Njuguna Ndung'u: Banking and financial sector developments in Kenya

Remarks by Prof Njuguna Ndung'u, Governor of the Central Bank of Kenya, at the Kenya Institute of Bankers 2nd National Banking & Finance Conference, Mombasa, 26 June 2014.

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Mr. Reuben Mbindu, Chairman, Kenya Institute of Bankers;

Chief Executives of Commercial Banks and other Financial Institutions here present;

Distinguished Ladies and Gentlemen:

It is with great pleasure that I join you this morning at the start of this landmark conference. I take this opportunity to thank the Kenya Institute of Bankers for fulfilling its promise to hold such a conference on an annual basis. I appreciate your invitation to this conference and applaud everyone who participated in organising this conference for their commendable commitment.

Ladies and Gentlemen: My task this morning is to represent the Cabinet Secretary to The National Treasury who could not make it as the Chief Guest to this 2nd National Banking and Finance Conference. Let me start with some few remarks on the performance of Kenya's banking sector.

The banking sector has recorded an improved performance – the sector's balance sheet expanded by 15.6 percent from Ksh.2.50 trillion in May 2013 to Ksh.2.89 trillion in May 2014 mainly supported by an expansion of banking services and financial inclusion. Consequently, the sector's profitability increased by 12.5 percent from a profit before tax of Ksh.48.7 billion for the quarter ended May 2013 to Ksh.54.8 billion for the quarter ended May 2014. The gradual improved performance has been supported by continued rollout of innovative banking products, adoption of cost effective delivery channels, and continued expansion of banks across the country and beyond Kenya.

Ladies and Gentlemen: As part of Kenyan banks desire to improve their performance, they have explored business opportunities within and beyond Kenya's borders. As at 31st December 2013:

- Eleven Kenyan banks had established subsidiaries in East African Community (EAC) member states and South Sudan. One Kenyan bank owned a 50% stake in a Mauritius bank while another Kenyan bank had a minority stake of 11.4% in a bank operating in Malawi.
- The eleven Kenyan banks had established 288 branches in EAC member states and South Sudan as compared to 223 branches in 2011.
- The foreign subsidiaries had a total of 5,219 employees compared to 3,760 in 2011.
- The total assets of the foreign subsidiaries stood at Ksh,306.3 billion compared to Ksh.195.6 billion in 2011.
- The foreign subsidiaries had mobilised deposits worth Ksh.236.5 billion compared to Ksh.152.5 billion in 2011.

Ladies and Gentlemen: This snapshot of cross-border operations of Kenyan banks demonstrates that the banking sector has made a sizeable contribution to the economic growth of not only Kenya but that of the entire Eastern Africa region and beyond. I note with satisfaction that the practices of Kenya's banks operating outside the country are serving as best practices in some of the host countries. I therefore commend the Kenyan regional banks for their role in strengthening the financial sectors of the regional countries.

Ladies and Gentlemen: The continued regional expansion of Kenyan banks augurs well with the on-going EAC integration process. Allow me now to share with you the current efforts by the EAC Central Banks towards the envisaged East African Monetary Union (EAMU). The Monetary Union Protocol was signed by the EAC Heads of State in November 2013 with an envisaged timeline for a single regional currency by 2024. Pursuant to the Protocol, the EAC Central Banks are required to integrate their financial systems and adopt common principles and rules for the regulation and supervision of the financial system by 2018. In this regard, the EAC Central Banks have already commenced efforts towards the harmonisation of the EAC Central Banks supervisory and regulatory rules and practices. The starting point was a request in 2011 to the players, especially those with regional presence, to indicate the aspects they would wish to be harmonised.

Ladies and Gentlemen: In order to achieve a harmonised and improved supervisory and regulatory framework, the EAC Central Banks agreed to use the pronouncements by international standard setting bodies such as the Basel Committee on Banking Supervision (BCBS), Financial Stability Board (FSB) and Financial Action Task Force (FATF) as a basis for the harmonisation exercise. The main aspects of the supervisory and regulatory rules and practices that will be harmonised include the legal status of licenced entities, licensing requirements, licence validity, prudential requirements on capital and liquidity, corporate governance requirements, permissible activities, prudential returns and public disclosures.

The EAC Central Banks have developed a convergence criteria for all aspects of divergence and expect to attain convergence by the Monetary Union Protocol deadline of 2018. The benefit of these developments to Kenyan banks is to increase the market size, allow diversity of banking products and strengthen our banks. We have introduced the East African Payment System (EAPS) to reduce the cost of doing business. We are now working on convertibility of the EAC currencies – MOUs have been signed. These initiatives will bring the EAC closer together. The central banks in EAC believe that these are important quick wins for the EAC regional integration process.

Ladies and Gentlemen: For the continued regionalisation of the banking sector operations to generate the desired impact, a concerted effort to up-scale the skills and competences of our human resources as a region is necessary. In this regard, the Kenya Institute of Bankers (KIB) and other capacity building institutions should rise to the occasion not only to modernise their capacity building initiatives but to develop programmes that cater to the capacity needs of the entire EAC region and beyond.

As the banking sector players establish presence across borders, KIB should explore avenues of satisfying the emerging human resource needs in the countries where the banks are expanding to. I am aware that the annual East African Banking School organised by the EAC Banking Institutes is designed with the regional banking sectors in mind. However the on-going integration calls for more tailored capacity building initiatives. In this regard, KIB and counterpart Banking Institutes should re-examine their strategies to ensure that the envisaged integrated financial market is not derailed by inadequate human resource capacity.

Let me now turn to some interesting and current outcomes and landmark achievements for the Kenyan economy, that will continue to enhance and consolidate our financial sector performance:

First, the success of the Sovereign Bond debut for Kenya that was over-subscribed by over 500%. The government took US$2.0 billion against US$8.8 billion offered at an average interest rate of 6.6%. This success has several implications:

1. The Sovereign Bond brings into the market an asset that is risk free and will form a benchmark of pricing risk free assets in Kenya. Since the interest on the Sovereign Bond is fairly competitive, it will lead to a re-pricing downwards of domestic financial assets – so domestic interest rates will decline.

2. The Sovereign Bond is already trading in the Irish Securities Exchange – This will improve Kenya's standing and rating in the international capital markets.

3. The government, due to this success of entry into the international capital market, will reduce expensive domestic borrowing. This will of necessity release some liquidity into the domestic market. For this liquidity to be usefully applied to domestic and regional investments, interest rates on lending will have to decline substantially.

4. Since government domestic securities have now a competing exogenous substitute, those banks that have depended on trading with government securities will now have to apportion a larger proportion of their funds for domestic lending to firms and households. The KIB should now help such banks to re-build their infrastructure for monitoring and screening existing and potential borrowers but also supported by the Credit Reference Bureaus. This may have been left behind in the rush to trade with risk free securities.

Second, the Kenya Bankers Association has provided a breakthrough to transparency in pricing of banking services. In a Committee chaired by the Cabinet Secretary to the National Treasury and whose recommendations were announced by the President, there will be a reference interest rate to be called KBRR (Kenya Banks Reference Rate). It will be an average of CBR and the 91-day Treasury bill – a risk free return on asset indicator.

The first KBRR will be announced by the MPC on July 8th, 2014. For us at the Central Bank the KIB and indeed this Conference should lead the way to show how pricing of credit will benefit inclusive growth of the financial sector, by benefitting both the borrower and the lender. At the end, we will support very strong inclusive growth agenda of the Government.

Finally, the FATF (Financial Action Task Force), a standard setting body on Monday 23rd June 2014 upgraded Kenya from the ***Dark Grey List*** to the ***Grey List*** on its Anti-Money Laundering/Combating the Financing of Terrorism (AML/CFT) Regime. Kenya's AML/CFT regime was in 2011 found to be deficient. Since then, the country amended its laws, introduced the Terrorist Financing Law and established the Financial Reporting Centre. For KIB and Kenyan banks, it means it is easier for correspondence bank facilities, easier to negotiate competitive rates for international credit lines and above all, the credit and risk rating for the country is now positively enhanced. These are the issues KIB should take on board to see the prospects of the financial sector development in line with the government growth agenda.

With these remarks, it is now my pleasure – on behalf of the Cabinet Secretary to The National Treasury, Hon. Henry Rotich – to declare the 2nd KIB National Banking and Finance Conference, officially open.

I wish you fruitful deliberations and report progress to develop our financial sector in line with the Government's development agenda.

Thank you.