CENTRAL BANK OF KENYA

REVISED RISK-BASED CREDIT PRICING MODEL

AUGUST 2025

THE CENTRAL BANK OF KENYA

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1.0 BACKGROUND

A consultative paper on the review of the risk-based credit pricing model was released to the public for comments on April 23, 2025. At the end of the consultative period, the Central Bank of Kenya (CBK) received 45 responses from the Kenya Bankers Association (KBA), 13 commercial banks, the International Monetary Fund (IMF), the European Bank for Reconstruction and Development (EBRD), Kenya Association of Manufacturers (KAM), Automotive Parts Manufacturers Association of Kenya, non-bank financial institutions, individuals, consultancy firms, academia, and corporate firms.

Based on review of the responses, CBK held consultations with some respondents to discuss their feedback on the consultative paper. Subsequently, CBK has reviewed all the responses received on the proposed Risk-Based Credit Pricing (RBCP) model.

2.0 INITIAL PROPOSAL

In April 2025, CBK had proposed the following RBCP methodology: -

- The use of the policy rate, Central Bank Rate (CBR) as the common reference rate for determining lending rates in the Kenyan banking sector. CBR, as the common reference rate, reflects the cost of funding to the banks. The common reference rate will change every two-months when the Monetary Policy Committee makes any change pronouncement on the CBR.

- The lending rates were to be determined by adding a premium ("K") to the CBR. The premium ("K") was to comprise of: -

  a) The banks operating costs related to lending,
  b) Return to shareholders, and
  c) The borrowers risk premium.

- Where a banks' cost of funding would be more or less than the common reference rate (CBR), the bank was to factor in the extra/lower amount in the premium ("K").

- The banks were to submit their proposed premium ("K") to CBK for review and noting prior to rolling out.

- The new model was to apply to all loans as defined under clause 1.4.3 of the CBK Prudential Guideline on Risk Classification of Assets, Provisioning and Limitation on Interest Recoverable on Non-Performing Loans (CBK/PG/04):

  a) For new loans, it was to apply immediately from the effective date of the revised RBCP model.
  b) For existing loans, banks were to transition them to the new model within 3 months from the effective date.

- CBK was to publish the components of each bank's lending rate premium ("K") on its website, the Total Cost of Credit (TCC) website, and in two newspapers of nationwide circulation.

3.0 SUMMARY OF THE COMMENTS ON THE CONSULTATIVE PAPER

Some of the notable comments on the consultative paper are as summarised below: -

- The banks supported CBK's quest for a transparent, and customer-centric credit-pricing framework, which will improve risk differentiation, and address concerns over perceived high lending rates through a more robust and market-responsive pricing model.
- Some of the respondents viewed the CBK's requirement to review and note the RBCP models before their roll out as a re-introduction of interest rate capping.
- Respondents proposed the use of the interbank rate to align with the global best practice where base rates are derived from short-term market rates. Some of the market base rates cited that are derived from short-term market rates include, Secured Overnight Financing Rate (SOFR), Sterling Overnight Index Average (SONIA) and Euro Interbank Offered Rate (EURIBOR).
- There was a proposal for the differentiation between personal borrowers, Small and Medium Enterprises (SMEs), and sophisticated corporate borrowers. This will allow contracting outside the proposed benchmark rate (CBR + K) for clients who request the use of other reference rates.
- In the consultative paper, CBR was presented as a reflection of the cost of funds for banks. However, the respondents indicated that the actual cost of funds is primarily driven by the cost of deposits and the cost of long-term borrowed funds. The return offered on commercial bank deposits is not directly benchmarked against the CBR. It is instead influenced by depositors' evaluation of the opportunity cost of investing in government securities, which has not been referred to in the proposed RBCPM.
- Banks recommended a 6-month transition period to the new RBCP model for both new and existing loans to allow sufficient time for system reconfiguration and operational readiness as opposed to the 3 months proposed in the consultative paper by CBK.
- Respondents proposed the exclusion of the following facilities from the RBCP model: foreign currency denominated loans, negotiated loans, credit card loans, staff loans, institutional scheme loans, digital lending products, Islamic facilities, syndicated loans, fixed rate loans, trade loans, cash covered loans, short-term loans, loans under special arrangements and fee-based facilities. These were cited to have peculiar contracting arrangements on which their pricing should be based.
- Respondents proposed that loan origination and arrangement costs should be charged upfront and disclosed within the Annual Percentage Rate (APR). As a result, they should be excluded from the 'K' component. They further recommended that CBK allow charging of commitment fees and late payment fees.
- Respondents raised concern on disclosing commercially sensitive information, such as operating costs and return-on-equity targets. They argued that this may compromise their proprietary strategies, encourage uniform pricing and undermine competitive differentiation and innovation in the market. Further, they argued that in their view, the existing Total Cost of Credit website portal already meets the objective of informing consumers (transparency on the loans costs) hence there is no need to publish on the CBK website and newspapers as proposed by CBK.

4.0 REVISED RBCPM

a) Proposed common reference rate for pricing of loans and advances

CBK has decided the use of the **overnight interbank average rate,** now renamed **Kenya Shilling Overnight Interbank Average (KESONIA)** as the common reference rate for determining lending rates for all variable rate loans. The total lending rate will be "**The Kenya Overnight Interbank Average Rate (KESONIA) + Premium ("K")"**.

The use of **KESONIA** as the **common reference rate** was decided since it is market-based. Further, the overnight interbank average rate closely aligns with the policy rate (Central Bank Rate) under the current monetary policy implementation framework.

Where the use of interbank rate as the reference base rate is not practical, customers may be availed the use of the **Central Bank Rate (CBR)** as the **alternative reference rate**.

There are two widely used methodologies for deriving common reference rates from overnight interbank average rates. These are **simple average** of past overnight interbank average rates and **compounding in arrears** over the interest period. CBK has considered the pros and cons of the two approaches to guide the appropriate methodology to adopt in line with international best practices.

i. Simple average

Simple average of daily overnight rates is derived by adding up the daily overnight interbank average lending rates over an interest period then dividing by the number of days.

Pros

- The rate is based on historical data, allowing interest amounts to be determined before the period starts. This supports operational efficiency for banks and provides customers with certainty about their repayment obligations.
- The methodology is simple and removes the need for daily data capture, day-count compounding formulas, making it easier for institutions or borrowers to understand and compute.

Cons

- The rate is based on past market conditions, which may not align with the actual interest period, particularly during periods of volatility or shifting rates. Additionally, it may delay the transmission of monetary policy changes.
- This approach overlooks daily market fluctuations, which may potentially mask signs of short-term funding stress or ease.

ii. Compounding in arrears

Compounding interest in arrears in Risk Free Rates (RFRs)[1] refers to calculating interest by compounding the daily overnight rate in each day over an interest period.

Pros

- Enables immediate transmission of monetary policy to the real sector through adjustments in bank interest rates and responds in real time to changes in market conditions.
- Minimizes the impact of temporary spikes on interest rates caused by unusual supply and demand factors affecting a benchmark rate on a particular day.
- It is based on transaction-based overnight rates, reflecting the actual cost of funds over the period.

Cons

- Requires systems capable of computing and tracking daily interest rates, applying the appropriate day-count conventions, and accurately compounding the interest rates.

[1] *Compounding interest in arrears in risk free rates (RFRs) is the computation of interest where interest is calculated by compounding the daily overnight rate each day over an interest period.*

- Customers may wish to verify the compounded interbank rate but may not be familiar with the methodology used to calculate it.

Based on the analysis above, CBK has decided the adoption of KESONIA compounded in arrears, as the common reference rate for determining lending rates for all variable rate loans except for foreign currency denominated loans and fixed rate loans. CBK will publish the KESONIA rate and the KESONIA compounded index daily at the start of business at 9.00 a.m. for rates applicable to the previous day. This will provide transparency by allowing users to easily verify the applicable rate over a specific period. The methodology of determining KESONIA compounded in arrears as well as its features is attached as **Appendix I**.

b) **Premium (K)**

The lending rates will be determined by adding a premium ("K") to the common reference rate. Banks will define the components that make up this premium, which may include: -

i. **The banks operating costs related to lending -** Comprises salaries and allowances, directors' remuneration and other expenses, repairs and maintenance, depreciation, occupancy and rental expenses, contract services and other operating expenses.
ii. **Return to shareholders** - The expected shareholders return from lending business.
iii. **The borrowers risk premium** - The compensation that the banks expect from their borrowers depending on their risk profiles. CBK expects a detailed credit-scoring model that covers both qualitative and quantitative aspects of a borrower, when determining the customers' creditworthiness, and that the risk premium should be customer-specific.

c) The **total cost of credit** = KESONIA + Premium ("K") + Fees/Charges[2]. The components of the total cost of credit are to be disclosed directly to the customers, to the public through the Total Cost of Credit website, and to the CBK.

d) In pricing loans and advances, banks should uphold their commitment to the Kenya Banking Sector Charter by ensuring fairness and transparency.

5.0 IMPLEMENTATION OF THE REVISED RISK BASED CREDIT PRICING MODEL

i. Each bank will develop its own risk-based credit pricing model and the corresponding policies and procedures within three (3) months of the issuance of the final revised RBCP model. The bank should obtain its Board of Directors' approval of its model together with the corresponding policies and procedures.

ii. Banks will submit to CBK their board approved risk-based credit pricing models, policies, and procedures within 15 days after their Board approval, and not later than 15 days after the end of the three months referenced in (i) above.

iii. CBK will review each bank's model, policies and procedures, post implementation as part of its surveillance process.

iv. The new model will apply to all variable rate loans except for foreign currency denominated loans, whose pricing is primarily influenced by external factors such as currency risk, and fixed rate loans.

[2] *The fees and charges may include loan origination, arrangement, commitment, default, and late payment fees, which are charged separately and must be disclosed to the customers and CBK.*

v. There will be a three-month transition period for banks to adopt the new model after the three-month period provided for development and approval of the model by the bank's Board.

vi. All banks will publish their weighted average lending rates and all fees and charges for all their lending products on the "Total Cost of Credit" website within the three-month transition period referenced in v above.

vii. All banks will thereafter, on a monthly basis, publish their weighted average lending rates, and weighted average premium ("K"), all fees and charges for all their lending products, and Annual Percentage Rate (APR) on the Total Cost of Credit website. They are also required to concurrently submit them to CBK.

6.0 TOTAL COST OF CREDIT WEBSITE

CBK and the KBA jointly worked on a "Cost of Credit" website portal in an effort to promote transparency and enhance competition in the banking sector. The development of the Cost of Credit website portal was finalized, and the website launched in June 2017.

Since its launch in 2017, the TCC website has provided consumers with a loan comparison calculator and educational content on credit costs. While it has increased transparency for banking products, users have reported difficulties in navigating the site, understanding certain financial terms, and using the tool effectively-particularly on mobile devices.

CBK is currently working on initiatives to revamp the Total Cost of Credit website to enhance customer centricity and adopt new developments in the evolving financial landscape, and the adoption of risk-based credit pricing models that have introduced new cost structures and disclosure needs.

Banks will post their weighted lending interest rates, weighted average premium ("K"), and all fees and charges for all their loan products on the TCC website within the three months transition period of implementation of the new RBCPM. They are also required to concurrently submit them to CBK.

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APPENDIX I

CENTRAL BANK OF KENYA

COMMON REFERENCE RATE FOR THE RISK BASED CREDIT PRICING MODEL (RBCPM) - THE KENYA SHILLING OVERNIGHT INTERBANK AVERAGE (KESONIA)

AUGUST 2025

COMMON REFERENCE RATE

A. Background

The overnight interbank average rate is now renamed the Kenya Shilling Overnight Interbank Average (KESONIA).

B. Key Components of the KESONIA-Based Benchmark Framework

The key components of KESONIA are outlined below:

Component	Description
Benchmark Rate	KESONIA – Kenya Shilling Overnight Interbank Average. A transaction-based benchmark representing the average interest rate at which Kenyan banks lend and borrow unsecured overnight Kenya Shilling funds. It is calculated as a volume weighted average of actual transactions published daily by the Central Bank of Kenya, and is designed to serve as Kenya's near risk-free reference rate (RFR).
Fallback	Central Bank Rate (CBR) to serve as the fallback reference rate where KESONIA is not available.
Governance	Administration and oversight by the Central Bank of Kenya, aligned with principles for financial benchmarks, ensuring transparency, accountability, and methodological integrity.

C. Conventions for Compounded KESONIA and Introduction of a Lookback Period

When using compounded KESONIA, the interest rate payable is aggregated over the interest period and finalized at the end of the period. The eventual rate becomes increasingly certain as the end of each period approaches and most of the KESONIA observations are known.

Financial institutions will however need some lead time to inform their clients of the actual interest payable. There is therefore a need to develop conventions to provide a lag period after the last KESONIA observation for the final interest to be calculated and verified before payment advice is sent to clients. This period is referred to as the **lookback period**.

The look back period for purposes of calculating interest on KESONIA linked variable rate loans shall be **five (5) days**.

D. Basis of KESONIA

Interbank Overnight KESONIA is underpinned by up to Kes 60 billion worth of daily Interbank volume transacted in the market. The Kenya interbank unsecured market is therefore deep and reliable.

E. What is KESONIA Compounded Index

The '**KESONIA Compounded Index'** refers to an index that will be published by the Central Bank of Kenya that reflects the cumulative effect of compounding daily KESONIA rates over time.

F. Calculation of KESONIA Compounded Index

The KESONIA Compounded Index is calculated as follows:

$$KESONIA\ Compounded\ index = KESONIA\ Compounded\ Index_{i-1} \times \left(1 + \frac{KESONIA(i)\text{-}1 \times a(i)\text{-}1}{365}\right)$$

Where;

- **KESONIA Compounded Index$_i$ =** The index for date i, calculated and published on date i, rounded to eight (8) decimal places (KESONIA Compounded Index$_1$ = 100.00000000).
- **KESONIA Compounded Index$_{i-1}$ =** The index for business day i-1, calculated on business day i-1. While the published value of the index is always rounded to 8 decimal places, the underlying calculation uses the previous day's index value that has been rounded to 18 decimal places.
- **KESONIA $_{i-1}$ =** The KESONIA rate for business day i-1, calculated and published on business day i
- **a $_{i-1}$ =** The number of calendar days for which KESONIA$_{i-1}$ applies. This is equal to the number of calendar days between business day i-1 and business day i

It is proposed that the KESONIA Compounded index will be published daily by 9.00am at the start of business for rates applicable the previous business day.

On weekends and bank holidays, the KESONIA rate is held constant from the last working day.

Computation of KESONIA compounded rates from KESONIA compounded index

To calculate the compounded KESONIA rate for any reference period, the KESONIA Compounded Index values for the start and end date of the reference period are combined in the following formula:

$$Compounded\ KESONIA\ rate\ between\ x\ and\ y = \left(\frac{KESONIA\ compounded\ index\ (y)}{KESONIA\ compounded\ index\ (x)} - 1\right) \times \frac{365}{d}$$

Where:
x = start date of the reference period
y = end date of the reference period
d = the number of calendar days in the reference period

KESONIA compounded Index and compounded rates workings for 30 days tenor

KESONIA Publication Date	KESONIA Rate	Daily accrual	KES Compounded Index	Compounded KESONIA O/N rate	Compounded KESONIA 1M rate
2-Feb-25	11.15%	0.03085594	100.99828606	11.1511%	11.4013%
1-Feb-25	11.15%	0.03084652	100.96743954	11.1511%	11.3983%
31-Jan-25	**11.15%**	**0.03083710**	**100.93660244**	**11.2333%**	**11.3953%**
30-Jan-25	11.23%	0.03105486	100.90554758	11.2416%	
29-Jan-25	11.24%	0.03106823	100.87447935	11.2413%	
28-Jan-25	11.24%	0.03105784	100.84342151	11.2460%	
27-Jan-25	11.25%	0.03106125	100.81236026	11.2436%	
26-Jan-25	11.24%	0.03104506	100.78131519	11.2436%	
25-Jan-25	11.24%	0.03103550	100.75027969	11.2436%	
18-Jan-25	11.33%	0.03120678	100.53197062	11.3302%	
17-Jan-25	11.33%	0.03119709	100.50077352	11.3313%	
15-Jan-25	11.32%	0.03115545	100.43842764	11.2995%	
5-Jan-25	12.04%	0.03302443	100.12389804	12.0390%	
4-Jan-25	12.04%	0.03301354	100.09088451	11.0390%	
3-Jan-25	11.04%	0.03026217	100.06062234	11.0619%	
2-Jan-25	11.06%	0.03031576	100.03030658	11.0619%	
1-Jan-25	11.06%	0.03030658	100.00000000		

NB: For purposes of illustration. KESONIA index set to start on January 1, 2025, as shown above.

Below is an illustration of calculation of compounded interest payable in 30 days for a loan facility of Kes 10 million starting from 1st January 2025 to 31st January 2025.

Computation of interest payable using KESONIA 30 day compounded Index	
Principal Amount	**10,000,000**
Interest period start date (A)	1-Jan-25
Interest period end date (B)	31-Jan-25
Number of calendar days (C)	30
KESONIA Index observation start (D)	100.00000000
KESONIA Index observation end (E)	100.93660244
Compounded int over the observation pd (F)= (E/D-1)*365/C	0.113953297
Compounded int over the interest period= (=F*C/365)	0.009366024
Accrued interest over 30 days @10 million= (E/D-1)*1*10 million)	**93,660.24**
Principal + Interest	**10,093,660.24**

Computation of interest payable using KESONIA 30 day compounded rate	
Principal Amount	**10,000,000**
30 day compounded KESONIA rate applicable as computed	**11.3953%**
Tenor - days	30
Accrued interest over 30 days payable	**93,660.24**
Principal + Interest	**10,093,660.24**

G. FREQUENTLY ASKED QUESTIONS

What is KESONIA?

- KESONIA stands for the Kenya Shilling Overnight Interbank Average. It is a transaction-based benchmark rate reflecting the average interest rate at which banks in Kenya lend and borrow unsecured overnight funds in Kenyan Shillings.

Is KESONIA a new rate?

- No. KESONIA is a formal renaming of the existing overnight interbank average rate. The methodology remains unchanged and continues to reflect actual overnight interbank lending transactions.

Why was the name changed?

- The name change aligns with international benchmark reform practices and provides a clearer identity for Kenya's risk-free reference rate, consistent with global standards such as the Sterling Overnight Index Average (SONIA) of UK, and the Secured Overnight Financing Rate (SOFR) of US.

Does KESONIA affect how the overnight interbank weighted average rate is calculated?

- No. There are no methodological changes. The rate continues to be calculated as a volume-weighted average of overnight interbank transactions.

What is KESONIA compounded in arrears?

- KESONIA compounded in arrears refers to calculating interest by compounding the daily overnight rate in each day over an interest period.

Will KESONIA be the only rate in use?

- KESONIA will be applicable to all variable rate loans except for foreign currency denominated loans and fixed rate loans. Where KESONIA is not practical, the customers may be availed of the use of Central Bank Rate (CBR) as the alternative reference rate.

What if KESONIA data is unavailable?

- Fallback to CBR is allowed for that period. Contracts should provide for this contingency.

Is KESONIA a risk-free rate?

- Yes. It reflects overnight unsecured lending among banks, with minimal term or credit risk.

Will contracts or systems need to be updated?

- Yes. Commercial banks will update internal documentation, system references, pricing models, and legal agreements to reflect the KESONIA naming convention going forward.

What are the broader implications of adopting KESONIA?

- Adopting KESONIA supports a broader shift to international best practices on benchmark reference rate frameworks. It lays the foundation for further developments such as term rates, KESONIA-linked financial products, and a domestic derivatives market.

Where will KESONIA be published?

- KESONIA will be published daily by the Central Bank of Kenya on its website and included in relevant market data feeds and reports.

Does the KESONIA framework apply to existing loans and previously negotiated agreements?

- The revised RBCPM will take effect from September 1, 2025, for all new variable rate loans. As for existing variable rate loans, the revised RBCPM will take effect from February 28, 2026, at the end of a 6-month transition period for finalisation of the necessary arrangements.