KENYA CREDIT INFORMATION SHARING INITIATIVE
A PROGRESS REPORT 2008-2011

CHALLENGES AND OPPORTUNITIES

FEBRUARY 2012

FSD Kenya
Financial Sector Deepening

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FSD Kenya
Financial Sector Deepening

The Kenya Financial Sector Deepening (FSD) programme was established in early 2005 to support the development of financial markets in Kenya as a means to stimulate wealth creation and reduce poverty. Working in partnership with the financial services industry, the programme's goal is to expand access to financial services among lower income households and smaller enterprises. It operates as an independent trust under the supervision of professional trustees, KPMG Kenya, with policy guidance from a Programme Investment Committee (PIC). In addition to the Government of Kenya, funders include the UK's Department for International Development (DFID), the World Bank, the Swedish International Development Agency (SIDA), Agence Française de Développement (AFD) and the Bill and Melinda Gates Foundation.

Government of Kenya | UKaid from the Department for International Development | THE WORLD BANK | EMBASSY OF SWEDEN Nairobi | afd AGENCE FRANÇAISE DE DÉVELOPPEMENT | BILL & MELINDA GATES foundation

Table of Contents

Tables and Figures

TABLES

FIGURES

Abbreviations

AMFI	Association of Microfinance Institutions
ASCA	Accumulating Savings and Credit Association
CBK	Central Bank of Kenya
CRB	Credit Reference Bureau
DTM	Deposit-Taking Microfinance Institution
EAC	East African Community
FSD	Financial Sector Deepening
ICT	Information and Communication Technology
KCPA	Kenya Credit Providers Association
KBA	Kenya Bankers Association
KSHS	Kenya Shillings
MFI	Microfinance Institution
NBFI	Non-Bank Financial Institution
NPL	Non-Performing Loan
SACCO	Savings and Credit Co-operative
SASRA	SACCO Societies Regulatory Authority

EXECUTIVE SUMMARY

THE PROJECT

Lending is an important element of financial intermediation, which is itself at the heart of an economy's financial architecture. It therefore behoves policy makers to continually review the credit market to minimize inefficiencies that hinder faster economic growth. Non Performing Loans, though declining, remain a concern to the quality of lenders assets in Kenya's financial sector. In addition, good borrowers have been disadvantaged by high interest rates and stringent collateral requirements, as banks cushion themselves against the risk of high Non Performing Assets.

These challenges have been an outcome of information asymmetry, which in the past continually led to the rejection of good credit risk applicants because their credibility could not be objectively proven. On the flip side, serial defaulters adversely affected bank performance, threatened sector stability and inhibited growth of credit to the private sector.

As a result, the need to introduce credit referencing as a risk management tool was identified by Kenyan lenders as necessary to create a vibrant and globally competitive financial sector. Following remarkable efforts and support of the Central Bank of Kenya (CBK), Kenya Bankers Association (KBA), and Financial Sector Deepening Trust (FSD–Kenya), a successful roll out of the credit information sharing mechanism amongst banks was officially launched in July 2010.

This was pursuant to the gazetting of regulations governing the licensing, operations and supervision of banking sector credit reference bureaus in July 2008. Prior to that, legal amendments to the Banking Act had been made in 2003 and again in 2006 to provide for credit information sharing within the banking industry. Today, all commercial banks and the Deposit Protection Fund Board (DPFB) share negative credit information on their customers with licensed credit reference bureaus (CRBs). In the year 2011, provisions were further introduced in respective legislation governing MFIs and SACCOs to introduce sharing of credit information, although relevant regulations are yet to be prepared.

In 2007, CBK and KBA formed a Joint Task force to oversee the implementation of CIS amongst commercial banks and the Deposit Protection Fund Board. Two years later, Kenya Credit Information Sharing Initiative (KCISI) was set up as a project office operating under the auspices of the KBA to champion the establishment of a credit reporting mechanism in Kenya's banking sector, and coordinate the sharing of information among banks through all licensed CRBs. KCISI's Project Manager continues to oversee the functions that have led to the success of the CIS project thus far.

PROGRESS 2008 - 2011

The progress which was made in the short period since the initiation of the project has been remarkable. From the registration of the first credit bureau in February 2010, the level of information sharing increased dramatically. The level of support for information sharing amongst banks and the level of interest amongst SACCOs and MFI's for participating in information sharing is a notable achievement. The project established a sound basis for broad credit information sharing in the Kenyan financial sector.

TARGETS MET

The project achieved most of its targets and a sound basis has been established for the future of the project. There are a number of areas which should be identified as priorities for the future, which we have listed below. Most of these issues were not within the control of the Project Team, or were not part of the formal targets for this phase of the project. However, these areas would have to be prioritised in order to avoid certain significant risks and to ensure that the full potential of information sharing is realised. These issues are as follows:

- Certain important legal obstacles have to be addressed;
- There is a need for increased capacity building in the banking sector;
- It is a priority to make further progress in implementing positive information sharing amongst banks;
- It is similarly a priority to make rapid progress towards inclusion of MFIs and SACCOs in information sharing; and,
- The proposed Credit Providers Association still has to be established.

POSITIVE INFORMATION SHARING

Amongst these issues, progress towards positive information sharing amongst banks and progress towards the inclusion of SACCOs and MFIs in information sharing should be afforded the highest priority. Progress in these would address a number of strategic priorities and would reduce a number of significant risks to which the project is currently exposed:

a. it would enable credit information to make a much greater contribution in *curbing potential debt stress*;

b. it would lower the level of *credit risk in retail banks in an environment of rapidly expanding consumer credit*;

c. it would protect the SACCO movement, a strategically important sector in the Kenyan financial sector, from growing risk;

d. it would reduce the risk of legal challenges due to the negative perceptions created by negative information sharing; and,

e. it would enable the project to make a more constructive contribution to financial inclusion.

ROLE OF THE CENTRAL BANK

The Central Bank of Kenya played a critical role in developing the credit information market. It is important to retain the continued support and involvement of the Central Bank as this would assist in dealing with potential legal challenges and support the achievement of strategic development priorities. However, there is a valid concern that the banking industry is relying excessively on the Central Bank for leadership. There is considerable scope for progress through industry agreements. This will create greater flexibility which could be important in the manner in which the credit information industry evolves.

USE OF CIS BY BANKS

All registered banks are submitting data. Enquiry volumes have increased from 48,000 per month in August 2010 to 88,000 in May 2011. In recent months the number of retail banks which are doing enquiries increased to 31. Although the enquiry volumes for the majority of banks are very small (4 banks account for 90% of all enquiries; 9 banks for 97% of all enquiries), all the primary retail banks are doing enquiries. These banks report that the bureau data is of significant benefit, both in avoiding risky clients and in causing clients to pay arrears instalments.

PREVAILING VIEW OF CIS

The current view of credit bureaus and credit information sharing is primarily as a debt collection tool. The primary benefits identified by survey participants are:

a. a mechanism to identify and avoid 'serial defaulters',

b. a mechanism to pressurise clients to meet their loan obligations; and,

c. a mechanism to improve the 'repayment culture'.

Whilst these are valid benefits, it does represent a narrow view of credit information sharing and could undermine the strategic development of credit information sharing.

DANGERS IN NEGATIVE INFORMATION

The fact that only negative information is being shared and the extent to which old and outdated debts are being captured on the bureaus represent a major threat. It is likely to increase the risk of a public backlash and undermine the credibility of credit information sharing. These weaknesses are to a large extent caused by weaknesses in the current data retention rules and weaknesses in the legislation.

SEARCH FOR FULL FILE INFORMATION SHARING

Extending information sharing beyond negative information and beyond banks to encompass positive information sharing between banks as well as MFIs and SACCOs should be the highest priority in the next phase of the project. Credit information is currently being shared on approximately 200,000 consumers. However, there are approximately 5 million consumers who have credit agreements with formal sector financial institutions. *This implies that current information sharing cover less than 5% of the consumers who have formal sector credit agreements.* Even for consumers on whom information is shared, only the defaulted agreements would be listed. This implies that the credit bureaus are currently of *limited value in credit risk management, of similarly limited value in assessing consumers' level of debt commitments or in preventing over-indebtedness.*

RISKS TO CIS SYSTEM

In our view, the biggest threats to the development of credit information sharing, and to the credit market in general, relate to the following factors:

- There may be a more significant threat of debt stress than what is generally recognised. The fact that only negative information is being shared and that non-banks do not participate in information sharing, limit the potential role that credit bureau information could play in preventing escalating defaults as result of debt stress. SACCOS are particularly exposed. However, certain retail banks are growing their consumer lending and credit exposure aggressively and are also at risk.
- The fact that only negative information is currently being shared further implies that *consumers' engagement with credit bureau records would nearly always be negative.* There is a significant threat of increasing resistance from consumers, as well as increasing legal action challenging the legality of information sharing. With an expansion in the volume of negative information being contributed by participants and an increase in the number of institutions doing enquiries, these risks will increase.

HOW TO PROGRESS

We note that there is a strong view amongst some of the stakeholders that the focus of the project should in the medium term remain on information sharing amongst banks, initially focusing on improving the quality of the information and thereafter on expanding the project from negative information sharing to positive information sharing. For this group, the focus of the next few years should remain on information sharing amongst banks with participation by other groups being delayed until a later stage. We believe that there are significant dangers in such an approach and recommend that the expansion to include parties such as SACCOs and MFI's and to expand to positive information sharing should be a priority.

LEGAL FRAMEWORK CONSTRAINT

A major constraint in addressing these problems relates to the legislation which governs information sharing, i.e. (a) the limitations in credit bureaus' conditions of registration and (b) restrictions on sharing of bank information with other institutions. Credit reference bureaus' conditions of registration appear to prevent them from servicing parties other than banks, thus preventing them from acquiring new clients and from seeking out new sources of data and expanding the credit information market. The restriction which prevents bank data from being shared with entities other than banks implies that such institutions will gain limited value from information sharing and removes the incentive for these institutions to share date. It is a priority for these limitations to be removed or modified. The limitations would severely constrain the ability of the credit information market to evolve and develop.

FINANCIAL INCLUSION

Within the current limitations, credit reference bureaus make at most a very limited contribution to financial inclusion. However, if the weaknesses which have been identified are addressed, information sharing through credit reference bureaus has the potential to make a significant contribution to financial inclusion.

RECOMMENDATIONS

1. That an extensive review of the legislation and regulations be undertaken. Any legislative restrictions on the sharing of bank data with entities other than banks should be removed, as should the current narrow restrictions on the registered credit reference bureaus. The legislative amendments should be sufficiently extensive to create an enabling framework for the development of information sharing over at least the medium term future.

2. We recommend that information sharing be expanded to (a) include MFIs, SACCOs and any other credit granting institutions (including trade credit), and (b) to expand bank information sharing to positive data. This would substantially improve the value of the credit referencing system in respect of prevention of defaults as well as in the prevention of over-indebtedness. It would also enable the credit referencing system to make a positive contribution to financial inclusion.

   - The legal changes would greatly assist in implementing the recommended expansion.
   - Such an expansion could also be facilitated by establishing a Memorandum of Understanding (or similar instrument) for voluntary and reciprocal positive information sharing between the leading banks, SACCO's and MFIs.

3. We recommend that a formal and independent opinion be obtained on the legal arguments and concerns which banks are raising on information sharing. Such an opinion would also assist in defining the most appropriate remedy.

4. We have not gone as far as recommending that positive information sharing should be compulsory. However, we wish to note that there are compelling reasons for this to be considered, even if this is only a temporary measure.

   - Compulsory positive information sharing including both banks and non-bank credit providers could make an important contribution to bank stability and could reduce the risk of bank failure significantly. It could also make a dramatic impact on financial inclusion, which would have a positive impact on the rate of economic growth as well as on poverty reduction.
   - High risk clients (or 'serial defaulters') would increasingly turn to banks which do not do enquiries. Banks which focus on 'name lending' may also see limited value in credit bureau information. Both these factors point to a potential for increased prudential risk, which may well justify increased scrutiny by the central bank of any bank which do not use the credit bureau data in its loan appraisal process.

5. The establishment of the envisaged Credit Providers Association could play an important role in facilitating the expansion towards broader information sharing. This should include representatives of all the different types of credit providers and credit reference bureaus as well as the respective industry regulators. There would also be value in creating a forum for regular engagement between the Credit Providers Association and consumer representatives.

6. We view the establishment of an 'ombud' or adjudicator which could to deal with consumer complaints as a high priority. As a voluntary scheme funded by the credit industry this could be established speedily and at a fairly low cost. This could make an important contribution in dealing with consumer complaints.

7. Further work is required in the next phase of the project to address certain operational problems and capacity constraints. This should include:

   a. A project to improve the credit industry's expertise and technology in respect of the utilisation of credit information in loan appraisal and credit management.

   b. Support for technical capacity building in credit reference bureaus, including areas such as score card development and value added services provided to credit providers. We accept that this should in principle be funded by the institutions themselves but note that the current enquiry volumes may limit credit reference bureaus' financial capacity to invest in these areas.

   c. A review the current data sharing arrangements and potential to affect improvements, including areas such as the following: (a) improvements to the data sharing template, (b) data retention rules (including stricter limitations on submission of data on old debts; stricter application of prescription rules); and (c) more flexible and robust consumer identification rules.

8. There are a number of areas in which we recommend further research and investigation:

   a. Research on the size and profile of the consumer credit market, the levels of indebtedness and the threat of debt stress. Current statistics are fairly limited and appear insufficient as a basis for establishing the level of risk or for developing a strategic response. The threat which debt stress and the potential of escalating defaults pose to retail banks and to SACCOs require special attention.

   b. Research on areas of information exchange which could contribute to expanding the access to finance and financial inclusion. We would like to note that expanded information sharing is also of value to financial services other than credit, an aspect which is currently receiving little attention. Such research should also look at potential information sets which could be of benefit to lending to the SME sector, an particularly to SMEs which are located outside of the major metropolitan areas.

9. We believe that there is a strategic opportunity for the credit bureaus to play a role in creating or expanding access to public data, such as property ownership data, vehicle registration or judgments and summonses. This would have significant benefit to every segment of the financial system and it may be achievable at a fairly low cost. It could make a dramatic impact on access to finance in all parts of the country. We strongly recommend that a special research project be undertaken to assess the feasibility of such a structure and to determine whether this would require legal changes, public money or donor support. We would like to note that this could improve the commercial viability of registered credit reference bureaus, which is an area which may not be receiving sufficient attention at present.

10. We recommend that FSD Kenya should continue their support for the project. Despite the important progress that has been made, there are still significant challenges as had been outlined in this report. The progress which has been made may well be undermined if the support and funding by FSD Kenya is withdrawn.

Chapter 1

INTRODUCTION

1.1 TERMS OF REFERENCE

The consultants were required to perform a project completion review on the Credit Reference project (Project SWD/CredBur/08/2011). The review had four specific tasks:

- A formal project review assessing the performance of the project against the defined project objectives and outputs with particular focus on effectiveness, efficiency and relevance of the project.
- A review of FSD's role in the credit reference project, identifying the achievements and key lessons learned.
- An analysis of stakeholder cooperation and identify ways to increase stakeholder buy-in.
- A recommendation to FSD Kenya on the case for a second phase of the credit reference project and strengthening its future impact.

1.2 CONSULTING TEAM

The consulting team consisted of Gabriel Davel (team leader), Tshangwane Serakwane (credit bureau specialist) and Mark Kimondo (Kenyan financial sector specialist).

1.3 WORK PERFORMED

A number of interviews were conducted with different stakeholders over the course of two separate visits to Kenya. The interviewees represented the following stakeholders:

- FSD Kenya;
- The Project Manager and Project Implementation Team;
- The Kenya Bankers Association;
- Ogilvy PR, in relation to the public awareness campaign for the project;
- The two registered Credit Reference Bureaus;
- Representatives from a number of banks,
- Representative from Ministry of Finance;
- Members of the Joint Task Force;
- The Micro Finance sector;
- Public utilities;
- The Higher Education Loans Board; and,
- The Central Bank of Kenya (CBK).

The consulting team reviewed a broad range of documentation related to the project. The primary documents included in the review were:

- Credit reference Programme Investment Committee Project Appraisal Report (PIC PAR);
- Credit reference Project Concept Note (PCN);
- Credit information sharing in Kenya: Assessing the proposed implementation process;
- Project monitoring sheets (PMS); and,
- KCPA 5 year roadmap report.

The conclusions and observations were extensively discussed with the Central Bank, FSD Kenya and the project manager. The preliminary findings were presented at two different workshops, the first including a broad range of representatives from all the sectors, and the second consisting of the members of the CBK/KBA Joint Task Force which is responsible for the project. These workshops involved extensive discussion of the operational and strategic challenges and option and the feedback from these engagements has been integrated into the findings as per this report.

Chapter 2

STATISTICAL OVERVIEW OF PROGRESS

The statistics presented below were gathered from various sources, ranging from a) KCPA Roadmap document, b) Central Bank of Kenya report on CRB submissions, c) CRB Africa Limited, and d) Stakeholders that were interviewed during the review.

2.1 DATA SUBMISSION

Nearly all the registered banks are submitting data. Only non-performing loans are submitted. Approximately 203,000 consumer records are held by credit bureaus in Kenya, with a further 9,900 business accounts. Private individuals represent 95% of the records whilst business/corporates represents 5% records. This represents just over 662, 000 records submitted by banks to the credit reference bureaus (as at April 2011).

Figure 1: Consumers and business with records

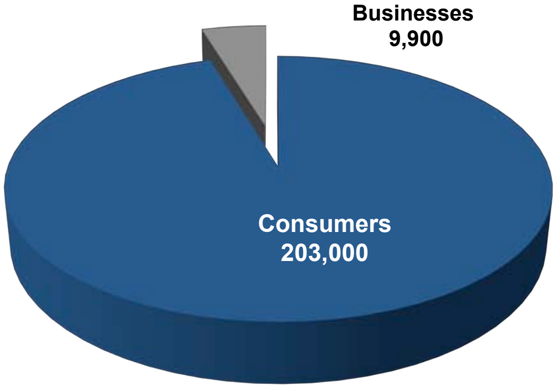


Table 1: Consumers and business listed on bureaus

	Number	Percentage
Consumers	203,518	95%
Businesses	9,954	5%
	213,472	100%

2.2 SUBMISSIONS AND REJECTIONS

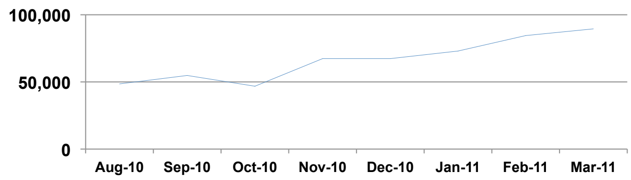
The number of non-performing records reported by the banks to the credit bureaus was at its highest in November 2010, at 697,890. The credit bureaus reported the lowest rejection rate of data submitted by the banks in January 2011 at 2.5%. For the period from November 2010 to April 2011, the rejection rate was at its highest in March 2011 at 9.3% (note that these statistics are based on only one bureau, which is the only bureau that is fully operational currently).

The current rejection rate varies between 5% and 7%. This seems to be an acceptable level, given the early stage of data submission. We note that the bureau has the benefit of an existing database of consumer information, which assists it in the data verification process. There is general consensus that the current data template contributes to rejections that the number of mandatory field should probably be reduced and that the identification rules should be more flexible.

2.3 ENQUIRY VOLUMES

Enquiry volumes increased from 48,000 per month in August 2010 to 89,000 by March 2011 (88,000 for May 2011). In recent months the number of retail banks which are doing enquiries increased to 31. Although the enquiry volumes for the majority of banks are very small, all the primary retail banks are doing enquiries. These banks report that the bureau data is of significant benefit, both in avoiding risky clients and in causing clients to pay up on arrears. It is worth noting that 4 banks account for 90% of all enquiries and 9 banks for 97% of all enquiries (as at May 2011).

Figure 2: Banks enquiries



	Aug-10	Sep-10	Oct-10	Nov-10	Dec-10	Jan-11	Feb-11	Mar-11
Bank enquiries	48,538	54,794	46,780	67,309	67,301	72,950	84,456	89,463

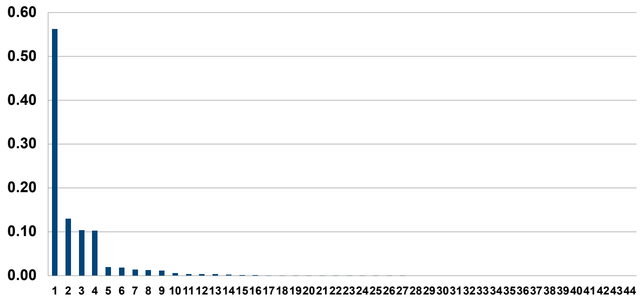
2.4 PARTICIPATING INSTITUTIONS

We considered whether the fact that enquiry volumes are dominated by a few institutions may be due to weak data quality. However, the fact that all the leading banks are doing enquiries and that they found high value in the enquiries seems to discount this possibility.

Table 2: Submissions and rejections

	Nov-10	Dec-10	Jan-11	Feb-11	Mar-11	Apr-11
Number of records submitted	697,890	402,735	658,471	551,985	637,006	662,412
Number of records rejected	37,840	26,639	16,646	33,744	59,396	42,071
Records rejection rate (%)	5.40%	6.60%	2.50%	6.10%	9.30%	6.40%

Figure 3: Participation, different banks



- The reason for the banks' slow entry appears to be largely related to the loan appraisal and processing methodology of different banks. Many banks appear to employ lending methodologies that are automated to only a limited extent, with extensive 'relationship lending' ("name lending" is a less complimentary descriptive term which is often used).
- We also have to take into account that the introduction of credit bureau reports in loan appraisal would generally require a change in the loan policy, as well as a change in the procedures for loan processing. Such changes would nearly always require approval by the board of directors or a committee of the board. It is thus reasonable to expect that there would be some delay on implementing such changes.

As part of Risk Based Supervisory methodology, it may be warranted for the Central Bank to give close attention to the institutions which are not doing enquiries. This may indicate that the relevant banks (non-enquiring banks) may employ weak loan appraisal methodologies or may be engaged in 'name lending'. This could indicate institutions with higher credit risk.

2.5 PARTICIPATION LIMITED TO BANKS

Currently, only banks are submitting data to the credit bureaus. Banks only submit data on non-performing accounts. Information from MFIs and SACCOs are currently not being shared and should be the highest priority in the next phase of the project. Credit information is currently being shared on only approximately 200,000 consumers. We estimate that there are nearly 5 million consumers who have credit agreements with formal sector financial institutions.

This implies that the credit bureaus are currently sharing information on less than 5% of the consumers with formal sector credit agreements, and shares only negative information on these clients. This implies further that the credit bureaus are currently of *fairly limited value in credit risk management and of similarly limited value in assessing consumers' level of debt commitments.*

Table 3: Number of accounts

	Accounts	% of
Banks	2,000,000	42%
SACCOs	1,875,000	40%
MFIs*	650,000	14%
Other	200,000	4%
	4,725,000	100%

Sources: Central Bank, SACCO Regulator, KCPA Roadmap and the mix for a non-bank MFI proxy.
* Deposit-taking MFIs

Figure 4: Number of accounts by sector

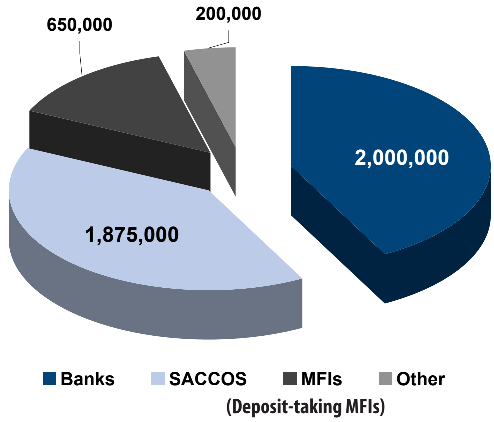
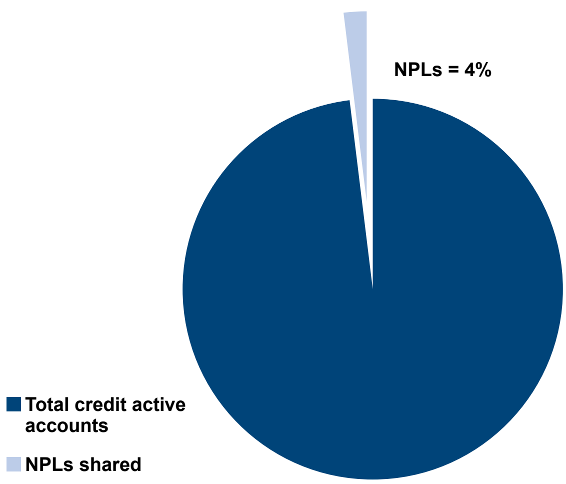


Figure 5: Accounts at bureaus vs formal credit



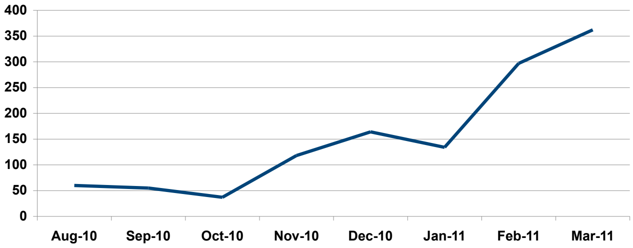
A greater integration with non-credit data could lead to a huge expansion in the underlying data, which could be of considerable benefit to client selection and expanded access to financial services.[2]

[2] Interviews with Treasury indicated that there are almost 21million MPESA users. Information from such sources or information from telecoms companies would add huge value to the credit referencing system.

2.6 CONSUMER CREDIT REPORTS

The requests by consumers for their credit reports have been increasing, from 60 in August 2010 to 362 in March 2011.

Figure 6: Customers' reports



	Aug-10	Sep-10	Oct-10	Nov-10	Dec-10	Jan-11	Feb-11	Mar-11
Customers' reports	60	55	37	118	164	134	297	362

2.7 CONSUMER COMPLAINTS

The number of complaints by consumers is very low. The highest number of complaints was 9, in November 2010. It is likely that the numbers would increase, when enquiries by banks increase.

Chapter 3

COMMENTS FROM PARTICIPANTS

3.1 COMMON THEMES

The common themes from the views from the different stakeholders are summarised in the tables below. This includes the views expressed in the individual interviews (table 4) as well as the views in the workshop which was conducted at the end of the assignment (table 5). The assessment and analysis is included in the next section.

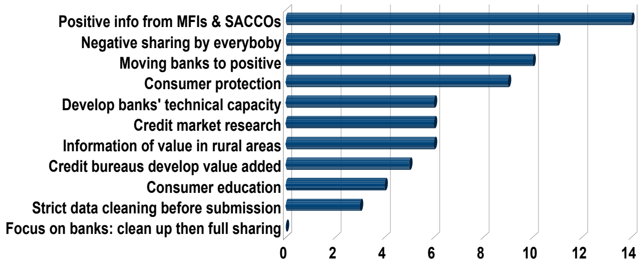
3.2 PRIORITISED LIST

During the course of the workshop the participants were asked prioritise the areas for attention. Figure 7 indicates the outcome of this exercise. The issues which workshop participants identified as the highest priorities were:

- Including positive information from MFIs & SACCOs;
- Include at least negative data from everybody (including MFIs + SACCOs);
- Banks to move from negative to positive information exchange;
- Implement robust consumer protection urgently, including a requirement that consumers must be notified before being listed.

Table 4: Views on the progress and value of the credit reference bureaus
Performance of project
▪ Progress was remarkable, deserving of an "A" rating.
▪ Central Bank played important supporting role. Involvement in the future would be critical for continued progress.
Governance
▪ Bankers played important role in the progress that was achieved, including contributing to the cost.
▪ The location of project within Banking Association discourages participation by other parties.
Value of information
▪ Information is proving valuable in identifying serial defaulters.
▪ Since doing enquiries, our bank achieved a remarkable decline in defaults (leading retail bank).
▪ Bureaus can play important role in moving banks from collateral based lending to information based products.
Debt collection
▪ The listing of defaulters create strong incentive to pay debts.
▪ At some point in our history, very weak payment culture with levels of non-payment for services sometimes as high as 70%.
▪ Listing utility and service arrears would improve collection.
▪ The bureaus could play an important role in changing the credit culture in Kenya.
▪ The data from banks under curatorship must be included urgently. It would improve collection. Some of the debts are more than 20 years old.
Operational issues
▪ Data template is restrictive and inefficient. Too many compulsory fields. Some products do not fit in current fields (e.g. dates for O/Ds and credit cards).
▪ Many institutions do not have sufficient information to meet all the requirements of the template. Greater flexibility would ensure that more data is loaded.
▪ Many banks do not have sufficient knowledge and technical expertise, therefore not using data.
▪ Banks do not respond to error messages. This results in data which is potentially valid being removed.
▪ Credit reference bureaus should improve value added services, including development of bureau scores, scorecards, research tools and credit analysis tools.
▪ Credit reference bureaus require financial support in technical capacity development. Low enquiry volumes imply that they have funding limitations.
▪ Central Bank should enforce compliance more strictly.
▪ Bureau reports need more detail in order to qualify data where needed.

Figure 7: Priorities for future



Priority	
1	Include positive info from MFIs and SACCOs
2	Include negative data from everybody (MFIs + SACCOs)
3	Moving banks to positive
4	Implement robust consumer protection urgently
5	Develop banks' technical capacity
6	More research on credit market
7	Get positive information from utilities & alternative rural data
8	Support credit bureaus so they can develop better services
9	Consumer education
10	Stricter cleaning rules lenders before submission
11	Focus on banks: clean up then full sharing

Table 5: Views on the challenges and priorities for the future

Data sharing with non-banks

- Telecoms and other service providers were initially enthusiastic to participate in information sharing. Lost interest as they are not able to gain any value.
- Many potential new participants could not be accommodated due to their weak systems.
- MFIs and SACCOs are extremely keen to participate. They would add huge value for consumer lending.
- SACCOs could be the big losers in the current environment, if there are big defaults.

Consumers

- Banks have a tendency to use the information as an excuse to decline credit, without considering the nature or amount of default. This would impact extremely negatively on consumer and could result in someone being locked out of the credit market for up to 7 years.
- It may undermine any increase in access to finance.
- Bureau data of little relevance to rural areas and marginal population groups. Negative data would make this worse.
- Rural consumers not able to access reports or lodge complaint. Have to come to Nairobi at huge cost.
- Consumers should be notified before they are listed, not afterwards. Consumers only find out when they are denied credit, when their rights are already compromised.

Risks

- High risk of increased litigation by consumers who are negatively affected. An unfavourable judgment could undermine all the progress that has been made.
- Risk of increasing backlash from consumers. Need credible complaints resolution capacity.
- High risk of debt stress: banks going down-market; MFIs going up-market; SACCOs caught in the middle.
- In current salary charge rules, SACCOs are last in the queue. SACCOs could be crippled if there is over-indebtedness without information sharing. Already > KSh 22 billion in deductions in suspense account, in excess of government employees' income.
- Low enquiries are an indication of 'name lending' amongst banks, these banks remain exposed to serial defaulters.

Future

- Central Bank has to make law to mandate banks to share positive information, to protect banks from risk of litigation.
- Lenders are too reactive, always waiting for Central Bank to take the lead.
- Priority in next phase should be on cleaning bank data. Then to move to positive information from banks and thereafter to other parties.
- Incorporating MFIs and SACCOs is the highest priority, to avoid over-lending to the same clients.
- Regional co-operation and harmonisation within EAC a high priority.

Chapter 4

SUMMARY OF OBSERVATIONS

We summarised our observations on different aspects of the project in the table below. We will draw on these observations in the following sections, which deals with our conclusions and recommendations.

4.1 CREDIT REFERENCE BUREAUS: REGISTRATION PROCESS AND BUSINESS PERSPECTIVES

i. The process of registration as a credit reference bureau is cumbersome and time consuming. The long delay in the registration of the second bureau delayed their entry into the market.

ii. We note that there is a big difference in the rejection rates between the two registered bureaus. In our view, such differences between different bureaus are inevitable. It is caused by differences in validation rules and business processes. In the Kenyan case it is related to the fact that one of the bureaus has access to an extensive existing debt collection database, which they are able to use to assist in validation and from which they can obtain missing information.

iii. Such differences are inevitable but may decline or at least stabilise over time. There may be justification in exploring mechanisms for co-operation between the bureaus, in order to enhance consistency. However, such differences are reflective of the process of competition between bureaus and could probably not be eliminated.

iv. We noted that the bureaus are involved in a number of different initiatives to seek out new sources of data and to engage with different parties in order to expand the scope of data being shared. This is a promising development which should be supported.

v. There are significant constraints which undermine credit bureaus' ability to add additional data sources and to expand the scope of data being collected:

- In terms of the conditions of registration, there is a limitation on the capacity of registered bureaus to engage with parties other than banks. We recommend that this limit be removed as it undermines the bureaus' ability to expand the sources of data. It also undermines the ability for the market to develop and evolve.
- There is a limitation on the sharing of bank data with other parties. This removes the incentive for other institutions to contribute their data to the data pool. We recommend that this limitation be removed.
- If there is a delay in affecting the required legal amendments, we recommend that options be explored for increased sharing between banks and other parties, within the parameters of the current regulations. Such sharing would be of significant benefit to credit risk management in banks.

4.2 OBJECTIVES OF CREDIT INFORMATION SHARING

i. There is divergence in the views of different parties on the business value of data sharing. The most common view is of credit bureaus as a "debt collection mechanism". i.e., that greater information sharing will enable financial institutions (and eventually also other parties, such as the water authority and electricity authority) to identify "serial defaulters" and to avoid providing credit or extending services to such parties. This will reduce defaults and will lead to a reduction in the cost of credit for performing clients.

ii. Participants also expect information sharing to create an incentive for defaulters to make payments against the defaulted debts. Participating credit providers indicated that they experience significant collections on non-performing debts since they started participating in credit information sharing.

iii. The Kenya Deposit Protection Fund Board similarly indicated that if they were able to list the clients of banks which are currently under curatorship, that this would assist them in the collection process. It should be noted that many of these banks were placed in curatorship in early 1990's, indicating that the debts may well be more than 20 years old. There are indications that some of these debts may even be from the mid-1980's, thus nearly 30 years old. *We suspect that the inclusion of debts that are this old could have a significant negative impact on the development of credit information sharing* (we will add further comment on this issue below.

iv. Other parties also mentioned objectives such as the following: (a) improving the repayment culture in Kenya, (b) improving risk management, and (c) rewarding good clients through the benefit of a clean credit record.

v. The majority of interviewees formulated the benefits of information sharing in terms of the benefits for debt collection, rather than credit appraisal or credit risk management. There is a significant risk that the credit referencing system could be viewed a "debt collection mechanism", which is likely to have negative consequences for the manner in which it evolves. We believe that this is serious risk to the development of credit information sharing in Kenya.

4.3 TYPES OF DATA BEING SHARED

4.3.1 Old or outdated data and data retention rules

i. The extent to which old and outdated data is being loaded in the credit bureaus, with the sole purpose of creating pressure on debtors to meet their loan repayments, is a threat to the credibility of the credit referencing system. The credit referencing system is thus used as a substitute for legal enforcement and for debt collection.

ii. It is quite likely that this will undermine the public support for credit information sharing.

iii. There is a real risk that some of these debts may not be legally enforceable, either due to contractual deficiencies or due to prescription.[3] Credit reference bureaus should not in any circumstances be used as a tool to pressurise consumers to meet debt obligations which may not be legally enforceable (or to force payment of debt on which the legal right of enforcement rights are in any way in dispute).

iv. The current data retention rules are fairly simplistic. We recommend that they be reviewed, with the following objectives:

- To create limits on the acceptance of old or outdated information;
- To create penalties on credit providers who submit data in respect of which the enforceability of the contractual rights are in doubt;
- To differentiate in the retention periods of different types of data, in order to (a) provide for fairly short retention limits on data that is subjective in nature; (b) longer retention periods for legal and public data; (c) reduced retention periods in cases where consumers settle debts which were previously in arrears.

v. Differentiated retention periods can create a strong incentive on consumers to improve their payment records while enhancing the credibility of credit information sharing. Differentiated retention rules can thus play an important role in the economic efficiency of credit information sharing.

4.3.2 Positive and negative data

i. Only negative information is currently being shared. This implies that the information inevitably has a negative impact on consumers.

ii. Until recently, only 5 banks were doing a significant number of enquiries. The greater the number of banks (or other entities) doing enquiries, the greater the number of consumers who will be impacted and the greater the threat of a backlash or of detrimental litigation.

iii. If both positive and negative information is shared, the credit industry will have much better grounds for defending the positive impact of information sharing on consumers' access to credit and to other services. Furthermore, the predictive value of credit information would increase and there would be an immediate increase in the number of consumers on whom the bureaus would have records, with the vast majority of consumers having only positive information on their records.

iv. A number of commentators expressed a fear that the sharing of positive data could lead to 'cannibalisation' of their client base. However, there is also a fairly high level of agreement that the benefit of positive information sharing outweigh this risk.

v. It is a high priority to move from negative to positive information sharing. (We comment on the legal and institutional factors in a different section of the report).

4.4 EXTENT OF PARTICIPATION IN INFORMATION SUBMISSION AND ENQUIRIES

i. Our understanding is that all banks (43) are submitting data but that only 5 banks were doing enquiries until recently (the number increased to 30 by May, but the enquiry numbers for most of these entities are negligible).

ii. There is a substantial difference between the number of NPLs (Non Performing Loans) reported to the Central Bank and the number of records reported to the credit bureaus. There are acceptable reasons for these differences - e.g. that data sets are old or records do not contain critical information (the information required for client identification is a particular concern).

- In our view these challenges are normal for the development of a credit referencing system and do not reflect negatively on the project of the participants.
- The volume of data would naturally expand with the expansion of further participants.
- Dealing with the constraints related to the data template would assist in expanding data collection. Greater flexibility in the identification rules is required, in order to enable the credit bureaus to deal with data sets which do not have all the prescribed information, yet have sufficient information to enable valid client identification.

iii. None of the participants raised serious concerns on data quality. This does not necessarily mean that the data is of high quality, but rather that the data is not yet used on a scale that is sufficiently to highlight potential weaknesses. This area requires on-going monitoring.

- We would like to point out that the success of data sharing is dependent on the volume of data and the enquiry volumes. Increasing the volume of data being shared is critical both to the value for the data for the credit industry (and the prevention of debt stress and defaults) as well as for the *commercial viability of credit bureaus*.[4]
- Data rules that are robust and flexible are important to enable the industry to expand. The current data template and rules are limiting the growth of the industry and should be reviewed.

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[3] Prescription refers to the time limit for legal enforcement of debt.

[4] This issue deserve a separate assessment. Any measures which undermine the viability of credit reference bureaus will inevitably undermine the development of the industry. At current enquiry volumes there is reason for concern on this issue.

iv. The fact that only 5 banks are doing significant volumes of enquiries is a significant concern.

- We considered whether concerns on the quality of information, or concerns on the extent of under-reporting may be reasons for the low level of enquiries. We also note that the primary reason for participation for the majority of banks appears to relate to compliance, rather than credit quality.
- Our interviews with the leading retail banks provided a much more positive perception. Firstly, it should be noted that nearly all the larger retail banks are active users of the credit reference bureaus. Furthermore, the feedback from these banks was nearly unanimous in the view that the data is extremely useful and that it has significantly improved the quality of their lending portfolios (primarily as result of the ability to identify and avoid "serial defaulters"). They also indicate that there has been a strong positive response from borrowers who are in default with significant collections from such clients.
- Our conclusion is that the low level participation in enquiry does not reflect on weaknesses in the data. The primary reasons for banks not doing enquiries appear to relate to the lack of automation and sophistication in the credit appraisal systems and methodology (including the loan appraisal processes applied by the majority of banks). Many of the commentators referred to the practice of "name lending", i.e., of loans being approved based on the relationship between a bank and a prominent or well-connected clients, while insufficient attention is given to the repayment record of clients.
- We would also like to note that a bank has to modify its loans appraisal process and criteria, in order to apply external credit reference checks and may have to obtain approval for any such changes at the board or credit committee. This may be an important reason for the delay in participation. Over time, with an increasing number of banks changing their loan appraisal methodology and inclusion of a credit reference check as a key criterion, the number of participating banks may well increase.

v. The development of the market and of the credit methodology applied by banks would naturally lead to greater information sharing, without any need for regulatory intervention.

vi. There are prudential considerations which justify close attention to banks which do not do enquiries. High risk clients (or 'serial defaulters') would increasingly turn to banks which do not do enquiries. Banks which focus on 'name lending' may also see limited value in credit bureau information. *Both these factors point to a potential for increased prudential risk, which may well justify increased scrutiny by the central bank of any bank which do not use the credit bureau data in its loan appraisal process*.

4.5 LEGAL CONSIDERATIONS

i. There are four different areas in respect of which the legal framework may have an impact on the evolution and development of credit information sharing

- Banks are expressing a concern on their potential liability for legal action by consumers, if they participate in positive information sharing. They prefer that such information sharing be mandated by legislation. However, we note that the central bank has some concern on mandating positive information sharing, preferring this to be done through voluntary agreements;
- The legislative framework places severe limitations on the application and use of data, even for very reasonable applications such as debt collection;
- The current regulations prevent the information received from banks from being shared with any other party;
- The current regulations limit registered credit reference bureaus in their ability to service parties other than banks.

ii. The last 2 issues are most critical to the expansion of information sharing. If bank data cannot be shared with other entities this removes the incentive for such entities to contribute their own data, or to allow banks access to their data. This will have a negative impact on banks' credit risk management, as well as on the expansion of credit information sharing. Credit bureaus' legal capacity to source data from other parties and sell information to other parties, is a prerequisite for the development of a dynamic and market-led credit information system. *We recommend that these limitations be modified on an urgent basis.*

iii. We have some reservations on the market participants' views on the first issues, i.e. mandated positive information sharing. There are sound reasons for the central banks' resistance to mandating positive information sharing. This does not necessarily conform to international best practice and there are consumer protection concerns, although we note that there are many examples of central banks which made information sharing compulsory. *However, we do wish to note that many of these arguments could similarly apply to negative information sharing, which necessarily have a negative impact on consumers.*

iv. *Therefore - if there is a sufficiently high risk of increasing debt stress and bank defaults into the future, the central bank may well have regulatory grounds to mandate both negative and positive information sharing between both banks and other credit providers, given the extent to which it would reduce credit risk and reduce the risk of bank failure.* MFIs, SACCOs and other financial service providers (including utilities and telecoms) would have to be included in such a mechanism for it to be effective.

v. There are many international examples in which banks share positive information, both with other banks and with non-bank service providers, without any form of central bank mandate (South Africa is only one example out of many). The current position adopted by the KBA appears unnecessarily defensive. Given the benefit of greater information sharing for the banking sector, banks should be encouraged to explore mechanisms to expand information sharing within the current legal framework.

vi. We recommend that intermediate arrangements be developed to overcome the limitation on the sharing of bank information with other parties. Potential interim solutions may include (a) changes to the regulations (within the limitations of the relevant clauses of the legislation); (b) explore the possibility of creating categories of positive information which could justifiably be shared both between banks and non-banks within the current legislative framework. An example of such a mechanism is summary information on all financial commitments, without disclosing the identity of the individual credit providers or specific transactions.

4.6 GOVERNANCE STRUCTURE AND LEGAL FRAMEWORK

i. The support which the Central Bank provided to this project and the application of regulatory measures (and 'moral suasion') to promote participation and address problems appear to have played an important role in achieving the progress thus far. The Central Bank should be commended for the constructive and progressive role which it played.

ii. We note that the level of information sharing is still quite limited, with the bureaus containing information on fewer than 5% of all credit active consumers. We identified a number of significant risks and challenges which will arise over the next few years (including the possibility of legal challenges to information sharing). *We do not believe that it is advisable to reduce the role of CBK or to dilute its responsibility for this project at this early stage.*

- Credit information sharing will play a critical role in the banking sector's ability to manage credit risk in a rapidly expanding market, with high risk of debt stress. The support for and expansion of the credit information system thus relate directly to the bank supervisors' prudential regulation of the banking sector. The dilution of the central bank's role may well put credit information sharing at risk which could increase the risk of bank stress and even bank failure.
- However, there may be potential for increased participation by other regulators and by other sectors in the governance of credit information sharing.

iii. We would recommend that institutional or governance arrangements be explored which could facilitate the expansion of information sharing beyond entities which are registered with the Central Bank. The establishment of the Credit Providers Association can make an important contribution in this area (we expanded on this issue in the next section).

4.7 CREDIT PROVIDERS ASSOCIATION

i. We note that very little progress has been made in the establishment of the Kenya Credit Providers Association (KCPA). This may not be a critical weakness but require greater attention in the near future.

ii. Our impression is that the fact that the project office is located within the KBA results in credit information sharing being narrowly focused on the needs of the banking sector. It also creates a disincentive for the participation of other sectors. This will undermine the development of credit information sharing.

iii. In terms of the institutional structure of the association, the following could be considered:

- It may be beneficial for both the CBK and any other related regulators to be involved in such an association. The credibility and authority of the regulators could play an important role in facilitating the development of the credit information industry;
- The involvement of the regulators does create the risk that the KCPA could be too narrowly focused on regulatory considerations. In order to avoid this, the association could potentially be structured as two different 'chambers', the one dealing with legal and governance issues and a separate chamber dealing with operational issues. The regulators' participation could potentially be limited to the legal and governance chamber;
- It is important for all registered bureaus to become full members of the association. Their contribution would be critical in dealing with operational issues and in defining the strategic agenda;
- It is important for the strategic development of information sharing to involve other industries which could potentially contribute valuable information. This includes institutions such as (a) SACCOs, (b) MFIs, (c) Utilities; (d) Telecoms and (e) any other party who may contribute data.
- There may similarly be value in including consumer representatives, or at least in creating a regular forum for engaging with consumer representatives. This can play an important role both in ensuring that consumer protection receives sufficient attention and in protecting the industry against a consumer backlash in the future.

4.8 ADJUDICATOR

i. A number of the stakeholders mentioned a need to establish a 'Credit Information Adjudicator' or a similar institution to deal with consumer complaints.

ii. A number of different issues would have to be considered in establishing such an adjudicator, e.g.

- Does it deal only with credit information; or more broadly with bank complaints;
- Or does it deal even more broadly with all complaints which relate to financial products?
- Is it a statutory or a voluntary / industry adjudicator?
- Will it be funded by industry, or by government?

iii. We believe that the establishment of an adjudicator should be a high priority. Despite the low level of complaints, this position is likely to change as information sharing expands and as more institutions do enquiries. An adjudicator could play an important role in protecting the credibility of information sharing and may also protect credit reference agencies against public resistance as result of perceived 'blacklisting'.

iv. The establishment of an adjudicator should be done in a manner that is fairly flexible, at a modest cost initially, but with the possibility to expand if the enquiry volumes expand.

Chapter 5

RISKS

5.1 ASSESSMENT OF POTENTIAL RISKS

Over the course of the project the different stakeholders mentioned a number of potential risks. We summarised the most important of these in table 6 below.

Table 6: Issues related to the data and value for industry

Risk	Comment	Rating Level of risk and impact
Lack of credibility as result of weaknesses in the data	▪ Current feedback most positive. ▪ Regulatory oversight and potential for regulatory intervention contains this risk. ▪ Addition of old data would increase the risk.	Low
Sharing of only negative data undermine value derived by credit providers	▪ Currently, sharing data on less than 5% of consumers with formal sector credit agreements. ▪ Negative data gives only limited indication of potential debt stress. ▪ Greatly limits predictive value of data. ▪ Limits the value for financial inclusion.	High
Excluding parties other than banks undermine value	▪ Currently, sharing data on less than 5% of consumers with formal sector credit agreements. ▪ Limit value for detection of potential debt stress. Overlap between different institutions of critical importance. ▪ Limits predictive value of data. ▪ Limits the value for financial inclusion.	High
Under-reporting and permanent differences between NPLs reported to CBK and information reported to credit reference bureaus	▪ Differences will continue for some time, but should incrementally reduce over years. **Mitigation** ▪ Larger and most active banks more up to date, reduces negative impact.	Moderate
Increasing differences between the information held by different bureaus	▪ Given different data validation procedures, differences could persist. ▪ But should reduce over time. ▪ Could be overcome by doing enquiries from both bureaus (or in high risk cases). ▪ Forcing standardisation would undermine competition and expansion of information sharing.	Moderate

Risk	Comment	Rating Level of risk and impact
In current format, bureau data is of limited value in preventing increasing debt stress	▪ There are reasons for concern about increasing debt stress, particularly in the urban market, given the exceptionally high portfolio growth of the leading lenders. ▪ The highest risk lie in the market segments where the target markets of retail banks, SACCOs and MFIs overlap. ▪ Current information sharing is not broad enough to enable participants to detect cases of over-indebtedness.	High
Issues related to the institution		
Risk	**Comment**	**Rating**
A public backlash due to perceptions of 'blacklisting'	▪ Currently only negative information. When enquiry volumes increase, more people will be negatively affected. ▪ Without positive data, little credibility in the claim that information sharing is beneficial for consumers. **Mitigation** ▪ Adjudicator can reduce risk.	High
Successful litigation against information sharing based on privacy considerations	▪ There is already more than one case against credit information sharing. ▪ Many people with high public profiles are going to be affected, and have enough money to litigate. ▪ An injunction can undo all the progress and destroy the commercial viability of existing bureaus.	Very high
Low volumes of data and enquiries (and high establishment and compliance cost) will undermine the viability of the registered Credit Reference Bureaus	▪ Current enquiry volumes still very low. ▪ Require significant expansion in volumes before the commercial viability of the credit reference bureaus would be assured. **Mitigating factors** ▪ Many opportunities for growth and expansion.	Moderate to high

5.2 DOMINANT RISKS

Amongst these risks, we identified the risk of a public backlash (or unfavourable litigation) and the risk of escalating debt stress as the dominant factors. We expand on these two areas below.

5.2.1 Perceptions of 'blacklisting' and the potential for a public backlash or unfavourable litigation

Currently, only banks are sharing information and are only sharing negative information.

With an escalation in the extent of information sharing and a greater level of enquiry, it is inevitable that increasing numbers of consumers will be refused credit on the basis that they have a 'negative credit record'. This risk will increase if significant volumes of data which may be old, out-dated or of doubtful quality are added to the information base (as is likely if portfolios of banks in curatorship are provided to the bureaus).

These factors are quite likely to result in increasing public resistance against information sharing. The risk will to some extent be reduced if positive information is also shared, which establishes a clear rational for consumers benefitting from information sharing. The establishment of an ombud or adjudicator with a fairly high profile could also play an important role in managing the threat of a public backlash and reduce the threat of unfavourable litigation. On-going research and publication of the public benefit of information sharing could play an important role in maintaining public support for credit information sharing.

5.2.2 Risk of escalating debt stress in a rapidly expanding market

The Kenyan consumer credit market is expanding rapidly. Thus far, the expansion appears to have been dominated by Equity Bank, with a growth rate of close to 100% per year, which has been maintained over a number of years. The other retail banks are increasing their own lending to the low and middle income consumer group. Whilst banks are expanding their outreach to low and middle income groups, MFIs appear to be expanding 'upmarket'. We also note that the SACCO sector already have a client base of more than 1.8 million consumers, caught in the middle.

There are similarities between these developments and the South African experience in the early 2000's, when a period of massive expansion was followed by a catastrophic collapse, resulting in 3 prominent bank failures and a number of related bank closures.

Only NPLs are being reported at present, with close to 50% under-reporting (comparison of NPLs reported to the central bank with bureau data). Until recently, only 5 banks were doing credit reference checks. MFI and SACCO data are being excluded from credit reporting, implying that less than 5% of credit active consumers are actually included in the credit referencing system. This further implies that despite the important role that credit bureaus can play in preventing escalating debt stress, it currently has only a very limited impact.

This risk can be contained through expanding information sharing to positive information and by including MFIs, SACCOS and other credit providers in the credit referencing system.

Chapter 6

FINANCIAL INCLUSION

6.1 LIMITED DIRECT IMPACT

We believe that the project has had limited impact on financial inclusion thus far. This conclusion is based on the following observations:

- Currently, only negative information is shared. This necessarily implies that most consumers on whom information is shared already has access to finance and may well be from middle and higher income groups;
- Without sharing positive information the credit referencing system is of little value in enabling a financial service provider to assess the repayment capacity of a consumer;
- The fact that information sharing is limited to banks similarly undermine any value that the credit referencing system may have for financial inclusion.

We note that any contribution by the credit referencing system to the prevention of over-indebtedness should be valued as a contribution to financial inclusion. However, even in this respect the current framework of information sharing is most limiting.

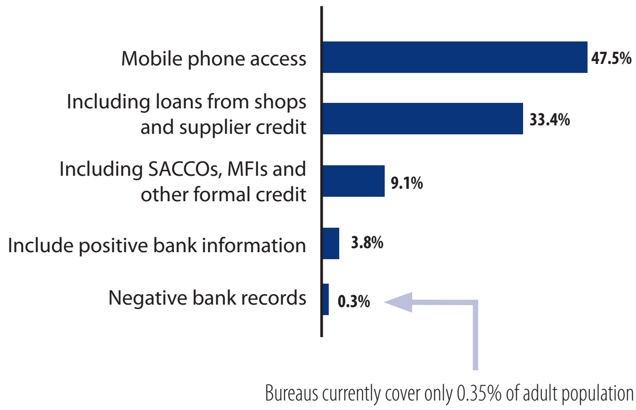
6.2 POTENTIAL CHANGES

There are a number of 'first order changes' which could be implemented and which would improve the value of the credit referencing system from the perspective of financial inclusion. These include (a) expanding the scope of information sharing to include SACCOs, MFIs and other credit providers, and (b) expanding from negative information sharing to positive information sharing. An expansion to positive information sharing is particularly important and should be prioritised.

However, it should be recognised that these changes would still imply that information is shared on only consumers who already have access to credit from one of these institutions. We note that only 9% of Kenyans have access to credit from formal institution and only 3.8% have access to credit from banks (FinAccess 2009). With current information sharing being limited to negative information from banks only, information is shared on around 0.3% of the population only. In the Kenyan context, with huge segments of the population excluded from financial services, it is important to include information which would enable financial service providers to identify and assess the capacity to service financial commitments for consumers who are excluded from the client base of the current service providers.

In order to achieve this objective, it would make a major impact if information from a broader range of institutions is shared. The inclusion of information from telecommunications providers could make a particularly important contribution to financial inclusion.

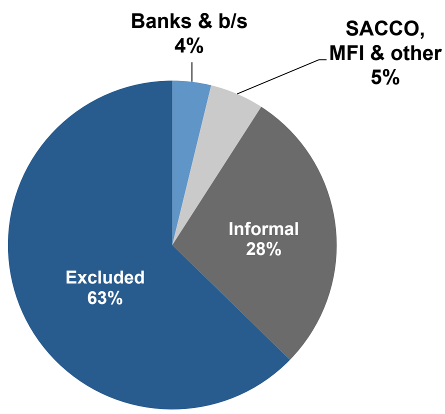
Figure 8: Potential increase in information



% of adult population covered by information sharing

- Currently, only non-performing loans of banks are shred. This covers only 0.35% of adult population of Kenya. 99% of population is this excluded from information sharing.
- By including positive bank data; and SACCOs and MFIs, the level of penetration could increase to 3.8% or 9.1%.
- Including mobile phone records would increase penetration to 47% of the population

Figure 9: Types of credit



6.3 POTENTIAL ROLE IN FINANCIAL INCLUSION

Credit information sharing has a huge role to play in any strategy to increase access to finance. Kenya has an advanced mobile network and mobile banking and money transfers have already made a huge impact on financial inclusion. This implies that information technology and mobile networks have an important role to play in increasing access to finance into the future. The credit information sharing infrastructure can play an important role in support of the application of the existing IT and communications infrastructure in expanding access to financial services.

Chapter 7

ASSESSMENT AGAINST ROADMAP

7.1 ASSESSMENT AGAINST TARGETS

The project achieved most of its targets. The progress which has been made in the short period since the initiation of the project has been remarkable. From the registration of the first credit reference bureau in February 2010, the level of information sharing increased dramatically. Although only 5 banks are doing significant volumes of enquiries, these include the leading retail banks and they report significant value from their enquiries.

The project has achieved a high profile and a high level of support for information sharing amongst all the stakeholders. An effective working relationship has been established with the Central Bank. A high level of interest has also been created in parties which are not yet included in information sharing, such as SACCOs and MFI's. The project established a sound basis for expanding credit information sharing in the Kenyan financial sector.

7.2 WEAKNESSES

The most significant weaknesses are in the areas listed below. We note that certain of these issues are not within the control of the project team, or were not part of the formal targets for this phase of the project.

- There is a need for increased capacity building in the banking sector. Many of the banks appear to have a fairly limited understanding of the value of information sharing or of the technical and procedural requirements for utilising the information in their credit management process. The project should do more work in this area.
- There are certain important weaknesses in the legal framework which will undermine the expansion and development of information sharing. (a) The most significant weaknesses relate to the ability for bank information to be shared with other parties; as well as the regulatory limitations on registered credit bureaus to provide services to sectors other than banks. (b) The legal position in respect of banks' potential liability for sharing positive information requires further analysis. (c) The data retention rules area fairly weak and have significant negative implications. The rules would also have to deal with the age of debts being submitted.

  The project deal more decisively with the implications of these weaknesses and should motivate for appropriate changes in these areas.
- There has been little progress in the establishment of the KCPA. This does not appear to be a critical weakness and it may have been appropriate to delay the establishment of the Association. We understand that steps are being taken to make progress in this area.
- The fact that only negative information is being shared is a critical weakness, as is the fact that only banks are currently participating in information sharing. These weaknesses undermine the credit reference system's capacity to add value in respect of protection against debt stress and to expand access to finance. We understand that steps are currently being taken to address these issues. However, more could be done to highlight the implications of the current information sharing model.
- Financial inclusion appears to have been an important objective in the establishment of the project. The current framework of information sharing limits the role of the credit reference system in this respect. More would have to be done to expand the potential impact of credit information sharing in this respect.

Chapter 8

ROLE OF FSD KENYA

8.1 IMPACT OF THE SUPPORT PROVIDED BY FSD KENYA

FSD Kenya's support for the project came at a critical time and made a deciding impact on the progress which has been made. Our understanding is that there have been previous attempts at credit information sharing, but that this has not been successful. FSD Kenya played an important role in lending support to the CBK and banking sector in implementing this initiative.

The project is sensibly structured and this may have played a positive role in the progress which was achieved. Some of the factors which played a role are (a) the creation of sufficient capacity, through the establishment of the project team; (b) the establishment of the 'roadmap' with explicit and measurable targets and verifiable events; and (c) regular internal and external assessments of progress.

8.2 FINANCIAL INCLUSION

We believe that the project has had limited impact on financial inclusion thus far. However, we do not believe that this qualification should be seen as a diversion from FSD Kenya's core mandate. Credit information sharing has a huge role to play in any strategy to increase access to finance. Kenya has an advanced mobile network and mobile banking and money transfers have already made a big impact on financial inclusion. This implies that information technology and mobile networks will continue playing an important role in increasing access to finance into the future. The credit information sharing infrastructure will play an important role in support of the application of the existing IT and communications infrastructure in expanding access to financial services.

8.3 CONTINUED SUPPORT FOR RESEARCH PROJECTS

It is important to keep the focus on financial inclusion in order to ensure that the strategic choices which are being made do not distract from this overall objective. It is also be important to explore potential areas for research or development, which may expand the impact of the credit referencing system on financial inclusion in the short to medium term. We made a number of suggestions as part of the recommendations.

Chapter 9

RECOMMENDATIONS

REVIEW LEGAL AND REGULATORY FRAMEWORK

The legislation which governs information sharing is a major constraint in the development of credit information sharing. This relates to (a) the limitations in credit bureaus' conditions of registration, which prevent them from servicing parties other than banks, thus preventing them from acquiring new clients and new data and expanding the credit information market, and (b) the restriction which prevent bank data being shared with entities other than banks. It is a priority for these limitations to be removed or modified as they would severely constrain the ability of the credit information market to evolve and develop.

We recommend that an independent opinion be obtained on the legal arguments and concerns which banks are raising on information sharing. Such an opinion would also assist in defining the most appropriate remedy.

EXPAND CIS BEYOND THE BANKS

We recommend that information sharing be expanded to (a) include MFIs, SACCOs and any other credit facilities, and (b) to expand bank information sharing to positive data. This would substantially improve the value of the credit referencing system in respect of both preventing defaults and prevention of over-indebtedness. It would also enable the credit referencing system to make a positive contribution to financial inclusion.

- The legal changes would greatly assist in implementing the recommended expansion.
- Such an expansion could also be facilitated by establishing a Memorandum of Understanding[5] (or similar instrument) for voluntary and reciprocal positive information sharing between the leading banks, SACCO's and MFIs.

EXPANSION TO POSITIVE INFORMATION SHARING

We note that there is a strong view amongst some of the stakeholders that the focus of the project should in the medium term remain on information sharing amongst banks, initially focusing on improving the quality of the information and thereafter on expanding the project from negative information sharing to positive information sharing. This would imply that the focus would remain on information sharing amongst banks over the next few years, with participation by other groups being delayed until a later stage. We believe that there are significant dangers to such an approach and recommend that the expansion to positive information and to parties such as SACCOs and MFI's should be prioritised.

FORMATION OF KENYA CREDIT PROVIDERS ASSOCIATION

The establishment of the envisaged KCPA could play an important role in facilitating the expansion towards broader information sharing. This should include representatives of all the different types of credit providers as well as the respective industry regulators.[6] There would also be value in creating a forum for regular engagement between the Credit Providers Association and consumer representatives.

ESTABLISHMENT OF A ROBUST CONSUMER PROTECTION MECHANISM

We view the establishment of an 'ombud' or adjudicator to deal with consumer complaints as a high priority. Such a 'voluntary scheme', funded by the credit industry, could be established speedily and at a fairly low cost. This could make an important contribution in dealing with consumer complaints and in protecting credit information exchange from a backlash by disgruntled consumers. It may also be favourably viewed in the case of litigation against credit information sharing.

INCREASE THE CAPACITY OF STAKEHOLDERS TO USE CIS

Further work is required in the next phase of the project to address certain operational problems and capacity constraints.

- A project to improve the credit industry's expertise and technology in respect of the utilisation of credit information in loan appraisal and credit management.[7]
- Support for technical information exchange which could contribute to the development of the technical capacity and value added services provided by credit reference bureaus. In principle, this should be funded by the institutions themselves. However, the current enquiry volumes are very low and place significant limitations on credit reference bureaus' financial capacity to make such investments.
- A review of the current data sharing arrangements in order to affect improvements, in particular in the following areas: (a) improvements to the data sharing template, and (b) a review of the data retention rules (and the limitations on submission of data on old debts).

INCREASE RESEARCH

- Research on the size and profile of the consumer credit market, the levels of indebtedness and the threat of debt stress. Current statistics are fairly limited and appear insufficient as a basis for establishing the level of risk or developing a strategic response. The potential threat of debt stress to retail banks and to SACCOs requires special attention.
- Research on areas of information exchange which could expand access to finance and financial inclusion. Such research should also look at potential information sets which could be of benefit to lending to the

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5 The appropriate starting point may be to obtain commitment for such an MOU from the CEO's of the main stream banks, SACCOs and MFI's. If there is agreement on the risks in the current situation, it may be possible to obtain agreement on a set of data sharing rules which may be acceptable to all the major parties.

6 The regulators could potentially be represented in a separate 'governance & legislative chamber', or in an observer status. This is discussed in more detail in the relevant section above.

7 There are various mechanisms through which this could be achieved, such as technical workshops or 'knowledge sharing' visits to banks or credit bureaus which are applying such technology.

SME sector, an particularly to SMEs which are located outside of the major metropolitan areas.

- Credit reference bureaus could potentially play a role in creating or expanding access to public data, such as property ownership, vehicle registration or judgments and summonses. This would have significant systemic benefit and may be achievable at a fairly low cost. A special project could be undertaken to assess the feasibility of such a role and to determine whether this would require public or donor support.
- We recommend that FSD Kenya should continue their support for the project. Despite the important progress that has been made, there are still significant challenges, as had been outlined in this report. The progress which has been made may well be undermined if FSD Kenya withdraws their support.

For more information on the Kenya Credit Information Sharing Initiative (KCISI), please visit http://www.kenyacreditinfo.com

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