KENYA BANKERS ASSOCIATION

KBA POSITION ON THE CBK CONSULTATIVE PAPER ON REVIEW OF THE RISK-BASED CREDIT PRICING MODEL

CBK proposes the Central Bank Rate (CBR) as the base reference rate, with the final lending rates determined by adding a premium ("K") to the CBR. The premium 'K' shall comprise the bank's operating costs related to lending, return to shareholders, and the borrower's risk premium.

CBK will review each bank's proposed premium 'K' before rollout and determine **both the base rate and the premium 'K'** ***(Interest Rate Capping).***

The proposed interest rate capping by CBK is not supported in law and would have the following effect:

1. Reduced lending to Kenyans and businesses, especially MSMEs, as experienced between 2016 and 2019 when the interest rate capping law was in place.
2. CBK will not operationalize the monetary policy decision after setting the CBR. Setting the CBR without triggering its transmission leads to misaligning market outcomes from the policy.
3. Banks will not be able to honour our public commitment to support small businesses with loans of Kes 150 billion annually from 2025.

KBA proposed to CBK for the adoption of **interbank rate as the base reference rate**, that is, **market-driven** and allowing **the premium 'K'** to be fully flexible, underpinned by the following factors:

(i) Global best practice shows that market-based rates are derived from short-term market rates, such as the SOFR(USA), SONIA(UK), and EURIBOR (EU), which are all derived from short-term market rates.

(ii) Previous efforts towards a unified base rate, the Kenya Banks Reference Rate (KBRR), did not benefit from a supportive monetary policy framework that requires CBK to activate the transmission of policy action. Its design did not benefit from CBK actively operationalizing its policy decisions. The interbank market (aligned with the CBR) is the best anchor for transmitting monetary policy signals. There would be a weak transmission of policy signals if CBR is not operationalized via liquidity injections/withdrawals.

(iii) Flexibility on the premium 'K' is consistent with the law that recognizes a liberalized interest rate regime in Kenya. Beyond the base rate, 'K' should be allowed to be fully flexible across banks, products, and clients based on each bank's differentiated cost of funds, operational costs, shareholders' expected return on investment, and customers' risk premium.

All customers, including those with very high credit risk levels (such as low-income individuals and small businesses), should have access to loans to finance their activities at interest rates commensurate with their risk profiles.

In its proposal, CBK is silent on the interbank market corridor as the monetary policy implementation framework. This raises concerns about whether CBK has abandoned the interest rate corridor framework and whether the market still needs to consider the interbank rate as the operational target for monetary policy. Ignoring the interbank rate sets the market back to the pre-August 2023 challenges of CBR being misaligned with market conditions and, therefore, weaker transmission of policy.

The proposed rate capping is dangerous without clarity on the criteria for reviewing the proposed 'K'; submitting to CBK the premium 'K' for each customer is impractical.

CBK argues that the interbank market is prone to volatility during periods of tight liquidity; however, as per the Constitution and the CBK Act, it is CBK's mandate to apply its monetary policy tools to manage market liquidity conditions and mitigate volatility.

CBK indicates that the CBR reflects the cost of funds for banks. Two main factors determine the cost of funds for banks: the cost of deposits and the cost of long-term borrowed funds. The rate of return on commercial bank deposits is not benchmarked on CBR but rather the depositors' assessment of the opportunity cost of investing in Government securities, which is reflected in the treasury bill rate.

KBA does not support the CBK proposal in its entirety. By rejecting the interbank rate as a preferred unified base rate and proposing the CBR, the CBK will not operationalize the policy decision after setting the CBR.

As proposed, the reintroduction of interest rate capping contravenes the law that prescribes market-driven interest rates.

Interest rate controls will drive banks to stop lending to segments of the economy that are perceived to be risky, such as small businesses and low-income individuals, stagnating economic growth and development, employment creation, and investment.

The banking industry stands ready to engage and work with CBK to address the challenges in credit pricing, transparency and realize affordable credit flow to Kenyans, their households, and businesses.

Raimond Molenje, CEO
Kenya Bankers Association
30th April 2025