DPFB PRESENTATION ON FINANCIAL INCLUSION – A CASE FOR KENYA

Presented by

Rose Detho

Director, DPFB, Kenya

OUTLINE OF THE PRESENTATION

1. **Introduction.**
2. **Financial Inclusion in Context.**
3. **Overview of Financial Inclusion in Kenya.**
4. **Practical issues/challenges.**

1.1 INTRODUCTION

- Kenya plays a significant role in the East African Economy.
- 40% of region's GDP; 30% of the region's population.
- Classified as a Low Income County.
- 30% of population live on less than $1.25 a day; 40% live on less than $2 a day.
- Kenya growing rapidly – in 2010 GDP growth estimated at 5%.
- One of the most important sectors for development is the financial sector.

1.2 KENYAN FINANCIAL LANDSCAPE

- 43 commercial banks.
- I mortgage finance company.
- 3 Representative Offices of Foreign Banks.
- 2 Credit Reference Bureaus.
- 6 Deposit Taking MFIs.
- 124 Foreign Exchange Bureaus.
- Branch network has grown significantly: 772 in 2008 to 1,102 in June 2011 (42.7% growth).
- Deposits: Ksh. 573.5b in 2006 to Ksh. 1,420b in June 2011.
- Adults with bank accounts: 14% in 2006 to 22% in 2009.

1.3 KENYA's VISION 2030

- Kenya's Economic Development Plan – 2006.
- Specific attention to the development of the financial services sector.
- Embodies a policy commitment to financial inclusion.
- Expand banking services to parts of the excluded population, i.e. the rural areas.
- Catalyst for greater pool of savings with which to finance productive investments.
- Government committed to providing policy support for financial players acting in support of financial inclusion.

1.4 FINANCIAL INCLUSION INITIATIVES

- Deposit Taking MFIs.
- Agency Banking.
- Streamlining SACCOs.
- Credit Referencing.
- Non-bank telecom service providers: accessibility by innovative electronic payment systems such as M-PESA.
- Participation in Global Financial Inclusion Initiatives.
- Kenya seeks to broaden and deepen its financial sector.
- Reach a large population financially excluded from formal financial system.

2.1 FINANCIAL INCLUSION IN CONTEXT

- Kenya has significantly expanded the reach of financial services.
- According to FinAccess Survey of 2006 and 2009
  - ✓ Formal financial inclusion increased: 26.4% in 2006 to 40% in 2009;
  - ✓ Financially excluded decreased: 38.4% in 2006 to 32.7% in 2009;
  - ✓ In urban areas financial exclusion cut by half:42.9% in 2006 to 20.9% in 2009.

2.1 FINANCIAL INCLUSION IN CONTEXT Cont'd

- Banks, MFIs and SACCOs serve about 27% of adult population (banks serve 25%; SACCOs 9.6%; MFIs 3.4%)
- Many customers take advantage of more than one type of institution

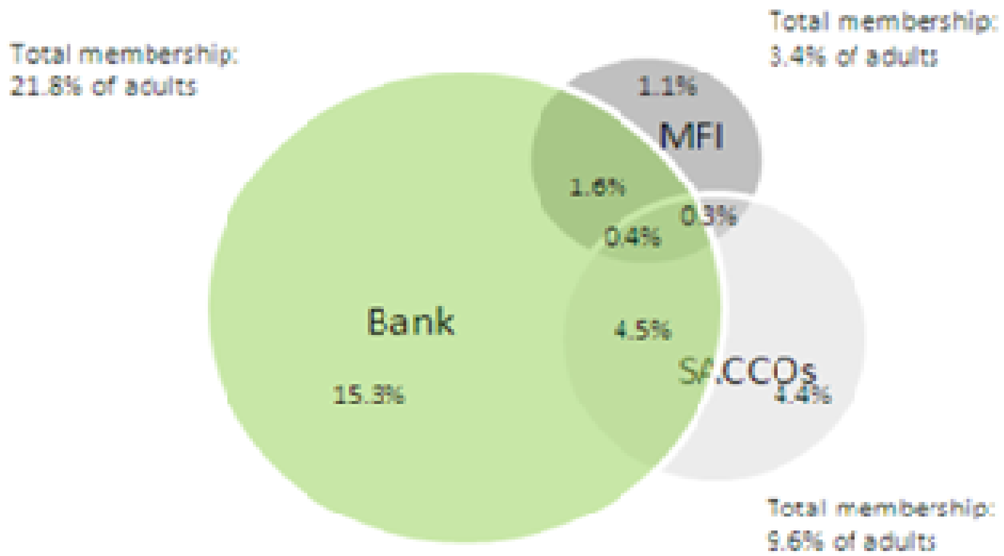


Figure 1: Comparative client bases of Banks, MFIs and SACCOs (percentage of adults 16 years and older)

Source: FinAccess, 2009

3. OVERVIEW OF FINANCIAL INCLUSION IN KENYA

3.1 A FAST-CHANGING FINANCIAL SECTOR LANDSCAPE

- Rapid expansion of bank branches within Kenya and regionally.
- Licensing of new banks and deposit-taking MFIs.
- Proliferation of new innovative business models.
- Roll out of agency banking.
- Increased complexity in the financial industry.
- Innovation in mobile payment systems.
- Convergence of financial services with the telecommunications industry.
- Further complicates the industry.
- New risk profiles and impact on deposit insurance.

3.2 TRANSFORMATIONAL IMPACT OF INNOVATION IN MOBILE PAYMENTS

- M-PESA launched in 2007 - Safaricom Mobile Payment System.
- Other providers launched similar services thereafter, i.e., Airtel Money, Yu Cash, Orange Money & Tangaza.
- Initial focus was geographic money transfers and bill payments.
- Currently created a link with full banking services.
- By August 2011, 18.5 million users of mobile payment systems across the four networks were being served by 52,689 agents.
- By August 2011, a monthly average of 39.3 million transactions with a value of Kshs.107.3 billion were handled across all networks.
- M-PESA is the dominant service and it accounts for over 90% of the statistics given above.

3.3 NEW GENERATION OF BANKS AND MICRO-FINANCE DEPOSIT-TAKING INSTITUTIONS LEADING THE WAY

- A number of commercial banks have a focus on MF arena.
- Succeeded in extending financial services to the previously un-served population.
- E.g. Equity Bank registered in 1984 as a Building Society then transitioned to a Commercial Bank in 2004.
- By June 2011 Equity Bank had 5.8m accounts, 40.7% of total accounts in the banking sector.
- Equity Bank employs a link with M-PESA electronic money transfer platform (M-KESHO).
- Other players include Kenya Commercial Bank; Co-operative Bank of Kenya; Family Bank; K-REP Bank.

3.4 THE MICROFINANCE ACT, 2006

- Operational from May, 2008.
- Facilitates transformation of credit-only MFIs, upon meeting set criteria, into Deposit-Taking MFIs ("DTMs").
- DTMs now have ability to access additional funds from deposits for on-lending.
- DTMs may be National or Community based.
- Include micro-insurance models – e.g. health and welfare insurance.
- CBK has, since 2009, licensed 6 DTMs with a deposit base of Ksh.9.6 billion as at June 2011.

3.5 Participation in Global Financial Inclusion Initiatives

- The Central Bank of Kenya(CBK) was a founding member of the Alliance for Financial Inclusion(AFI) in 2009.
- AFI is global network of policy makers from 81 developing countries in Asia, Latin America and Africa.
- AFI's seeks to promote sharing of cutting edge financial inclusion policies.
- Kenya's FI initiatives have benefited from AFI network experiences.
- Agent banking roll out informed by experiences of AFI members in Brazil and Colombia.
- Through AFI, CBK nominated as a non G20 partner of the Global Partnership for Financial Inclusion(GPFI) in 2010.
- Through GPFI, case study on Kenya's experiences with Standard Setting Bodies(SSB's) including IADI released in October 2011.
- Kenya's and four other country cases studies to be shared with SSB's to inform development and review of standards taking into account financial inclusion.

3.6 Strengthening Kenya's Financial Inclusion Initiatives

- Promoting evidence based financial inclusion policy- Updated National Financial Access Survey targeted for 2012.
- Enhancing consumer empowerment-Development of national financial education strategy underway through public-private partnership.
- Strengthening disclosures/transparency of charges and lending rates.
- Proportionate regulation to support development of wide spread financial services delivery channels/touch points across the country.
- Strengthening deposit protection/safety net mechanisms.

4.0 PRACTICAL ISSUES/CHALLENGES

4.1 CHALLENGES WITH SAFETY NET PLAYERS AND OTHER STANDARD SETTING BODIES (IADI, BCBS & CPSS)

- Regional expansion posing cross-border risks.
- Protecting the consumer: as financial service provision broadens in Kenya, the need for consumer protection and financial education becomes clear.
- Emphasis on sound financial products.
- Agent banking creates a new set of players – a new risk profile.
- Verification and definition of “bank customer” is proving to be a challenge.

4.2 NEW INNOVATIVE PAYMENT MODELS HAVE CHANGED OVERALL RISK LANDSCAPE FOR BANKING

- Mobile payment systems carry float accounts, held in trust at Kenyan banks.
- As mobile payments systems continue to grow, these deposits are the subject of further uncertainty.
- Currently outside the direct oversight of the banking regulator.
- Market confidence partially depends on regulator’s ability to protect the soundness of the financial system.

4.3 WHAT CONSTITUTES BANKING BUSINESS REQUIRES RETHINKING OF BCBS PRINCIPLE 2 ON PERMISSIBLE ACTIVITIES

- Recent innovations in the mobile payments.
- Highlight systemic links between banks, mobile network operators and payment systems in the overall banking landscape.
- The nexus of these players creates a need for interaction between the respective regulators and the respective standard-setting bodies.
- BCBS and CPSS should establish a demarcation on what constitutes bank business and deposit-taking and how mobile payment systems fit within the greater risk framework.
- Mobile payment systems may not constitute banking business as funds collected not intermediated by payment provider.
- Deposits are held in Kenyan banks implying some level of responsibility for the banking regulator.

4.4 CPSS PRINCIPLES YET TO FIND WAY INTO LEGISLATION

- In 1998, Kenya began a modernisation programme for its national payment system.
- Nairobi Clearing House automated in 1998.
- Kenya Electronic Payments System (KEPPS), a Real Time Gross Settlement (RTGS) implemented in 2005.
- High Value Capping introduced in 2009 (through EFT).
- Cheque Truncation (paperless clearing house) implemented in 2011.

4.5 THE NATIONAL PAYMENTS SYSTEMS BILL, 2011

- The Bill seeks to regulate and supervise payment systems and payment service providers, and for connected purposes.
- The Bill addresses payment instruments whether tangible or intangible that enables a person to obtain money, goods and services, or to otherwise make payment.
- Payment Service Provider – acting as a provider in relation to sending, receiving, storing or processing of payments or the provision of other services in relation to payment services through any electronic system.

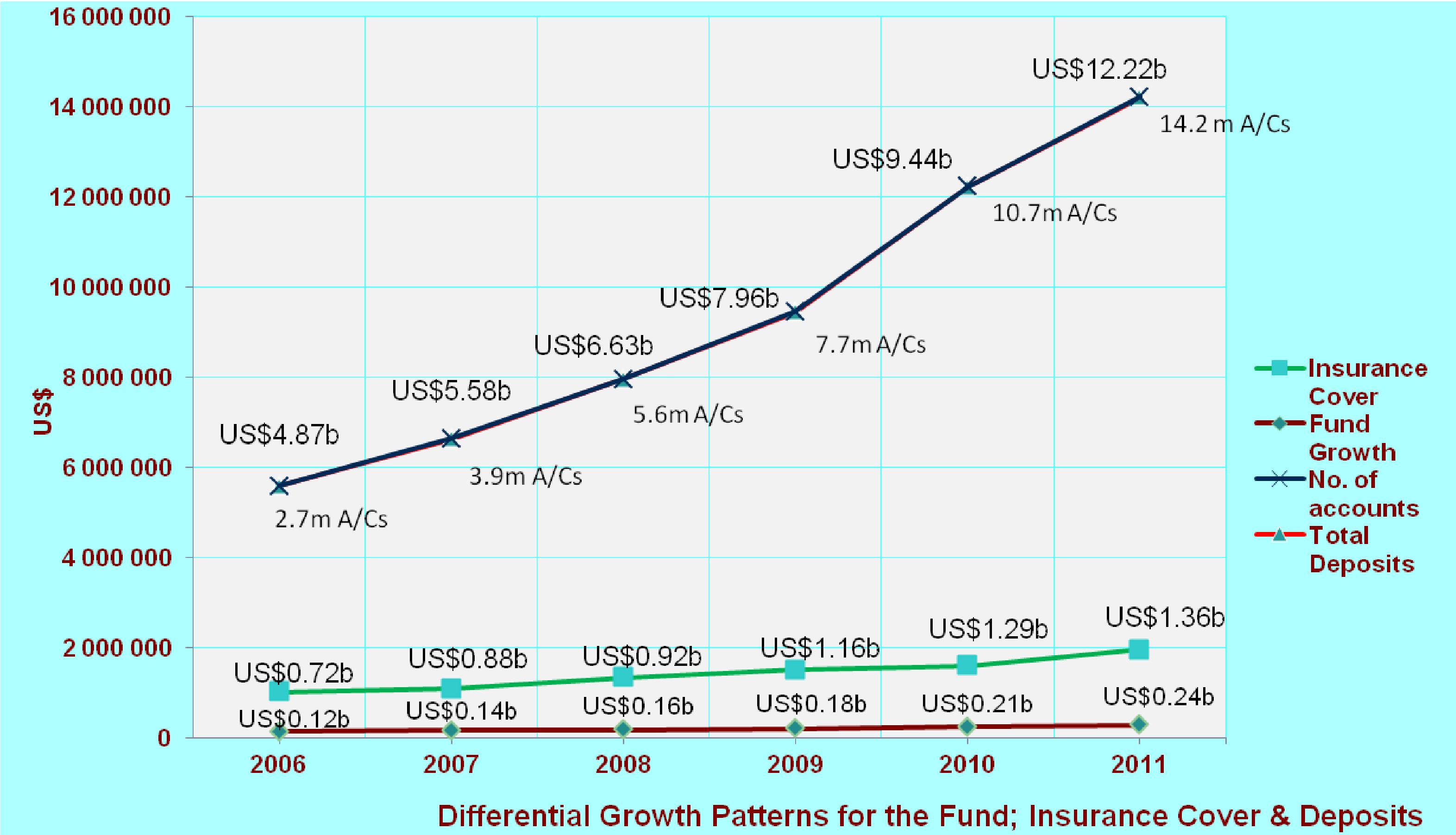
4.6 FINANCIAL INCLUSION AND DEPOSIT INSURANCE

- Difficult to keep pace with growth in deposits unleashed by financial inclusion drive (See DPFB coverage statistics below).
- Are IADI guidelines on 20-40% coverage relevant for Kenya?
- DPFB needs to rethink how to expand current insurance coverage and what the ideal level of coverage should be.
- DPFB has the difficult task of balancing the need for fund growth against the desire to keep access to deposit services as inexpensive as possible in order to encourage financial inclusion.

Table 1: Protection & Exposure Indicators as at 30th June, 2011

	Banking Sector Deposits	30/06/2010	30/06/2011	%Change
1	Total Deposits(Kshs. M)	1,222,160	1,420,457	16.2%
2	Total Protected Deposits (Ksh.m.)	136,291	168,120	23.3 %
3	Protection Level (2/1)	11.15 %	11.83%	0.68 %
4	Fund Balance (Ksh.m.)	24,101	28,124	16.7 %
5	Effective Cover (4/2)	17.68%	16.73 %	(0.95 %)
6	Number of Deposit accounts ('000')	10,676	14,213	33 %
7	Number of accounts fully protected ('000')	10,057	13,365	32.8%
8	Share of Protected accounts (7/6)	94 %	94 %	0 %
9	Exposure Level 2-4/2)	82.3%	83.3 %	1%

Chart 2. Effect of Financial Inclusion on Deposit Insurance as at 30.06.2011



- **Number of fully insured accounts – 13,365,472 (94% of total accounts).**
- **Effective cover – 16.7% (against an international benchmark of 40%).**

4.7 RISK LANDSCAPE COMPLICATED BY KENYAN BANKS REGIONAL EXPANSION

- Recent rapid expansion to Uganda, Tanzania, Rwanda and South Sudan.
- How to assess the risk of financial difficulties in other jurisdictions and the potential impact on the domestic protection regime.
- Many of the neighbouring countries do not have deposit insurance – can large deposit insurance risk burdens be transferred to Kenya?
- Exposure of Kenyan banks to risk business environments outside Kenya may impact their stability in Kenya, putting local deposits at risk.

4.8 HOW SHOULD DPFB HANDLE MOBILE PAYMENT MODELS

- Current model entails holding the float for M-PESA accounts in Trust accounts in commercial banks.
- Insurance cover is for one account (not each agent or pooled accounts).
- Some M-PESA clients use their accounts for short-term savings.
- How can deposit insurance be made more relevant for various mobile payment models and how should this be implemented.
- Deposit insurance coverage for mobile payment funds requires consideration within IADI.
- Need to harmonize with other non-bank financial institutions e.g. SACCOs; Insurance Companies; Capital Markets players; in a financial inclusive approach.

THANK YOU