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Developing a Credit Reporting Framework in Kenya

In 2000, the level of nonperforming loans in Kenya topped Kshs 112 billion (US\$1.4 billion). This posed a threat to the stability of the financial sector, and there was a consensus that a credit information sharing mechanism would help resolve the tendency of some debtors to take advantage of information asymmetry and resort to multiple borrowing, thus becoming serial defaulters. After several failed initiatives by various local stakeholders to set up credit bureaus, IFC was invited to provide assistance to the government authorities in setting up a legal and regulatory framework as well as to support private sector operators.

Background

Until about 10 years ago, very few countries outside of the Organisation for Economic Co-operation and Development (OECD) and Latin America had operational credit bureaus. In recent years, as retail growth has picked up dramatically around the world and technology become more available, many countries in Eastern Europe, Asia, and now the Middle East and North Africa have established credit bureaus. Sub-Saharan Africa, excluding South Africa, is the only region without fully functioning credit bureaus.

For several years a private operator in Kenya struggled to initiate a credit bureau. In 2002, the Kenyan Bankers Association (KBA) began an initiative to develop a private sector credit bureau that would be owned by the banks, but it eventually concluded that the preferred model would be to utilize the services of a private sector bureau licensed and supervised by the Central Bank of Kenya (CBK).

The CBK took the initiative, and the banking law was amended in 2006 to require financial institutions to share information with licensed private bureaus. The KBA had also been involved in various consultations in the past with the commercial banks but had not succeeded, so the banks were looking for an independent party to help manage the process.

In March 2006 a conference was held at the request of several financial institutions for IFC to provide leadership in accelerating the development of credit reporting in East Africa. The conference was well attended, with 88 participants representing central banks, commercial banks, government ministries, revenue authorities, bankers' associations and institutes, credit bureaus, stock brokers, insurance firms, small and medium enterprise (SME) finance and microfinance institutions, among others. The conference confirmed that credit information sharing was indeed a very important area, and the CBK Governor expressed the government's commitment to issuing the necessary rules to fast-track the growth of credit reporting. IFC's Africa Credit Bureau Program would provide support to the authorities on the international best practice in legal and regulatory framework as well as assist private sector operators.

Lessons Learned

1) Our role as "honest broker" needs to come out very clearly.

IFC's involvement in the program came at the right time, as several earlier attempts by various players had failed. IFC had extensive experience promoting the use of credit information services around the world and had no vested interest in running a private credit bureau in Kenya. We were therefore

quickly requested to take on the role of an honest broker and were well positioned to do so.

With IFC in this role, financial institutions, the KBA, and the CBK were willing to work together to develop the credit reporting framework. We were also able to share global experiences that supported comprehensive information sharing; none of the banks had been willing to share such information, fearing that other banks would steal their clients.

2) Get multi-stakeholder buy-in from the beginning of the project.

After the successful conference in 2006, we received the government's commitment to put in place the necessary steps that would fast-track the development of the credit information sharing framework. One of the lessons we learned was the importance of creating a task force that would include representatives from all the key stakeholders. This task force created the forum needed to discuss the various steps and key issues.

With IFC's help, the CBK consulted with all the stakeholders and drafted credit bureau regulations that reflected their interests. This ensured the full buy-in and engagement of all key players.

3) Identify an internal champion in the Central Bank.

Banks are the major providers of credit in most African countries, and the central banks, as the banks' supervisor, have an important role to play in the development of credit reporting. As we moved along, we quickly realized that it was important for us to identify someone on the inside who would advocate on our behalf and make sure that the issues discussed in the task force were presented to the senior management. We found such a person in Mr. Jared Getenga, who at that time was working as a manager in the Banking Supervision Department. We also asked him to chair the task force meetings. With continuous dialogue and exposure to various programs in the region, Mr. Getenga quickly developed an understanding of credit reporting and was able to move the agenda internally within the CBK.

As an insider, he engaged with the CBK Governor and carefully worked through all the internal procedures and politics so as to finalize the regulations. As a result, the Minister of Finance formally published the Credit Reference Bureau regulations on July 11, 2008. The regulations, which come into effect in 2009, provide for the licensing and establishment of credit bureau operations in Kenya. The regulations also make it mandatory for financial institutions to report nonperforming loans, and provide for the protection of consumers by defining their rights.

4) The two important E's! – education and exposure.

As credit bureaus are a relatively new feature in most of Africa, a comprehensive awareness campaign is essential for the successful development of the credit information system. It was telling that at the initial meetings and discussions regarding credit bureaus, most of the

stakeholders semi-jokingly referred to them as the "animal," as they had only a limited idea of what a credit bureau was and how it would work.

One of the key lessons here was the importance of investing in education and exposure from the very beginning of the project. The first conference in 2006 was successful because it involved both private and public officials and they all had a chance to be educated on the needs and benefits of credit bureaus. As project implementation continued, we organized workshops and study tours for the KBA and CBK teams. Supervisory authorities need training and capacity building to effectively enforce laws and regulations governing information exchange.



Members of the study tour at the Central Bank of Morocco

There has been a lot of debate in the past about the cost of study tours and their effectiveness. In Kenya, it was very clear that the exposure visits were highly beneficial. For example, during their study tour to South Africa, the KBA and CBK teams visited three credit bureaus to understand their operations, and met with the National Credit Regulator in South Africa to discuss their regulations. After the tour we noticed a marked enthusiasm to advance the project, which led to the official publication of the regulations. The CBK has now begun to receive applications from viable credit bureaus.

Conclusion

Some testimonials from our partners:

John Wanyela, Executive Director of the Kenya Bankers Association: "IFC has played a major developmental role to ensure that Kenya establishes credit reference bureaus. IFC's global view has been greatly appreciated."

Jared Getenga, an official from the Ministry of Finance, "The Ministry of Finance will work with the Central Bank of Kenya and IFC to share international best practices in order

to ensure that we support the successful operation of credit bureaus under the new regulations.”

The development of credit bureaus in Kenya presents a significant opportunity to improve the overall credit culture and support the development of credit markets. But this process takes time. To ensure success, consistent effort and focus are required over a period of time to ensure progress and success.

Now that the regulations are in place, the CBK has started receiving applications from viable credit bureaus. One private credit bureau has already submitted its application, and two international firms are looking for local partners before submitting theirs. Once the applications have been accepted, the CBK will license and supervise the credit bureaus.

Another highlight – the KBA is recruiting a program manager who will coordinate the relationship between the licensed bureau and the commercial banks, finalize the different fees and contracts, and define the reporting framework to ensure that the sharing of information between the bureaus and banks actually takes place.

With our intervention, the new regulations will guide the system of credit information sharing and will help identify and isolate serial loan defaulters, who account for the huge stock of nonperforming loans. With time, this will enable banks to lower the price of credit facilities for borrowers who show a good credit profile.



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