



EDITORIAL

A private member's bill was tabled in Parliament towards the end of last year aiming to control interest rate spreads closely paralleling similar moves a decade ago. Again it has raised strong passions for and against. The aim is to restrict commercial banks from charging borrowers more than 4% over the Central Bank Rate (CBR) and set the minimum deposit rate to 70% of CBR. With the CBR currently at 18%, the maximum lending rate would be 22.0%, minimum deposit rate 12.6%, and the spreads limited to 9.4%. *Average* lending rates in the banking sector at the end of last year were 20.0%, deposit rates 7.0% giving rise to a spread of 13.0%.

Proponents of interest rate controls cite the failure of market-based policies to deliver results. A reading of historical data might seem to support their position. Following liberalisation in the early nineties, interest rate spreads increased dramatically. Policy moves in 2003 to reduce the cash ratio did result in a move downward but since then we have seen little positive change. Although internationally, Kenya's spreads are not out of line with its peers they are certainly higher than the emerging economies group it aspires to join.

Unfortunately an unintended consequence of interest rate controls could be a reduction in financial access. Because transaction costs in finance include a significant fixed element, lending smaller amounts is *relatively* more costly than lending larger sums. Thus for micro-lending to be profitable, interest rates have to be higher. Today banks have no problem complying with the proposed caps in their financing of large corporates but they would in lending to *Mama Mboga*. A similar argument applies to deposit taking. Accounts with low balances and limited levels of activity would become unprofitable unless the banks found a way around the regulations - a distinct possibility - the result could be a sharp reversal in recent improvements in financial inclusion. The problem with seeking to control prices is that it treats the symptoms not the root causes. Much more promising are on-going policy initiatives to improve competition, encourage the use of new technologies, increase price transparency, develop credit information sharing and reduce costs in the legal and regulatory system.

David Ferrand
Director

NEWS AND VIEWS



Radha Upadhyaya, from the University of London's School of Oriental and African Studies (SOAS) delivers her presentation at FSD's 7th research colloquium on 26th January, 2012. The presentation focused on the role of segmentation in Kenya's banking sector.

Developments in credit information sharing

Over the last two years, the Kenya Credit Information Sharing Initiative (KCISI) has helped put in place a mechanism through which commercial banks and the Deposit Protection Fund Board share customer information on non performing loans. The project closed phase I in July 2011 with some good news: we have a functional system running that provides reliable repayment history of loan applicants. However, this mechanism must be deepened and expanded, if it is to contribute more meaningfully to Kenya's credit market.

KCISI has rolled out an ambitious new phase aimed at achieving four main outputs: (i) a functional legal and regulatory framework for full file comprehensive credit reporting; (ii) participation of all credit providers in a functional credit information sharing (CIS) system; (iii) greater understanding of CIS by all stakeholders in the country; and (iv) enhanced capacity of all institutions involved in the CIS mechanism to function efficiently.

In 2012, KCISI will lay the foundation for these efforts. It will commence work on the revision of laws to improve transparency and consumer protection within the credit market. Beginning with deposit-taking microfinance institutions (MFIs) and other MFIs, more lenders will pilot the data sharing arrangements during the year.

Government to people (G2P) project updates

In 2008, the Government of Kenya (GOK) in partnership with the UK's Department for International Development (DFID), introduced a cash transfer scheme to provide small regular cash grants to some of the poorest and most

vulnerable households in Kenya. The Hunger Safety Net programme (HSNP) targeted households in the arid and semi-arid lands (ASAL) which are regularly affected by drought. The first phase has been successfully piloted over the last three years in order to learn about the optimal arrangements and design for the scheme. FSD has supported the development and management of the payments component. Equity Bank was contracted by FSD to roll out an innovative agent based system to reach deep into the rural north.

HSNP has achieved its goal of providing regular payments to a diverse group of beneficiaries in northern Kenya in the counties of Turkana, Marsabit, Wajir and Mandera. DFID is funding these regular payments that have now achieved the targeted number of 60,000 households (supporting an estimated 300,000 people) with cash transfers every two months. The amounts have also been increased from KShs 2,150 to KShs 3,000 per cycle. In the second phase planned to commence in 2012, there is an expectation based on current demographics that HSNP will eventually expand to cover approximately 450,000 households across the whole of northern Kenya. Over the long term, it is anticipated that the scheme will form part of a national social protection framework which will address the needs of over three million Kenyans living in extreme poverty. FSD Kenya will continue supporting the payments component. Our aim will be to ensure beneficiaries have a safe and convenient way to access their payments while simultaneously taking the opportunity presented to increase financial access offering a range of services to both beneficiaries and others in poor communities reached by the new programmes.

CONSUMER PROTECTION IN THE FINANCIAL SECTOR



A commercial street in Limuru town, central Kenya. Since 2007, the Central Bank of Kenya and FSD Kenya have been working together to provide useful information on various bank charges and lending rates to consumers of financial services so that they can make informed banking choices.

Evidence gathered over the last two years suggests a continued lack of transparency in the pricing of financial services in Kenya. A recent analysis undertaken as part of a consumer protection diagnostic study confirmed that consumers are still struggling to understand the different pricing structures offered by banks. There is a growing sense of distrust among bank customers with 19% of those interviewed claiming that financial institutions are not honest when it comes to availing information related to interest rates charged on loans.

Since 2007, Central Bank of Kenya and FSD Kenya have been working together to tackle this issue. A survey on bank charges and lending rates was developed, which sought to provide more accessible information to consumers. At the heart of the approach was the calculation of the monthly costs faced by the average user at every bank across a range of retail financial services. The average utilisation in terms of number of withdrawals and deposits associated with transaction and current accounts was determined through a survey of bank users. By providing data on the primary retail financial services in a simple form, showing the cost for each bank on a uniform basis, the aim was to (i) allow consumers to better understand the likely costs they would face in using a product and (ii) compare readily among different banks. An ancillary benefit was to provide a more relevant price index of retail financial services than simply looking at interest rate spreads. Not only are fees a significant part of the pricing of many retail financial products but average spreads are only a weak proxy for the price of consumer borrowing.

In the last quarter of 2011, FSD Kenya supported CBK to undertake a quick study that would determine the usefulness of the published survey data in its current form,

to the average current and prospective bank customer, with the aim of identifying potential improvements that can be made to enhance the dissemination of the information to consumers. The specific objectives of the research were to establish whether the information booklet on bank charges and lending rates: (i) provides easily understood information on the various charges and lending rates to core consumer groups; and (ii) motivates consumers to use the information to make informed choices and shop around for more affordable or suitable financial services and products. A total of 172 consumers (88 women and 84 men) participated in the study.

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A majority of the respondents were excited that such information was available but found the publication too technical. They suggested re-writing the document using simple and plain language. Consumers would prefer the information to be published in simple English and Kiswahili. The use of illustrations and imagery to explain the key terms should also be considered. Further, consumers would

like to see cost comparisons between banks, SACCOs and deposit taking MFIs. Consumers said that they would avoid banks that have difficult access requirements regardless of the terms on loans. For this reason, they would like to have access to information on the requirements for opening accounts, accessing bank loans and that opportunities available for negotiating better terms and conditions with providers should be availed. They would like a regular flagging of banks that raise their charges and interest rates.

This study indicated that consumers do want information on bank charges and interest rates, and that this should be provided to them on a more regular basis.

The respondents indicated that they would use the information to make informed choices and to shop around for appropriate financial products and services. Communication through printed posters in banking halls and local radio stations were the preferred channels. Low income consumers preferred to be reached through road shows where they can also receive face to face training. Information should also be made publicly available through the local chief and at public resource centres. A regular newspaper pullout would also be useful.

This study indicated that consumers do want information on bank charges and interest rates, and that this should be provided to them on a more regular basis. Banks could do more to avail this information as well as invest in educating their customers to fill the knowledge gap. There should be increased flexibility and variability in the way this critical information is disseminated and it should be disaggregated in content based on the specific needs of different target groups, so that only relevant information is disseminated to its potential users. FSD and CBK are keen to work together to help meet these needs and a new initiative will be launched shortly responding to these consumer insights. A copy of the last survey on bank charges and lending rates published in December 2008 can be downloaded from www.fsdkenya.org.

EVENTS CALENDAR

- 6 - 7 March** **2nd Annual Africa Banking & Finance Conference**, Nairobi - Kenya.
For more information, email: abfc@aidembs.com Website: www.aidembs.com
- 7 - 8 March** **AITEC Banking and Mobile Money COMESA**, Nairobi - Kenya.
For more information, email: info@aitecafrica.com
- 2 - 3 April** **Africa Mobile Money Research (AMMREC2012)**, Nairobi - Kenya.
For more information, email: ammrec2012@uonbi.ac.ke Website: www.ammrec.uonbi.ac.ke

FSD Kenya is an independent Trust established to support the development of inclusive financial markets in Kenya

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