Consumer Education on Banking in Kenya

Banking industry stability is good for the economy

Kenya has been recognised as one of the most promising economies, not only in the East Africa region but across the Continent, due to its market-based policies that enable growth of the various sectors, including financial services; and the Government's progressive role of fostering public-private sector engagement.

With such enabling environment, the banking industry has over the years collaborated with the Central Bank of Kenya (CBK) and National Treasury to develop both interim and long-term measures to support economic development while responding to concerns raised by the banking public regarding financial services accessibility and the cost of credit.

This collaborative approach, which has been supported by adequate fiscal and monetary policies in a stable macro-economic environment, has resulted in positive development -- characterized by growth in deposits, increased lending, and improved returns on investment.

In 2013, Kenya's banking industry recorded continued growth and stability, which stimulated expansion of credit across several economic sectors, including Trade, Manufacturing, Agriculture and Transport and Communications. Household demand for credit was also met by banks with an increase in personal loans.

Overall, gross loans from banks expanded from Ksh1.36 trillion in December 2012 to Ksh. 1.60 trillion in December 2013, according to the CBK Credit Officer Survey. During the year 2013, banks also increased deposits by 12.5pct and attracted investments with shareholder funds increasing by 18.91pct to Ksh.431 billion.

Frequently Asked Questions

Banking is as simple as it is complicated. There are various factors that affect how banks operate, and in turn influence the fees and rates banks charge on loan products, and pay for deposits.

What is interest rate?
A: Interest rate is the price of money. The loan interest rate is the price a bank charges you for a credit facility; the deposit rate is the price a bank will pay you for a deposit.

• Bank customers can negotiate a higher interest rate for cash deposits that they keep with a bank for a period of time (i.e. fixed deposits). This is common practice, particularly with large cash deposits.

• The loan interest rate is made up of two components: Margin/Spread; and the Cost of Funds.

✓ The Margin covers the Risk, Operational Costs, and Returns expected by Shareholders.

✓ The Cost of Funds is essentially what banks pay for deposits; and costs associated with mobilising funds such as bonds and lines of credit.

Why do some countries have lower interest rates than others?
A: Different markets are characterised by different policies that influence market liquidity. These policies include fiscal policy such as Government borrowing and expenditure.

• A much more developed market, for example South Africa, would typically have lower interest rates than a developing market like Kenya.

Credit Information Sharing & Your Credit Report

Many borrowers make a lot of effort to repay their loans, but previously did not get rewarded for it because this good repayment history was not available to other loan providers. With the introduction of Credit Information Sharing across the industry, banks can now better distinguish between good borrowers and defaulters.

This means borrowers with a "Good Credit Report" or "Good Credit History" are able to negotiate more favourable loan interest rates based on their credit rack record.

In future, other credit providers like the SACCOs, telecoms and utility companies will provide and access this information as well.

Building your credit history

A "Credit History" is an official record of the advances (loans/credit) you have repaid over time. This history is used by your banker (credit analyst) in loan risk assessment.

One of the key components of your Credit History is a "Credit Report". A "Credit Report" is generated by a licensed Credit Reference Bureau and contains detailed information on credit accounts and loans, bankruptcies and late payments, and recent inquiries by credit providers (banks, deposit-taking microfinance institutions, etc.).

Within the Report is a "Credit Score", which is a measure of credit risk calculated using a standardised formula. A positive score is characterised by frequently paid bills; lack of defaults on outstanding balances; maintaining steady employment; and the use of no more than 25% of a customer's available credit. On the other hand, a negative credit score is characterised by late payments; bankruptcy; fraud charges; liens or foreclosures; and loss of employment.

Your rights to accurate reporting

Did you know that the law requires credit reference bureaus to supply you with one free credit report per year, and a free credit report whenever a bank makes an adverse decision about you using information obtained from a credit report?

Bank customers should request for their Credit Report every year. And if there is any inaccurate information, there are laws and regulations on how to settle the disputed record. If a dispute is not settled within a specified period, the disputed information will have to be removed from the databases of all Credit Reference Bureaus.

To request your Credit Report, Contact the licensed Credit Reference Bureaus: Transunion CRB (email: reports@crbafrica.com); or Metropol (email: creditbureau@metropol.co.ke).

For more information on Credit Information Sharing, please log on to :
www.ciskenya.co.ke

on Interest Rates

Why are banks not lowering their loan interest rates? Isn't this affecting access to credit?
A: Banks are actually lowering their loan rates, and have done so consistently since June 2012.

- In fact, commercial bank lending rates declined from an average of 19.3% in 2012 to about 16.8% as at December 2013.

- According to the Central Bank Credit Survey, demand for credit generally increased in 2013 in response to the decline in interest rates. The gross loans from banks expanded from Kshs.1.36 trillion in December 2012 to Kshs.1.60 trillion in December 2013 – this was a significant contribution to economic development.

- As the macroeconomic environment improves and Government borrowing decreases, you should expect that more banks would lower their interest rates (on both the lending and deposits side).

- Meanwhile, banks are keen to reward borrowers through increased lending. One of the interventions introduced by Kenya Bankers Association and Central Bank of Kenya is the Credit Information Sharing Initiative, which will see banks better price their loan products – based on the individual customer's risk profile (or credit report). This initiative also minimizes the reliance on traditional collateral, which is a challenge for most.

- Another promising industry intervention is enhancing competition and promoting consumer protection through pricing transparency. Towards this end, KBA has adopted a transparent pricing mechanism to facilitate standardised disclosure on the cost of borrowing to loan applicants. Currently banks are required to disclose the Total Cost of Credit to loan applicants. By mid-2014, banks will introduce the Annual Percentage Rate (APR) framework which will enable customers to compare pricing and make even more informed decisions.

What is the impact of high interest rates?
A: High interest rates (or expensive money) are a symptom of market conditions. It should not be assumed by borrowers or depositors that a high interest rate regime is permanent. When you have high inflation or a depreciating currency, interest rates tend to be high; once market stability is attained, rates trend downwards, as we have seen in the recent past.

If low interest rates provide benefits to borrowers, why wouldn't we just keep rates low all the time?
A: Generally, all stakeholders, including banks, Government and the Central Bank prefer interest rates that promote stability, and encourage borrowing.

What benchmarks do banks use to determine lending rates?
A: The variables that influence rates include the T-Bill rate; Interbank rate; Cash Reserve Ratio; Liquidity Ratio; and the Central Bank Rate (CBR).

Is there a standardized policy on interest rates disclosure?
A: Through the Kenya Bankers Association and with support from Financial Sector Deepening (FSD) Kenya, banks are working to develop an Annualized Percentage Rate (APR) which basically compares the interest rates charged by various banks, based on the common factors used to calculate the annualized equivalent rate.

- APR will enable consumers of financial services to make informed, "like for like" comparisons between bank loan rates.

More Resources

Visit the Kenya Bankers Association web site **www.kba.co.ke** to download the "Total Cost of Credit" template and more consumer information, including the "Consumer Guide to Banking in Kenya" (2013 edition).

Know Your Credit Rights

The Terms and Conditions of bank products and services spell out a customer's rights and responsibilities. Bank customers should always feel free to ask bank staff or branch managers to explain unclear Terms and Conditions. It is advisable that these conditions are understood before a contractual agreement with the bank is signed. This is especially the case when it comes to loan and other credit agreements.

Ask About the Total Cost of Credit

Total Cost of Credit refers to the total amount payable for a loan, including all bank fees and charges, and estimated third party costs such as legal fees, and valuation and stamp duty in the case of loans secured by a physical asset.

Before signing a loan agreement, a customer should request the bank to provide them with a Total Cost of Credit breakdown. This estimate will not only empower the customer to make an informed decision, but also will enable the customer to compare the fees and charges within the market.

Example – Total Cost of Credit Summary	
Loan Type	Mortgage
Loan Amount	5,000,000.00
Type of Interest Rate	Reducing Balance Method
Interest Rate Period	Annually
Standard Interest Rate	14.00%
Fixed or Variable Interest Rate	Fixed
Loan Period Time	Years
Loan Period	5.00
Additional Charges:	
Application & Processing Fee	
Monthly Service Fee	
Third Party Costs:	
Brokerage Fees	
Attorney & Notary Fees	
Total Credit Life Insurance	
Other Insurance Specific to Taking out Credit	
Government Levies	
Valuation	

Note: Previously, banks would charge a fee or additional interest for early termination of a loan contract. Under Section 62 (1) Consumer Protection Act 2012, a borrower is now entitled to pre-pay the loan at any time without any charge or penalty.

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