Njuguna Ndung'u: Financial stability and financial inclusion

Keynote address by Prof Njuguna Ndung'u, Governor of the Central Bank of Kenya, at the 5th Joint CMA/CBK/RBA/IRA Board Members retreat on collaboration among domestic financial sector regulators, Mombasa, 13 October 2011.

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Chairpersons here present;

Board Members of Financial Sector Regulators here present;

Chief Executive Officers;

Colleagues;

Ladies and Gentlemen:

I am honoured by the invitation to address this gathering on financial inclusion and financial stability, an increasingly topical issue. At the outset, I would like to thank the Retirement Benefits Authority for hosting this 5th Joint Retreat for the Board Members of Domestic Financial Sector Regulators.

Ladies and Gentlemen: At a time like this, a pertinent question begs an answer: what does financial stability entail? While the concept cannot be easily captured in a single word, a few attributes need to be demonstrated for a given system to be described as financially stable. These include: public confidence and trust in the institutional framework – owing to sound design of the infrastructure; predictability; efficiency; sound ethical behavior by market participants and competence of financial authorities, among others. To paraphrase, financial stability may be said to be present in an economy when the financial system functions as it is supposed to.

Financial stability in a given jurisdiction serves to instill confidence in users of financial services. It encourages and facilitates productive economic activities and thereby contributes to a society's overall well-being and progress. The role of regulators, in this regard, has historically been to oversee financial stability using traditional performance indicators as a guide. These indicators include conventional performance measures such as the quality of assets in institutions, earnings and performance, liquidity and capitalization.

Ladies and Gentlemen: In our country's history, the Kenyan financial sector has on a number of occasions undergone severe tests of its stability, involving failure of systemically important financial institutions, that have dented market confidence in our financial system. As regulators, we have a fiduciary role to maintain public confidence in the financial sector by addressing all factors that would undermine the sector's long-term stability, without which it would lose its long-term relevance as a medium of economic interaction and payments system. Maintaining public confidence entails ensuring that the sector keeps up with all pertinent global developments to ensure it remains relevant to the needs of the public from which it derives its mandate.

Ladies and Gentlemen: Alongside financial stability comes another topical issue in development debates across the globe, financial inclusion. For the financial system to be relevant to society, it needs to ensure that as much of the eligible target population has opportunity to access a variety of financial services ranging from credit, savings and payments, transfers, pensions, capital markets and insurance services. Inclusion is an essential pre-condition to enhancing wealth creation and poverty reduction and ultimately broad based economic development. The Consultative Group to Assist the Poor (CGAP) defines financial inclusion as a "***state in which all people who can are able to have access to a full suite of quality financial services, provided at affordable prices, in a convenient manner, and with dignity for the clients***". These financial services are delivered by a range of providers, most of them private, and reach everyone who can use them, including disabled, poor, rural, and other excluded populations.

Ladies and Gentlemen: Why should we, as regulators, be concerned about the levels of financial inclusion in our respective jurisdictions? Individuals and households lacking adequate access to a full range of responsibly delivered, affordably priced, convenient, formal financial services would be severely constrained in participating fully in the economy. As an entity, the financial sector would also face bleak prospects in terms of expansion and longevity, which holds back overall economic development. But more importantly, financial inclusion is supported by financial stability.

In Kenya, the proportion of the population totally excluded from formal financial services, as revealed by the Finaccess 2006 and 2009 surveys, stood at 38.3% and 32.7% respectively. The proportionate reduction between the years is largely attributable to the advent of mobile-based financial services which have indeed revolutionized the provision of formal financial services and availed these to the market affordably and conveniently. For us to bring costs of financial services down, we need full inclusion.

Ladies and Gentlemen: Given the statistics above, as financial sector regulators, we share common aspirations of making the financial sector more stable, efficient and accessible. Though these objectives may at times appear competing, they are for the most part complementary. Stability is a pre-requisite for efficiency, while both are in turn required to raise inclusion. In cognizance of this, the Central Bank, jointly with other players, has undertaken several initiatives and reforms aimed at boosting overall inclusion. These include:

- ***Licensing of Deposit Taking Microfinance Institutions (DTMs)***, focusing on the lower end of the market concentrated in rural and peri-urban areas. The licensed DTMs had 57 branches, 1.5 million deposit accounts valued at Ksh.9 billion (USD90 million) and 0.53 million loan accounts with an outstanding loan portfolio of Ksh.15 billion (USD150,000) as at the end of August 2011.
- ***Rolling out Agency Banking***, with over 8,000 agents being contracted by 7 banks countrywide and more than Ksh.17 billion worth of transactions conducted through agents as at the end of August 2011 since roll-out in July 2010.
- ***Implementation of Credit Information Sharing***, with more than 900,000 reports on customers on credit applicants being requested by banks as at 31st August 2011 since roll out just a year ago.
- ***Introduction of Sharia Compliant Banking***, with two institutions so far offering exclusive Sharia products, with a growing market footprint.
- ***Mobile-Based Financial Services***, utilizing technological platforms to enable the provision of innovative financial services. In just over 5 years, over 15 million Kenyans have been integrated into the financial system through this innovative channel.
- ***Financial Education Initiatives*** under the Financial Education and Consumer Protection Partnership (FEPP), which has commissioned four pilot financial education projects through Equity Bank, Faulu Kenya, Plan International and Mediae. These pilot projects aim to establish the feasibility of different approaches to financial education in Kenya in order to inform the development of a national strategy for financial education.

Owing to the above, there have been notable improvements in financial access especially among the lower population segments, including the growth of bank deposit accounts from 2.5 million to close to 14 million to date.

Ladies and Gentlemen: Beyond the local scene, the Central Bank has also been active in international forums with a view to learning from others' experiences. The Bank has been an active member of the Alliance for Financial Inclusion (AFI), a global member-based network which provides an international platform for policymakers in developing countries to learn and share knowledge towards enhancing access to basic financial services for their un-banked and under-banked populace. AFI has a membership from 81 developing countries in Africa, Asia and Latin America.

Through its membership of AFI, CBK was appointed as a non-G20 member of the Global Partnership for Financial Inclusion (GPFI) in December 2010. GPFI is a G20 initiative to propel financial inclusion through peer learning, knowledge sharing, policy advocacy and coordination. Now that AFI is opening its membership to associate members, I take this opportunity to urge fellow financial sector regulators to consider joining this worthwhile forum, in order to facilitate joint contributions towards greater inclusion in our local sector.

In the same vein, I am pleased to note that both the CBK and CMA were recently invited, and accepted to join the Regional Consultative Group for Sub-Saharan Africa of the Financial Stability Board (FSB). FSB is a global association established to coordinate at the international level the work of national financial authorities and international standard setting bodies and to develop and promote the implementation of effective regulatory, supervisory and other financial sector policies in the interests of financial stability. The Association brings together national authorities responsible for financial stability in 24 countries and jurisdictions, including regulators and supervisors.

Membership in the consultative forum will provide both the CBK and CMA with an opportunity to contribute in key decision making and policy formulation from a regional and global perspective for the benefit of our entire financial sector. It will also create an avenue to contribute in shaping the development and implementation of financial sector policies aimed at realizing financial stability. I am sure that both the CBK and CMA will carry the voices of the other domestic financial sector regulators.

Ladies and Gentlemen: The continuous evolution of the financial sector towards greater sophistication and value provision requires the regulators to move ahead in surveillance and vigilance to maintain the requisite stability and efficiency. For regulators to remain effective in their mandate, they need to remain in step with the financial services industry and its operating environment. For this reason, continuous capacity building is necessary, as is sustained cooperation between the different regulators to ensure coordinated efforts towards financial stability and financial inclusion.

Thank you for your attention.