CENTRAL BANK OF KENYA

7TH KENYA BANKERS ASSOCIATION ANNUAL BANKING CONFERENCE

Thursday, September 27, 2018

Keynote Address by
Dr. Patrick Njoroge, Governor, Central Bank of Kenya

As Prepared for Delivery

Good morning! I want to begin by thanking the Kenya Bankers Association (KBA) for inviting me to speak at this auspicious Annual Banking Conference. I applaud KBA for organizing this conference for the last seven years, and contributing to thought leadership on topical banking sector issues.

The theme of the conference ***''Credit Market Dynamics in an Evolving Regulatory and Market Participants' Environment''*** is quite apt given the conjuncture—where the global, regional and national financial markets are today. For instance, in Kenya, there has been considerable discourse recently on the cost and availability of credit. The discussion is now morphing to the potential role of disruptive non-traditional credit providers that leverage on technology, but discussions about consumer protection in these new environments has not gathered much steam. However, I am informed that these issues will be discussed during the conference and I look forward to the findings.

The year 2018 has been a year of anniversaries. On August 7, we marked twenty years since the bombing of the American Embassy in Nairobi, just a few steps away from the Central Bank building. And just a few days ago, on the 21st of September, we marked the fifth anniversary of the Westgate attack. Both of these were tragedies, marked with sombre reflections by our fellow citizens.

We marked another recent anniversary that is less familiar to many ordinary Kenyans, but one that is felt acutely by practitioners in the financial sector. Ten years ago, on September 15, 2008, the storm that had been brewing for a year finally broke. Lehman Brothers, a company that had been in existence for one hundred and fifty eight years, shut its doors. Ordinarily, companies come and go. After all, creative destruction is the mantra of the day and only the fittest survive. New blood, new ideas and new companies are essential to the health of capitalism, and, conversely, old ideas and old companies must be discarded when the time comes. But, of course, Lehman was different. The canary in the coal mine was dead. The deluge was upon us.

The effects of the global financial crisis were deep, powerful and lasting. Some are being felt to this very day. The ordinary citizen—Wanjiku—may not give you the precise details of what happened ten years ago. She may not speak of "systemically important financial institutions" or tell you what a subprime mortgage is. She may not speak eloquently about collateral debt obligations, or calculate the point at which a bond goes from investment grade to junk. But Wanjiku, the ordinary citizen that all of us serve, understands some fundamental facts. She understands the fundamental principles of finance, commerce and social interaction. She understands some basic principles that are easily forgotten, ignored, or overlooked in the pursuit of sophistication or profits. The rest of my remarks will expand on this idea.

In the recent weeks, there has been extensive debates on the lessons from the global financial crisis and whether the global financial system is now safer. These discussions have also asked whether a sense of exuberance is creeping back into the global financial system, that could unwittingly lead us to the next crisis—another "Minsky moment" where current booms sow the seeds of a future dramatic collapse. These are questions I will leave for participants of the conference and I would be keen to know your thoughts.

In diagnosing the cause of the global financial crisis, a lot of ink has been spilled on the inadequacy of regulation and the trend towards deregulation in the lead up to the global financial crisis. Regulation, especially regulation that recognizes and acts on risks, is crucial. And we all appreciate the major drive globally towards strengthening the regulation and supervision of global financial markets. But let's also appreciate the following crucial fact—at its core, the global financial crisis was about human beings. What human beings chose to do and what they chose not to do. At its heart, the global financial crisis was about ethics.

Ethics is not a financial term and conjures up difference images and responses by for different people and different responses. Some in the audience may be thinking: of course my institution is highly ethical—we have rules! Our legal team always ensures that we comply to all laws and regulations! We won a governance award the other day! Our values are printed and displayed in our headquarters! Our email signature tells the world that we are guided by good principles! Even more, we are renowned for training our staff rigorously on our code of conduct! While all these may be related to the core message of raising our ethical standards, I believe there is a need to think deeper, dig deeper, and be more earnest on this matter.

While the business of defining ethics can be left to philosophers, we can agree on the more pedestrian description given by the renowned American humanist Aldo Leopold: "*Ethical behavior is doing the right thing when no one else is watching even when doing the wrong thing is legal*." Many of you may be wondering why laws cannot be put in place to prevent unethical behaviour once and for all. Wonder no more—life is more complex than rules. Misconduct happens first and laws are passed later—as we have seen elsewhere, innovation generally goes ahead of regulation. There is therefore need for something else besides a set of rules to control the behaviour of people and institutions: *we need to understand and pursue ethical values*. A lot has been said about this in the aftermath of the global financial crisis.[1] Let me touch on three areas for your reflection.

[1] https://blog.iese.edu/ethics/2014/06/25/ten-recommendations-for-the-necessary-ethical-rearmament-of-banking/

First, institutions need to develop a responsible corporate culture that entrenches proper market conduct. Culture that goes beyond neat slogans to actually being the guiding force that leads to ethical behaviour and ethical outcomes. You may say the right thing on your corporate culture statements and governance code of conduct declarations, but if your employees know and are told day after day that profit is the only motive, they will behave accordingly. If they notice that customer needs take second place to corporate profit, nothing stops them from treating customers in a similar fashion—badly—in pursuit of expanding the bottom line. If they see rules bent, and notice that the most ruthless are the ones who get the pat on the back, the promotion and, ultimately, the corner office, they will behave in ways that show the greatest rule breaking and ruthlessness.

The banking sector's role in economic development calls for a balance between pursuit of economic profit and serving the community in an environment of shared prosperity. When financial institutions start to embrace excessive risk and questionable practices, they stop performing their ethical-social function, which is necessary for society's prosperity. Codes of Conduct by players or industry associations should include relevant aspects of ethical behaviour of all stakeholders including employees, customers, suppliers and competitors, local communities, and owners. Each of these stakeholders play a role in success or failure of their institutions.

Second, transparency is at the centre of ethical behaviour. All relevant information must be explained even if it is more than what is required by law. Over the years, customers have complained over the lack of transparency in the pricing of products and services by banks. I acknowledge you are making positive steps in this area, but much more remains to be done. This is particularly in the area of credit risk pricing. Customers need to be clear on what their credit reference record means for them in the pricing of credit. Beyond product pricing, you need to be transparent on your governance, business models and risk and reward trade-offs particularly in respect to compensation policies. And this cannot be driven by enforcement by the regulator. You, the people in this room, must be the ones to go above and beyond the strict interpretation of transparency rules.

Third, compliance without integrity is futile. Compliance with codes of conduct and other means of self-regulation are good. But this is only useful when the focus is on a shared mentality of integrity that goes beyond mere compliance. The mentality of "we comply" for compliance sake cannot sustain a business for long. I remind you of another anniversary, but this one of a much more recent event. Two weeks ago yesterday, we informed the Kenyan people of the action we took against some of you because of non-compliance with integrity laws. Make no mistake – it was not easy. We considered all the possible negative outcomes that could be triggered by those actions. Ultimately, however, we did not hesitate, and would not hesitate to do it again, under similar circumstances. Banks must steer away from being used as conduits for ill-gotten funds. The Kenyan people – Wanjiku – demand that of us, and will treat us very unkindly, were we to look the other way.

The reason why there is such palpable disappointment – I dare say it extends to anger – from the ordinary citizen to you in this room is exactly that. Wanjiku feels that her banker prefers expediency to empathy. She feels that her banker would rather hunt for a loophole than show leadership. Would rather seek supernormal profit than search for solutions. The old adage about the banker asking for their umbrella back when it starts raining may have been funny once, but not when the rain is this heavy, and when Wanjiku already has a flu.

So I ask you to reflect on your work, and your conduct. As Kenyans, we would rather watch with pride, and gasp in admiration, when Eliud Kipchoge becomes the fastest marathoner in history, than wonder anxiously whether our banker will be with us in the long haul. We would rather spend our energy thinking of ways to increase and share our prosperity than despairing about whether we are all in this together.

We must do better. We must be the guiding light for the banking and financial sector and for this great country we all call home. This would be very easy if we all insist on ethical practices and putting Wanjiku before anything else. I want to finish with an idea that is attributed to the philosopher Immanuel Kant: *"May you act so that the principle of action might safely be made a law for the whole world."* Had this advice been heeded in the run up to 2007, the Global Financial crisis would have been averted. The Queen of England would also not have asked the professors at the London School of Economics in November 2008: *"If the [antecedent of the global financial crisis] was this bad, why did nobody notice it?"*

It is now my distinct honour to declare the 7th KBA Annual Banking Conference officially opened.

Thank you for your attention.