has embraced financial education as a critical component of its financial inclusion strategy. When consumers are financially literate, they are able to make informed financial decisions. In this regard, CBK and all the other financial sector regulators are members of the Financial Education and Consumer Protection Partnership (FEP), a private–public partnership, spearheaded by the Financial Sector Deepening Trust Kenya with an aim of developing a National Strategy for Financial Education in Kenya.

On the same token, ***Ladies and Gentlemen***, as efforts progress towards a more developed financial sector, there is need to ensure existence of adequate disclosure of information by providers of financial services, efficient dispute resolution mechanisms, comparability of offers and data protection. As financial regulators embrace innovations in their jurisdictions, there is need to ensure that the innovations have adequate consumer protection safeguards. Kenya’s new constitution promulgated in August 2010 entrenches consumer protection in the Bill of Rights and mandates Parliament to enact consumer protection legislation. But in addition the constitution allows for strong institutions and protects them. Strong institutions define appropriate incentives and the rules of the game to encourage prudent behavior. This is good for the financial market to allow defined entry and orderly exit from this important market.

Ladies and Gentlemen: As I conclude, let me reiterate that innovative solutions for strengthened regulatory framework for a financial sector lie with the players. The regulators, the regulated and market participants should think outside the box. They exist for each other and it is only through their acceptance to promote, advise and partner that a smarter regulatory framework is put in place that enables the private sector to prosper.

With these remarks, ***Ladies and Gentlemen***, I take this opportunity to wish you fruitful deliberations while I look forward to receiving the forum’s report in due course for us to consider the relevant innovative solutions tailored to our circumstances.

Thank you.