KENYA BANKING SECTOR CHARTER

I. Preamble

This Banking Sector Charter (BSC) is issued pursuant to Section 33(4) of the Banking Act and Section 48(2A) (6) of the Microfinance Act, which empowers the Central Bank of Kenya (CBK) to issue directions with respect to the standards to be adhered to by an institution[1] in the conduct of its business in Kenya.

The Charter applies to an institution carrying on banking business[2], financial business[3], the business of a mortgage finance company[4] and microfinance banks and shall be effective immediately.

The Charter represents a commitment from institutions in the banking sector to entrench a responsible and disciplined banking sector cognizant of, and responsive to, the unique socio-economic realities of the Kenyan populace.

The Charter is premised on the banking sector's vision hinged on four central pillars: -

(i) Adoption of customer-centric business models by banks;
(ii) Risk-based credit pricing;
(iii) Enhanced transparency and information disclosure; and
(iv) Entrenching an ethical culture in banks – doing the right thing.

The Charter should be read together with the provisions of the Banking Act, Microfinance Act, Regulations and Guidelines issued by the CBK from time to time.

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[1] An "institution" means a bank or financial institution or a mortgage finance company as defined in the Banking Act.

[2] "banking business" is defined in the Banking Act as: -
- (a) the accepting from members of the public of money on deposit repayable on demand or at the expiry of a fixed period or after notice;
- (b) the accepting from members of the public of money on current account and payment on and acceptance of cheques; and
- (c) the employing of money held on deposit or on current account, or any part of the money, by lending, investment or in any other manner for the account and at the risk of the person so employing the money;
- (d) such other business activity as the Central Bank may prescribe.

[3] "financial business" means:
- (a) the accepting from members of the public of money on deposit repayable on demand or at the expiry of a fixed period or after notice; and
- (b) the employing of money held on deposit or any part of the money, by lending, investment or in any other manner for the account and at the risk of the person so employing the money.

[4] A "mortgage finance company" is defined as a company which accepts, from members of the public, money-
- (a) on deposit repayable on demand or at the expiry of a fixed period or after notice; or
- (b) on current account and payment on and acceptance of cheques.

II. Background

In August 2016, Kenya's Parliament passed a law that amended the Banking Act by introducing (i) a cap on **lending rates at 4 percent** above the Central Bank Rate (CBR) and (ii) a floor on the **deposit rates at 70 percent** of the CBR.

The amendment was in response to concerns raised by the public regarding the high cost of credit in the country, which was perceived to have locked out a large segment of population from the credit market. The high cost of credit was as a result of structural rigidities and failures in the market for bank credit. Thus, the interest caps sought to address the market failure by limiting the discretion of banks to raise interest rates on loans at will, with a view to enhancing the affordability of credit and enhancing transparency.

The Government had, in the recent past, introduced several reforms to lower the cost of credit. The reforms include introduction of the Credit Information Sharing (CIS) mechanism in 2010, the Kenya Bankers Reference Rate in 2014, agency banking in 2010 and establishment of additional currency centres in 2009. Despite the Government's efforts, the banking sector continued to maintain high costs of credit, prompting the public's call for interest rate capping.

There have been further developments made in the banking sector as a result of the ongoing regulatory reforms aimed at strengthening consumer protection and helping improve transparency and competition in the sector. These include; enhancing the CIS framework, review of the consumer protection framework, implementing the movable collateral registry (Movable Property Security Rights Act, 2017), increasing transparency of the pricing of products through the launch of the total cost of credit website in 2017 and adoption of customer-centric business models by banks.

Some of the structural rigidities that led to market failure and prompted the interest rate caps, still remain. The removal of the interest rate caps is critical to developing a market-led financial sector; however, the banking sector must fully demonstrate that they are responsible and disciplined.

III. Kenya Banking Sector Charter

It is in the interest of the Kenyan financial sector and populace to work towards reversing these measures and go back to a regime with freely determined and market-driven interest rates; but in a disciplined environment. In pursuit of developing a responsible and disciplined credit market, CBK is issuing this Kenya Banking Sector Charter. The Charter is expected to facilitate a market-driven transformation of the Kenyan banking sector and bring about tangible benefits for Kenyans.

Objectives of the proposed Banking Sector Charter

i) To increase access to affordable and appropriate financial services to the unbanked and under-served population of Kenya.
ii) To enhance the quality of financial services to those already banked yet are negatively impacted by the high prevailing interest rates.
iii) To create a roadmap to guide in the development of a more resilient, competitive and dynamic financial system based on the four central pillars of the banking sector's vision.
iv) To ensure that institutions proactively engage their customers in financial literacy and consumer education drives, to enhance customers' financial knowledge and skills for them to make informed financial decisions.
v) To provide the basis for the sector's engagement with other stakeholders.
vi) To establish targets and quantified responsibilities with respect to each objective and outlines processes for implementing the Charter as well as mechanisms to monitor and report on progress towards given goals which are aligned with Kenya Vision 2030.
vii) To ensure institutions develop and submit a time bound plan approved by the Board in compliance with the Charter for CBK's monitoring purposes.
viii) To ensure institutions submit quarterly reports to CBK on the progress of their implementation of the Charter by timelines determined by the CBK.

In pursuit of these objectives, the Charter commits institutions in the banking sector to transform in the following areas: -

1. Fairness

- In order to improve the credit pricing of loans extended to borrowers as well as implement differential credit pricing, based on a customer credit rating, institutions are henceforth mandated to **implement risk based credit scoring techniques** in their loan screening processes. The credit scoring rating should be sourced from any of the licensed credit reference bureaus.

    - Banks have been reluctant to use credit scoring techniques instead they prefer to put all individual borrowers on the same risk bracket which allows them to charge high interest rate for personal loans. They have tendencies of using the CIS mechanism negatively as a blacklisting tool.

    - The use of appropriate credit scoring techniques shall be ascertained by CBK through various avenues, including during on-site examinations and through conducting consumer protection diagnostic exercises like mystery shopping surveys, for example.

- To enhance fairness, it is also critical to ensure that transparency and full disclosure of the terms and pricing of products is implemented. In line with the Prudential Guideline on

Consumer Protection Guideline and Consumer Protection Act, 2012, institutions are henceforth required to publish in their respective websites and places of business: -

- Key fact statements of all their products.
- Complaints handling and consumer recourse mechanisms.
- An institution, on receiving a complaint, shall provide the complainant with a prompt written acknowledgement within 48 hours and resolve the complaint in 7 working days.
- Terms and conditions of their products including, but not limited to, allowance of cooling off period, customer complaint processes, protection of consumer data and privacy.

2. Transparency

A joint initiative by the Kenya Bankers Association and the Central Bank of Kenya (CBK), to enhance transparent pricing reporting was launched in June 2017. Some commercial banks are yet to upload their charges and fees to the website which is aimed at enhancing transparency in the pricing of credit.

It is against this backdrop that CBK now mandates **all commercial banks to upload their respective internal and external fees for all products on the cost of credit website** to enable customers make rational financial (product) decisions. The institutions will be held liable on any erroneous or outdated data posted in the website arising from the institutions' errors. Failure to adhere to this clause will result to administrative sanctions as embedded in Section 49 of the Banking Act.

Further the Banking industry should begin to move towards the development of a **Banking Services Pricing Index.**

3. Financial Literacy

As financial services and products become sophisticated and widespread throughout the country, financial literacy[5] will need to be addressed in order to ensure proper use of the available financial services and products offered by institutions. Increases in access to financial services along with rapid growth of the financial sector, will cause more consumers to be exposed to risks that these products/services pose through their normal use. Improved information disclosure may be counterproductive if the information disclosed is not understood by consumers with low level of financial literacy.

[5] The Organization for Economic Cooperation and Development (OECD) has **defined financial literacy** as follows: 'A combination of awareness, knowledge, skill, attitude and behavior necessary to make sound **financial** decisions and ultimately achieve individual **financial** wellbeing.'

In this regard, institutions should:

- Provide technical assistance to Micro, Small and Medium Enterprises (MSMEs) in an effort to enhance their capacity development, in terms of business and financial skills, which will enable them secure financing.
- Develop financial literacy initiatives that are distinct from the common product advertising and marketing, and that are more targeted, strengthened and coordinated to have greater impact in terms of effectiveness and efficiency.

4. Financial Access

The Banking Sector Charter is intended to broaden and hasten the transformation process of the banking industry into a responsible and disciplined industry. This will be through a focus on making financial services accessible to the previously unbanked and under-served through the provision of affordable financing of MSMEs and other underserved segments of the Kenyan economy.

To broaden the outreach of financial services, there is need for institutions to embrace new business models deploying technologies and risk management systems to serve all consumer segments, particularly the un-banked and under-banked. Therefore, the business models of banks should be innovative, responsive and dynamic to address the specific needs of their customers. In this regard, institutions should demonstrate:

- Consumers input towards the development of the product are considered;
- Strategic benefit of the product to the consumer is evidenced;
- Required resources and competences to offer the products sustainably are available; and
- Innovative and dynamic business models and channels are employed.

Similarly, for the consumers who are perceived to be risky and thus barred from accessing financial services optimally**, credit risk reduction mechanisms** should be considered and adopted.

In this regard, to achieve the desired penetration of affordable and appropriate financial services, institutions should:

- Promote enterprise development, each institution to undertake to increase its business loans towards MSMEs financing by at least 20 percent by 2020 from December 2017 baseline.
- Seek to understand their consumers and develop customer-centric business models that meet their consumers' diverse needs, demands, preferences and experiences appropriately.

5. Compliance with Charter

Banks should develop and submit to CBK a time bound plan to comply with the Charter that is approved by the Board within 30 days of the effective date of the Charter. The plan will be used by CBK to monitor compliance.

6. Reporting Mechanism

Each institution shall submit a quarterly report to CBK on the progress of its implementation of the Charter within 10 days after the end of every calendar quarter.

7. Remedial Measures

CBK may pursue any or all remedial actions provided for under Sections 33, 33A, 34 and 55 of the Banking Act and Microfinance Act and may take such other administrative actions as it may deem appropriate.

8. Effective Date

The effective date of this Charter shall be September 1, 2018.

CENTRAL BANK OF KENYA
AUGUST 2018

Glossary of Terms

1. **Agent banking** is an alternative delivery channel for offering banking services in a cost effective manner using entities contracted by an institution to provide specified banking services on its behalf.
2. **Credit Information Sharing** refers to a process where credit providers (such as banks, microfinance institutions, Saccos, etc.) exchange information on their outstanding loans and advances through licensed Credit Reference Bureaus (CRBs).
3. **MSMEs** refers to micro, small and medium enterprises. This Charter adopts Kenya's official definition, in which MSMEs are defined according to employment size.
4. **MSMEs** are enterprises having between 1 and 99 employees.
5. **Micro-enterprises** are enterprises that employs less than 10 employees;
6. **Small enterprises** are enterprises that employs between 10 and 49 employees
7. **Medium sized enterprises** are enterprises that employs between 50 and 99 employees.