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Papers Laid

By the chair Departmental Committee on Finance Planning and Trade Hon Benjamin Langat on Tuesday 26.4.2016

REPUBLIC OF KENYA

THE NATIONAL ASSEMBLY

ELEVENTH PARLIAMENT – FOURTH SESSION

THE DEPARTMENTAL COMMITTEE ON FINANCE, PLANNING & TRADE

....

REPORT ON THE CONSIDERATION OF THE BANKING (AMENDMENT) BILL, 2015

CLERKS CHAMBERS
DIRECTORATE OF COMMITTEE SERVICES
PARLIAMENT BUILDINGS
NAIROBI

APRIL, 2016

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ABBREVIATIONS

APR	-	Annual Percentage Rate
CBK	-	Central Bank of Kenya
CBR	-	Central Bank Rate
KBA	-	Kenya Bankers Association
KBRR	-	Kenya Bankers Reference Rate
TMDS	-	Treasury Mobile Direct Systems
NPS	-	National Payment Systems
KRA	-	Kenya Revenue Authority
CIS	-	Credit Information Sharing

1.0 PREFACE

On behalf of the Departmental Committee on Finance, Planning & Trade and pursuant to provisions of Standing Order 199 (6), it is my pleasant privilege and honour to present to this House the Report of the Committee on its consideration of the Banking (Amendment) Bill, 2015. The Bill was committed to the Committee on 2nd December 2015 and it is on the basis of this that the Committee makes this report pursuant to Standing Order 127.

1.1 Mandate of the Committee

The Committee on Finance, planning & Trade is one of the Departmental Committees of the National Assembly established under Standing Order 216 and mandated to:-

(a) investigate, inquire into, and report on all matters relating to the mandate, management, activities, administration, operations and estimates of the assigned ministries and departments;
(b) study the programme and policy objectives of ministries and departments and the effectiveness of the implementation.
(c) study and review all legislation referred to it;
(d) study, assess and analyse the relative success of the ministries and departments as measured by the results obtained as compared with their stated objectives;
(e) investigate and inquire into all matters relating to the assigned ministries and departments as they may deem necessary and as may be referred to them by the House;
(f) vet and report on all appointments where the Constitution or any law requires the National Assembly to approve, except those under Standing Order 204 (*Committee on Appointments*); and
(g) reportsand recommendations to the House as often as possible, including recommendation of proposed legislation.

1.2 Committee Membership

The Committee was constituted by the House on Thursday 16th May, 2013 and comprises the following members:

1. The Hon. Benjamin Langat, MP **(Chairman)**
2. The Hon. Nelson Gaichuhie, MP **(Vice Chairman)**
3. The Hon. Dr. Oburu Oginga, MP
4. The Hon. Jimmy Angwenyi, MP
5. The Hon. Eng. Shadrack Manga, MP
6. The Hon. Alfred Sambu, MP
7. The Hon. Shakeel Shabbir Ahmed, MP
8. The Hon. Sammy Mwaita, MP
9. The Hon. Sammy Koech, MP

10. The Hon. Abdul Rahim Dawood, MP
11. The Hon. Abdullswamad Sheriff, MP
12. The Hon. Andrew Toboso, MP
13. The Hon. Daniel Nanok, MP
14. The Hon. Dennis Waweru, MP
15. The Hon. Iringo Cyprian Kubai, MP
16. The Hon. Joash Olum, MP
17. The Hon. Jones M Mlolwa, MP
18. The Hon. Joseph Limo, MP
19. The Hon. Lati Lelelit, MP
20. The Hon. Mary Emase, MP
21. The Hon. Patrick Makau King'ola, MP
22. The Hon. Ronald Tonui, MP
23. The Hon. Rose Nyamunga, MP
24. The Hon. Sakaja Johnson, MP
25. The Hon. Sakwa Bunyasi, MP
26. The Hon. Stephen Bitok, MP
27. The Hon. Sumra Irshadali, MP
28. The Hon. Timothy M .E. Bosire, MP
29. The Hon. Tiras Ngahu, MP

1.3 CONSIDERATION OF THE BANKING (AMENDMENT) BILL, 2015

Publication, Comittal and objectives of the Bill1.3.1 The Banking (Amendment) Bill, 2015 was published on 18th November 2015 and read a First time on 2nd December, 2015 and thereafter committed to the Departmental Committee on Finance, Planning & Trade for consideration, pursuant to Standing Order 127.

1.3.2 In processing the Bill, the Committee invited comments from the public by placing advertisement in the Daily Nation on 22nd January, 2015 pursuant to Article 118 of the Constitution. Subsequent to the said advertisement, the Committee received submissions from the Kenya Bankers Association, the Attorney General and the National Treasury on the Bill.

1.3.3 The Committee having analyzed the Bill noted that the main objective of the Bill was to provide a mechanism for regulation of banks and financial institutions' interest rates through the introduction of ceilings. The Bill proposes to put a cap on the rate of interest charged for loans and to fix the minimum rate of interest that such institutions must pay on deposits held. It also criminalizes anybody that violates these provisions.

Summary of submissions from Stakeholders

1.3.4 The Kenya Banker's Association (KBA), the National Treasury and the AttorneyGeneral opposed enactment of the Bill arguing that introducing controls on interest rates may pull back the banking sector growth momentum and that Kenya may not attain its aspiration of being an International Financial Center under the Vision 2030. Controls on interest rates have been shown to reduce the savings level in a country as well as promoting credit rationing by commercial banks. In the recent past, the government has put measures aimed at reducing the interest rates i.e introduction of Kenya Bankers' Reference Rate (KBRR) for pricing credit; enforcement of full disclosures of all banks charges; implementation of National Payment Systems (NPS); and Implementation of the Treasury Mobile Direct Systems (TMDS) among other measures.

1.4 COMMITTEE OBSERVATIONS AND RECOMMENDATIONS

Having analyzed the Bill and the submissions from the stakeholders, the Committee observed the following:-

(i) Interest rates charged by the Kenyan commercial banks are some of the highest in the world. The country has time and again witnessed banks reap huge profits even during times of economic hardship.

(ii) As much as the government may argue against regulating interest rates through legislation, commercial banks have not been responsible enough with the interest rates they charge on loans and the ones they offer on deposits. As a result, the spread is very high and also cost of credit is very high.

(iii)Banks never disclose most bank charges imposed upon customers. Enactment of this Bill will obligate commercial banks to disclose all the charges and terms relating to the loan to the borrower before any loan is granted. This is against the law that requires that any charges levied by banks be approved by the Central Bank and the Cabinet Secretary for Finance.

(iv)Enactment of this Bill will go along way in bringing sanity in the Banking sector in so far as containing the cost of credit in Kenya.

1.5 ACKNOWLEDGEMENT

Mr. Speaker, Sir,

The Committee is grateful to the Offices of the Speaker and the Clerk of the National Assembly for the logistical and technical support accorded to it during its sittings. The Committee wishes to thank all the stakeholders for their participation in scrutinizing the Bill.

Finally, I wish to express my appreciation to the Honourable Members of the Committee who made useful contributions towards the preparation and production of this report.

It is my pleasant duty and privilege, on behalf of the Departmental Committee on Finance, Planning & Trade, to table its Report on the consideration of the Betting, Lotteries and Gaming (Amendment) Bill, 2015 pursuant to Standing Order 127.

Signed ....Date.20-04-2016..

(HON. BENJAMIN LANGAT, MP)
CHAIRPERSON, DEPARTMENTAL COMMITTEE ON FINANCE, PLANNING & TRADE

2.0 CONSIDERATION OF THE BILL

2.1 BACKGROUND INFORMATION

2.1.1 The Banking (Amendment) Bill, 2015 proposes two key amendments to the Banking Act. The first amendment is on the disclosure of information on loans where a *bank or financial institution shall, before granting a loan to a borrower, disclose all the charges and terms relating to the loan.*

2.1.2 The second amendment is with regard to the introduction of a capping on lending rates and determination on the minimum interest payable to depositors. The Bill states that a bank or financial institution shall set *the maximum interest rate chargeable for a credit facility in Kenya at no more than four percent, the base set and published by the Central Bank of Kenya; and the minimum interest rate granted on a deposit held in interest earning [account] in Kenya to at least seventy five percent, the base set and published by the Central Bank of Kenya.*

2.1.3 The Bill makes proposals on interest rates regulation on the back of the Central Bank of Kenya (CBK) being mandated by the CBK Act to pursue as one of its principal objective the fostering of "liquidity, solvency and proper functioning of a stable ***market-base***d financial system". It is believed that these proposals will reign on the commercial banks that have been reporting huge profits by exploiting their customers through charging high interest rates.

2.2 ENGAGEMENT WITH THE STAKEHOLDERS

Pursuant to Article 118 of the Constitution and Standing Order 127(6), the Committee received written memoranda from the National Treasury, the Attorney General and the Kenya Bakers Association on the Bill. All the three institutions opposed enactment of the Banking (Amendment) Bill, 2015. This section provides detailed submissions on the Bill by the stakeholders.

2.2.1 KENYA BANKERS ASSOCIATION (KBA)

Through its memorandum and subsequent meeting with the Committee on 9th March, 2016, the Kenya Bankers Association opposed enactment of the Bill on the following grounds: -

(i) Since the inception of a market-based interest rates regime, the market competition dynamics have shaped the credit-pricing trend. That trend has consistently been downwards, with upward spikes being associated with macroeconomic volatility and fiscal pressure; once market normalcy restored, the downward trend resumes. The interest rate spreads are now at single digit level.

(ii) The Banking industry has sufficient motivation to expand outreach for the benefit of its customers and the economy. The branch network has grown from 575 in 2006 to 1,443 by the end of 2014. Agency banking has picked momentum, with the number of agents rising from about 10,000 in early 2012 to 40,000 by the end of June 2015.

(iii)As a consequence of outreach expansion and synergetic partnership with other market players, the economy has seen the adult population that is financially excluded decline from about 39% in 2006 to 25% by 2013; those accessing finance from informal sources has correspondingly declined from 33% in 2006 to about 8%. Kenya is a leader in SME financing, which is estimated to be about 23% of the total lending by banks in 2013; credit to SMEs as a proportion of total bank lending in Nigeria and South Africa is still at single digit level.

(iv)The above-outlined positive developments have taken place on the back of enhanced transparency, for the benefit of customers. The CBK issues **Prudential Guidelines** pursuant to the Banking Act, thus such guidelines have the full force of the law. Prudential Guideline No 22 has very elaborate disclosure requirements that required banks to provide the customer with the **total cost** associated with a given loan as well as the **repayment schedule** for the loan. The transparency has been further enhanced by the banking industry rolling out the **Annual Percentage Rate** (APR) mechanism in July 2014, and the **Credit Information Sharing** (CIS) initiative-taking root with full-file information sharing now mandated.

(v) The Bill is implicitly motivated by the notion that interest rate caps on loans are meant to protect customers from excessive interest rates therefore making loans more affordable, and increase access to finance. The magnitude of the capping is arbitrary determined. The cap is packaged as one-size-fit-all solution; even in jurisdictions where there are caps on interest rates, they are often differentiated depending on parameters such as amounts, tenors, type of intuitions, and type of customer, among others. Even then, economies with caps on interest in the continent are elsewhere have performed worse off on the parameters of credit to GDP and financial inclusion compared to those without caps and the respective region's average.

(vi)Most critically, interest rate caps have consequences that will lead to the negation of the strides made in Kenya. Examples are:-

- They will discourage innovations aimed at high risk/low scale credit segment;
- They will lead to credit rationing and distortions to the detriment of SMEs, low income and first time borrowers;
- They will discourage supply of funds to the financial system, thus encouraging informal mechanisms. This will negate that strides that the country has made in enhancing financial inclusion through formal systems.

- Banks will have an incentive introduce additional fees or modify terms of the loans to increase the effective rates, thus negating the strides made in pricing transparency such as the APR mechanism.
- They will lead to credit concentration amongst large borrowers, with the attendant risks of non-performing loans and possible systemic risks.
- Non-financial market players will see an incentive to increase sales through credit under more stringent terms to the detriment of customers

(vii) Capping of interest rates does nothing to ameliorate the true causes of market failure whose addressing will precede a sustainable fall in interest rates in the long run. there are more effective ways of reducing interest rates on loans over the long run and of improving access to finance, including:

- Measures that enhance competition and product innovation;
- Improving financial consumer protection frameworks,
- Increasing financial literacy;
- Promoting credit bureaus and putting in place measures to enhance credit information sharing;
- Enforcing disclosure of interest rates; and
- Promoting microcredit products.

(viii) The legislative process should support the endeavour to sustainable lower interest rates and enable access to credit through initiatives already in place, including the following:

(a) ***Interest Rate Transparency:*** Require banks to use a common reference rate as well as implement the Annual Percentage Rate (APR) mechanism. A common reference rate, the Kenya Banks Reference Rate (KBRR), was developed and implemented with effect from July 2014. Similar, the APR mechanisms was rolled out in July 2014. The KBRR is being refined so as to yield the expected outcome, having been implemented for one and half years. While the influence of both measures will come with a time lag, a regular assessment of their efficacy will help in their implementation.

(b) ***Collateral:*** Enact amended Companies Act and Insolvency law; amend the Chattels Transfer Act and Hire Purchase Act to Promote Lending; Accelerate reforms in the Lands and Companies Registries; and establish the legal and regulatory framework to support the creation of an electronic movable assets register. There is commendable progress given the enactment of the Companies Act. The Legislature can help in expediting the process of the other aspects that have a link to collateral that supports credit provision.

(c) ***Legal Fees:*** This is a critical third party cost that influences the total cost the goes to the computation of the APR. Currently, the Advocates Remuneration Order spells out the minimum fees to be charged, thus not allowing for competitive pricing of legal services. The legislature can help address this matter for the benefit of borrowers.

(d) ***Information:*** Implement revised Credit Reference regulations. This will entail expand credit information sharing mechanism to include most of the credit providers including utilities, phone companies etc.)

(e) ***Efficiency:*** Implement the National Payments System (NPS) regulations to facilitate infrastructure sharing. Expedite establishment of Alternative Dispute Resolution Mechanism. There is commendable progress towards full implementation of the NPS.

(f) ***Instruments:*** Facilitate the use of Leasing and Factoring products; and enhance the efficiency of the horizontal Repo market.

(g) ***Consumer Protection:*** Enact financial services consumer protection law; and develop consumer protection and financial education national strategy and framework.

(h) ***Alternative investment vehicles:*** Fast-track implementation of Treasury Mobile Direct to offer retail/individuals alternative saving mechanisms besides saving through banks (Individuals to subscribe directly for government securities thus indirectly compel banks to offer competitive deposit rates); and fast track capital markets reforms to make capital markets a more efficient and attractive alternative source of long term funds.

(i) ***Opportunity Cost of Credit to Private Sector:*** Ensure Government Borrowing does not crowd out private sector and adopt alternative sources while improving Government cash management.

2.2.2 THE NATIONAL TREASURY AND THE ATTORNEY GENERAL

The Solicitor General, through his letter to the Committee dated 26th January, 2016 forwarded the views of the National Treasury opposing enactment of the Bill. The Principal Secretary for the National Treasury through his letter dated 18th December, 2015 had submitted the following views regarding the Bill to the Solicitor General opposing the Bill:-

1. The proposal to cap the lending and deposit rates to the CBR means that all banks will be charging the same interest rate on loans and paying the same rate on deposits. This amendment will eliminate competition in the loans and deposits markets. Lack of competition breeds inefficiency and slows down innovation.

2. The Kenyan Banking sector has in the past 11 years significantly enhanced its' outreach to Kenyans with relative stability. This has been on the back of a strengthened legal and

regulatory framework, conducive macroeconomic environment, innovation and competition. Interest rate caps could slow down this momentum.

3. The Government and the Central Bank have initiated a number of reforms to lower the cost of doing business. These include introduction of credit reference bureaus, agency banking, currency centres and identifying ways of reducing the cost of collateral. These initiatives along with other on-going infrastructure initiatives by Government are expected to lead to a reduction in the cost of business in the short to medium term. Banks are expected to pass on the cost savings to customers in the form of lower charges and lending rates.

4. Introduction of price controls for the pricing of loans will most likely lead to market distortions in relation to the pricing of inputs (deposits) and outputs (loans). This is because the proposed legislative amendment does not take account of the risk profile of the borrowers. As proposed, it will essentially result in treatment of all customers in the same way – as if their risk profiles are the same. The most likely consequence of this is that credit to the more risky part of the market will dry up and this could eventually have adverse consequences on the economy.

5. Limiting lending rates by law is likely to lead to credit rationing, and an increase in hidden charges to compensate for lost interest revenue resulting in less access to credit for small borrowers, who constitute the highest number of unbanked Kenyan population.

6. Fixing of interest rates and pricing of loans will pose sustainability issues for banks. The core business of institutions is to lend and mobilize deposits – that is intermediation. At present, about 40% of banks income on average is obtained from interest which is derived from charging interest on loans and other products.

7. Institutions may be discouraged from mobilizing deposits given the requirement to pay interest at seventy per centum of the CBR. We might see the trend where institutions stop offering savings accounts products and transform the same to transactional accounts, which do not attract interest rates. The impact of this move is that banks will not have deposits from savers, hence there will be decreased credit as funds become limited.

8. The banking sector has grown and flourished over the last few years due to the liberalization of the markets. There is a risk however of foreign investors withdrawing their investments if controls on interest rates are put in place as this would ultimately affect the bank's profitability and investors' ability to negotiate for better returns. In effect, controls would reduce the attractiveness of the Kenyan banking sector's investment climate to both local and foreign investors.

9. Kenya has committed itself to the on-going East African Community integration whose ultimate aim to achieve single currency by 2024. It is worth noting that the other countries in

the East Africa region have liberalised economies including interest rates. As a result, any regulation on interest rates may affect the integration and thereby isolating the country.

10. Kenya has continued to adopt international best practices in the hope of achieving the development objectives of Vision 2030. In particular, Kenya is aspiring to be an international financial centre and interest caps would hinder this ambition. Kenya therefore risks isolating itself from the global community by introducing interest rate controls in the market.

11. For regional banking groups, preference will be to invest more of their capital in jurisdictions without interest controls because in jurisdictions without interest caps, the banking groups will be able to price their products based on among others the risk profiles of the borrowers. This will be to the detriment of the Kenyan banking sector since banks may contract and diminish their operations in Kenya, which in turn will diminish Kenya's position as the regions' financial hub.

12. The current prevailing macroeconomic conditions characterized by inflationary pressures, exchange rate volatility and global and domestic shocks are temporary and are expected to unwind in the short term.

13. Kenya is currently on a programme with the International Monetary Fund (IMF). Interest caps at this juncture could jeopardize this facility which is critical for Kenya's macro-economic stability.

14. Since rollout of Kenya Banks' Reference Rate (KBRR) in July 2014, the average lending rate for the banking sector has experienced a downward trend from 16.9% in July 2014 to 15.46% in March 2015. It is expected that the lending interest rates will continue coming down as more loans are granted under the KBRR framework, which promotes more disclosure and transparency.

15. Banks will be charging the same interest rate on loans and deposits and this will not encourage competition. There may be complete market failure.

16. CBR is a signaling rate that is used by CBK to guide the market on what direction interest rates should take. Banks are not necessarily obliged to abide by this rate. The challenge arising from using the Central Bank Rate is that some banks may have cost of funds in excess of the CBR. A previous suggestion has been to use the Treasury bill rate (TB) as a benchmark for setting interest rate. However, with banks being the main investors in Government Treasury Bills, there exists potential of the rate being manipulated to favour them.

17. Extending restrictions under the proposed section 33B(1)(a) of the Banking Act to all persons, even those that are not currently governed by the Banking Act will be disastrous. The phrase ***"A person shall not ...."***extends to all persons including those that are not

affected or covered by the Banking Act. There are many credit providers who do not fall under or are not governed by the Banking Act. This provision will cause arbitrage.

18. The government has come up with the following policy initiatives to curtail high lending interest rates in Kenya:-

i) **Establishment of Currency Centres** by the Central Bank of Kenya in an effort to mitigate the high cost of transporting cash and also the increasing insecurity targeted at cash in transit. This is reducing the cost of doing banking business.

ii) **Introduction of agency banking in 2010** which allowed banks to provide banking services through third parties (agents) hence avoiding huge overheads incurred in establishing brick and mortar branches.

iii) **Introduction of mobile financial services** which offer convenient and economical channels of banking to customers.

iv) **Roll out of Credit Information Sharing in 2008** to enhance banks framework for credit risk management. Information asymmetry and high search costs due to lack of credit information sharing among banks had been cited as contributing to high risk premiums levied by banks.

v) **Promotion of consumer protection in the banking sector** through the introduction of a Prudential Guideline on Consumer Protection by the Central Bank of Kenya in 2013.

vi) **The establishment and strengthening of the Deposit Insurance Protection Fund** to guarantee depositors of their savings.

vii) **Increasing the minimum core capital of banks from Kshs 250 billion in 2008 to Kshs 1 billion in 2012** to promote strong banks and competition in the banking sector.

viii) The Central Bank of Kenya has been working with stakeholders in the banking sector to implement measures aimed at increasing transparency in pricing credit. Consequently, the Kenya Banks' Reference Rate (KBRR) was introduced in July 2014 as an outcome of discussions between the stakeholders, CBK and The National Treasury. The KBRR was developed as part of the recommendations by the ccommittee on Private Sector Credit and Mortgage Finance to enhance the supply of private sector credit and mortgage finance in Kenya by facilitating a transparent credit pricing framework. It is the base rate for all commercial and microfinance banks' lending.

As a result of the above initiatives, Commercial average lending rates have declined gradually from 16.91 per cent in July 2014 to 15.46 per cent in March 2015 while the average deposit rate rose slightly from 6.59 per cent to 6.63 per cent in the period. Consequently, the average interest rate spread declined from 10.33 per cent to 8.82 per cent during the period. This trend is expected to continue since all loans will be converted to the framework by June 2015.

3.0 COMMITTEE OBSERVATIONS

Arising from its interactions with stakeholders and its own analysis of the Bill, the Committee made the following observations in terms of the implications of the Bill if enacted:-

1. The Bill seeks to regulate interest rates in Kenya's financial system through setting the maximum lending rate to no more than 4 percentage points above the prevailing CBR and deposit rate at 70% of the CBR. Currently the CBR rate stands at 11.5%. This implies that in the event the bill is enacted at the prevailing CBR, the lending rate will stand at a maximum of 15.5% (11.5%+4%) and the deposit rate will stand at 8.05% (70% of 11.5).
2. The implication of this amendment when enacted is multifaceted: spanning the effects on the functioning of the financial sector, Economic effects, monetary policy transmission and government financing effects.

Financial sector and the economic effects

3. The benefit of regulating the interest rates (especially constraining the interest rate spread) include: increased credit access through reducing the cost of credit and providing savers a modest return on their deposits.
4. There is a possibility that consumers will be protected from abusive lending practices thereby enabling them to obtain loans at reasonable rates. All these positive outcomes could possibly accelerate private investments and growth in the economy.
5. Availability of credit would be low when interest rates are regulated due to diversion of money to other profit making ventures, for example, investing in real estate. Due to credit shrink, the amount available will not satisfy credit demandcausing a credit crunch.
6. The reduced credit availability implies that credit may be rationed among the borrowers by alternative means other than the price of credit (interest rate). The rationing will result in financial institutions setting rigid loan terms, screening borrowers more rigorously or increasing non-interest fees and charges to those seeking loans. For example, financial institutions may impose more stringent loan terms such as shorter maturities and higher minimum loan sizes which is biased towards individuals who are able to afford large down payments or large monthly payments.
7. Basing lending decisions heavily on individual characteristics such as borrowing history or income (without the flexibility of adding risk premium) has the potential for rationing credit away from new or high risk consumers.
8. Further, when lenders institute non-interest charges such as fees to compensate for interest rate ceilings, they effectively raise the cost of credit for borrowers. This essentially means that while a ceiling on the interest rates may reduce the explicit price of credit (interest rate), it may not necessarily result in lower overall costs of borrowing

even for those able to obtain loans. Additionally, non interest charges make it more complicated for borrowers to comprehend the total cost of borrowing and more difficult to make well informed decisions.

9. Therefore regulating interest rates may fail to give consumers the protection and benefits that they intend to provide. Regulation may actually reduce the amount of credit that is available to low income or experienced borrowers or small and medium enterprises.
10. If financial institutions resort to this form of discrimination, then the non-corporate borrowers including the SME's will gradually be crowded out of the loans market. As a result, low access to credit will likely produce other forms of lenders in the economy such as loan sharks (shylocks). As a consequence of low access to credit, private investment may be affected negatively.

3.1.2 Monetary policy and government borrowing

11. Through the proposed regulation of interest rates, the minimum deposit rate and maximum lending rate will only vary whenever the CBR changes. Given that the CBR setting mechanism is designed to address macroeconomic stability, then the proposed lending rates will likely reflect the CBK perceptions of the broad macroeconomic factors.
12. The CBK sets the CBR to implement various policy intentions including controlling liquidity and inflation. Government's borrowing through Treasury Bills and Bonds is not fully delinked from monetary operations.
13. The changes in CBR and consequent effect on the interest rates spread under the proposed amendment will affect the rates on Treasury Bills and Bonds. Under the constrained non market determined interest rates, banks will likely change their lending patterns and one way is to increase lending to "low risk" government and the government might use this avenue to offer coupon rates which are favorable to it.
14. Thus, the proposed interest rates control to some extent might affect government borrowing costs and amounts. This implies that it is possible for the government to alter its borrowing costs (and amounts) by varying the Central Bank Rate (CBR).

4.0 COMMITTEE RECOMMENDATION

Having held meetings with the Stakeholders, and through its analysis of the Banking (Amendment) Bill, 2015 the Committee is satisfied that the Bill as drafted will reign in on commercial banks by reducing the interest rates and the cost of credit. This will have a multiplier effect in the growth of Kenya's economy.

MINUTES OF THE 1st SITTING OF THE DEPARTMENTAL COMMITTEE ON FINANCE, PLANNING & TRADE HELD ON MONDAY 25th JANUARY, 2016 IN CONTINENTAL HOUSE, COMMITTEE ROOM, 5TH FLOOR, PARLIAMENT BUILDINGS AT 10:00AM

PRESENT

1. Hon. Benjamin Langat, MP — **Chairperson**
2. Hon. Jimmy Nuru Angwenyi, MP
3. Hon. Shakeel Shabbir, MP
4. Hon. Ronald Tonui, MP
5. Hon. Mary Emase, MP
6. Hon. Sakwa John Bunyasi, MP
7. Hon. Dr. Oburu Oginga, MP
8. Hon. Lati Lelelit, MP
9. Hon. Ogendo Rose Nyamunga, MP

ABSENT WITH APOLOGIES

1. Hon. Nelson Gaichuhie, MP — **Vice-Chairperson**
2. Hon. Eng. Shadrack Manga, MP
3. Hon. Anyanga Andrew Toboso, MP
4. Hon. Timothy Bosire, MP
5. Hon. Dennis Waweru, MP
6. Hon Kubai Iringo, MP
7. Hon. Daniel Epuyo Nanok, MP
8. Hon. Sammy Mwaita, MP
9. Hon. Jones Mlolwa, MP
10. Hon. Alfred Sambu, MP
11. Hon. Sammy Koech, MP
12. Hon. Tiras Ngahu, MP
13. Hon. Abdul Rahim Dawood ,MP
14. Hon. Joash Olum, MP
15. Hon. Sumra Irshadali, MP
16. Hon. Patrick Makau King'ola, MP
17. Hon. Joseph Limo, MP
18. Hon. Sakaja Johnson, MP
19. Hon. Kirwa Stephen Bitok, MP
20. Hon. Abdullswamad Shariff, MP

IN ATTENDANCE

1.	Mr. Robert Nyaga	-	Parliamentary Budget Office
2.	Mr. Nicodemus Maluki	-	Third Clerk Assistant
3.	Mr. Fredrick Otieno	-	Third Clerk Assistant
4.	Ms. Anncettah Gacheri	-	Research Officer
5.	Mr. Eric Ososi	-	Research Officer
6.	Mr. Thomas Ogwel	-	Fiscal Analyst
7.	Mr. Erick Kanyi	-	Fiscal Analyst

MIN.NO. DCF/001/2016: PRELIMINARIES

The Chairperson called the meeting to order at 10:30am followed by a word of prayer.

MIN.NO. DCF/002/2016: CONSIDERATION OF THE BANKING (AMENDMENT) BILL, 2015

The Parliamentary Budget Officer informed the Committee as follows regarding the Bill:-

- The Bill intends to control interest rates charged by banks by placing a ceiling and a floor for lending and deposit rates respectively. On lending interest rates, the draft bill proposes an amendment to section 33A of the Banking Act by providing that the maximum rate would be "no more than four percent of the rate set by the Central Bank of Kenya (Clause 33B of the bill).
- Further, the Bill propose to set the deposit rate at atleast 70% of the base rate set and published by the Central Bank of Kenya (clause 33B of the bill). Here, the Bill seeks to use non-market mechanism to determine the interest paid by the banking institutions on the deposits they hold for customers.
- In operation, these particular clauses would require all banking/financial institutions to align the interest rates charged on loans and deposits to the Central Bank Rate (CBR) within the respective margins provided. As a result, the CBR would be the benchmark for the determination of the interest charged on loan advances and customer deposits.
- The direct implication then is that the financial institutions will lose the discretion to set the interest rates in accordance with their assessment of the market, risks and the individual loans/deposits policy.

Implications of the Bill when enacted

1. The Bill seeks to regulate interest rates in Kenya's financial system through setting the maximum lending rate to no more than 4 percentage points above the prevailing CBR and deposit rate at 70% of the CBR. Currently the CBR rate stands at 11.5%. This implies that in the event the bill is enacted at the prevailing CBR, the lending rate will stand at a maximum of 15.5% (11.5%+4%) and the deposit rate will stand at 8.05% (70% of 11.5).

2. The implication of this amendment when enacted is multifaceted: spanning the effects on the functioning of the financial sector, Economic effects, monetary policy transmission and government financing effects.

i) Financial sector and the Economy effects

3. The benefit of regulating the interest rates (especially constraining the interest rate spread) include: increased credit access through reducing the cost of credit and providing savers a modest return on their deposits.

4. There is also a possibility that consumers will also be protected from abusive lending practices and enable them to obtain loans at reasonable rates. All this possible positive outcomes could possibly accelerate private investments and growth in the economy but there are **some caveats** where restriction of credit access and distortion of the credit market will result.

5. Given the lenders costs, the amount of credit lenders (financial institutions) will provide when interest rate is regulated will be limited due to diversion of money to other profit making ventures, for example, investing in real estate. Due to credit shrink, the amount available will not satisfy all those willing to borrow (demand) at the set rates hence creating excess demand for credit hence may result to credit crunch (demand for credit being more than supply).

6. The reduced credit availability implies that credit may be rationed among the borrowers by alternative means other than the price of credit (interest rate). The rationing will result in financial institutions setting rigid loan terms, screening borrowers more rigorously or increasing non-interest fees and charges to those seeking loans.

7. For example, financial institutions may impose more stringent loan terms such as shorter maturities and higher minimum loan sizes which is biased towards individuals who are able to afford large down payments or large monthly payments.

8. Basing lending decisions heavily on individual characteristics such as borrowing history or income (without the flexibility of adding risk premium) has the potential for rationing credit away from new or high risk consumers.

9. Further, when lenders institute non-interest charges such as fees to compensate for interest rate ceilings, they effectively raise the cost of credit for borrowers. This essentially means that while a ceiling on the interest rates may reduce the explicit price of

credit (interest rate), it may not necessarily result in lower overall costs of borrowing even for those able to obtain loans. Additionally, non interest charges make it more complicated for borrowers to comprehend the total cost of borrowing and more difficult to make well informed decisions.

10. Therefore regulating interest rates may fail to give consumers the protection and benefits that they intend to provide. Regulation may actually reduce the amount of credit that is available to low income or experienced borrowers or small and medium enterprises.

11. If financial institutions resort to this form of discrimination, then the non-corporate borrowers including the SME's will gradually be crowded out of the loans market. As a result, low access to credit will likely produce other forms of lenders in the economy such as loan sharks (shylocks). As a consequence of low access to credit, private investment may be affected negatively.

12. The requirement that banking institutions do pay a predetermined minimum in interest on deposits coupled with the control of the maximum levels of interest on loans implies that there is a possibility that the interest income for banks would be reduced.

13. Where the interest income constitutes the greater part of the individual bank's overall profits, a reduction in the profitability levels may cause the smaller institutions to succumb and collapse altogether. The collapse of small financial institutions has adverse effects in the overall economy such as job losses, reduction in available loanable funds and emergence of dominant financial institutions.

14. In summary, the effect of the proposed control on the interest rates on the financial sector could be three fold.

    a) If banks respond favorably and profitably (through cutting costs or seeking alternative sources of capital), then the effect of the draft bill will probably improve access to credit and augment private investment.

    b) If banks respond negatively by cutting down lending to risky clients (rationing of credit), the likely outcome is falling credit to some sectors of the economy especially the small and medium enterprises sector. This could harm the overall wellbeing of the financial sector.

    c) The broader economic effects of the proposed amendment will greatly depend on how the financial sector responds to the new non market driven lending rate. If the financial sector responds as indicated in (a), then interest rate regulation could increase economic output. From (b) above, if declining bank profitability and credit restraint is widespread, then it is possible to see negative effect in private investments and economic growth.

ii) Monetary policy and government borrowing

15. Through the proposed regulation of interest rates, the minimum deposit rate and maximum lending rate will only vary whenever the CBR changes. Given that the CBR setting mechanism is designed to address macroeconomic stability, then the proposed lending rates will likely reflect the CBK perceptions of the broad macroeconomic factors.

16. The CBK sets the CBR to implement various policy intentions including controlling liquidity and inflation. Government's borrowing through Treasury Bills and Bonds is not fully delinked from monetary operations.

17. The changes in CBR and consequent effect on the interest rates spread under the proposed amendment will affect the rates on Treasury Bills and Bonds. Under the constrained non market determined interest rates, banks will likely change their lending patterns and one way is to increase lending to "low risk" government and the government might use this avenue to offer coupon rates which are favorable to it.

18. Thus, the proposed interest rates control to some extent might affect government borrowing costs and amounts. This implies that it is possible for the government to alter its borrowing costs (and amounts) by varying the Central Bank Rate (CBR).

Key observations

i) Interest rate controls does not ordinarily take into account the business environment facing the financial sector. Thus, banks would still have to deal with credit risk and cost of raising capital. Some of the prevailing measures to control credit risk include establishment of credit reference bureau in Kenya. It is yet to be documented the extent to which the current credit bureaus have assisted in reducing credit risk.

ii) A study conducted by the KBA in 2013 indicated that a wide deposit-lending interest rate spread could be indicative of the financial sector inefficiency. The results from the study revealed that **bank-specific** factors play a significant role in the determination of interest rate spreads. These include bank size based on bank assets, credit risk as measured by non-performing loans to total loans ratio, liquidity risk, return on average assets and operating costs

iii) There is also the need to explore policy options meant to enhance competition in the banking industry. In fact one of the major causes of high interest rates is the non-competitive nature of the financial sector. As one of the options to enhance competition in the banking sector, the KBA study recommended that market dominance by some of the banks be neutralized to allow competition.

iv) Again part of the responsibility for ensuring a competitive financial sector is on the borrowers themselves. This is because knowledgeable and informed borrowers assist in enhancing competition in credit markets. When borrowers do not know or cannot compare rates being charged by various lenders, each lender has more freedom to charge any rate-fair or unfair. A high level of borrower awareness can create a natural protection form unreasonable interest rates.

v) The sector also needs to explore internal as well as industry-driven strategies that counter some of the bank-specific factors associated with higher spreads. These could range from diversification of products to investment in cost-saving and efficient forms of technology.

vi) The high interest rates spread are also attributed to government debt; therefore, it is imperative for the government to progressively reduce its debt burden especially on issuance of Treasury Bills to pay up maturing debt. This means that the government must strive to balance its budget by spending cautiously while trying to revamp tax administrative structures to enhance revenue collection.

vii) **Best practice: -** In an effort to enhance the ability of consumers to compare interest rates charges and to discourage unfair lending practices, USA congress enacted the **Truth in lending Act in 1968.** This Act does not set interest rate limits; rather, it requires creditors to provide clear and consistent information about loan terms so that borrowers can easily "shop" for the best price and avoid charges that are out of line.

Committee resolutions

The Committee recommended for a comparative analysis in the countries with low interest rates in lending i.e. Dubai and Australia. This will guide the Committee in making its decision.

MIN.NO. DCF/003/2016: ANY OTHER BUSINESS

Under this agenda item the following issues were raised:

1. The Committee deliberated on the challenges facing the banking institutions in the country specifically the Imperial Bank Limited and resolved to invite the Central Bank of Kenya Governor for a meeting to appraise it on the status of the said Bank on 9th February, 2016.
2. The Chairperson informed Members that Mr. Evans Oanda had lost his father in-law and the burial arrangements were on going with the friends and relatives scheduled to hold a

meeting on Tuesday 2nd February, 2016 at Professional Centre. Members were urged to support him during this time of bereavement.

MIN.NO. DCF/004 /2016: ADJOURNMENT

The Chairperson adjourned the meeting at 2.00pm

Signed...**date**...........8-03-2016..........

Chairperson

MINUTES OF THE 9TH SITTING OF THE DEPARTMENTAL COMMITTEE ON FINANCE, PLANNING & TRADE HELD ON TUESDAY 16TH FEBRUARY, 2016 IN COMMITTEE ROOM, 2ND FLOOR CONTINENTAL HOUSE, PARLIARMENT BUILDINGS AT 10:00AM.

PRESENT

1. Hon. Nelson Gaichuhie, MP — **Vice-Chairperson**
2. Hon. Jimmy Nuru Angwenyi, MP
3. Hon. Shakeel Shabbir, MP
4. Hon. Timothy Bosire, MP
5. Hon. Ogendo Rose Nyamunga, MP
6. Hon. Jones Mlolwa, MP
7. Hon. Lati Lelelit, MP
8. Hon. Daniel Epuyo Nanok, MP
9. Hon. Kirwa Stephen Bitok, MP
10. Hon. Mary Emase, MP
11. Hon. Patrick Makau, MP
12. Hon. Tiras Ngahu, MP
13. Hon. Iringo Cyprian Kubai, MP
14. Hon. Sakwa John Bunyasi, MP

ABSENT WITH APOLOGIES

1. Hon. Benjamin Langat, MP — **Chairperson**
2. Hon. Dr. Oburu Oginga, MP
3. Hon. Alfred Sambu, MP
4. Hon. Eng. Shadrack Manga, MP
5. Hon. Abdullswamad Shariff, MP
6. Hon. Anyanga Andrew Toboso, MP
7. Hon. Joseph Limo, MP
8. Hon. Joash Olum, MP
9. Hon. Sumra Irshadali, MP
10. Hon. Sakaja Johnson, MP
11. Hon. Dennis Waweru, MP
12. Hon. Sammy Koech, MP
13. Hon. Sammy Mwaita, MP
14. Hon. Abdul Rahim Dawood ,MP
15. Hon. Ronald Tonui, MP

IN ATTENDANCE
CENTRAL BANK OF KENYA

Dr. Patrick Njoroge	-	Governor
Mr. Chris Gaazo	-	PA to Governor
Mr. Samson Burgei	-	Head of Communication & PR
Mr. Isaya Maana	-	MPC Secretariat
Mr. Matu Mugo	-	Assistant Director Bank Supervision

Ms. Neala Wanjala	-	Manager Legal Services
Mr. Mohamud Ahmed	-	Ag. CEO

NATIONAL ASSEMBLY

1. Mr. Evans Oanda	-	First Clerk Assistant
2. Mr. Fredrick Otieno	-	Third Clerk Assistant
3. Mr. Nicodemus Maluki	-	Third Clerk Assistant
4. Ms. Sharon Rotino	-	Research Officer
5. Mr. Eric Ososi	-	Research Officer

MIN.NO. DCF/035/2016: PRELIMINARIES

The Vice Chairperson called the meeting to order at 10:37am and said a word of prayer. He then welcomed the CBK Governor and his team to the meeting and requested everyone to do self introduction.

MIN.NO. DCF/036/2016: MEETING WITH THE GOVERNOR, CBK

The Governor, of the Central Bank of Kenya, Dr. Patrick Njoroge appeared before the Committee and submitted the following:-

1. The Kenyan Banking Sector remains sound and resilient.
2. In August 14th 2015, the Dubai Bank was placed under receivership. The Central Bank of Kenya appointed Kenya Deposit Insurance Corporation (KDIC) as a receiver of the Bank for a period of twelve months.
3. The Dubai Bank was experiencing serious liquidity and capital deficiencies hence unable to meet its financial obligations as and when they fall due.
4. The CBK is encouraging banks to strengthen their own operations by stepping up their practices, improved business models to support interest rates and be resilient.
5. The CBK has been encouraging the banks to strengthen their governance and also to reduce cost.

Imperial Bank Limited

- On 12th October 2015, the CBK was informed that the Imperial Bank Limited was involved in inappropriate business practices which prompted appointment of KDIC on 13th October, 2015 to assume the management and control of the bank for a period of twelve months.
- The CBK undertook investigations on the matter and found that the loans were being suppressed. There was a total of Khs 39 billion off balance sheet loan.
- The bank's lending never followed appropriate business practices.
- The bank was completely under water and had no enough deposits.
- The CBK got an acceptance of plan to pay depositors of Imperial bank by the shareholders of the Bank.

- The KDIC with the endorsement of CBK got into partnership with the KCB and DTB to pay Imperial Bank Limited depositors. The two banks accepted to use their resources and networks in their branches to pay the depositors.
- A total of 44,376 with Kshs. 1M and below were fully paid their deposits and approximately 4,942 with over Kshs. 2M were paid kshs. 1M.
- The investigations are still on going. Anybody found culpable will be dealt with according to the law.

MIN.NO. DCF/037 /2016: MEMBERS CONCERNS

Members raised the following concerns:

A. The source of the imperial Bank crisis (whether it was related to weak systems of or managerial improprieties)
B. Whether CMA was aware of the happenings within imperial bank especially. CMA had just approved issuance of bonds by Imperial Bank
C. Whether the CBK's website was working currently considering that the advertisements for jobs were done online but were mostly not accessible
D. Whether the CBK approves auditors of commercial banks
E. Why CBK doesn't publish the institutions that it has penalized in the past for various offences, as is the case in other jurisdictions such as the USA.

Governor's responses:-

A. The Problems in Imperial Bank arose as a result of manipulation of IT systems. It is possible that the staff of the CBK working in the supervision department may have concluded with the Imperial Bank managers to conceal the malpractices in the Imperial Bank. This can only be exposed through investigations. Anybody found culpable will be dealt with according to law.
B. To CBK has embarked on a process of capacity building of its staff both locally and internationally with a view to regulating commercial banks professionally and objectively.
C. The CBK approves all auditors of Commercial Banks. It is however sad the auditors of imperial bank did not properly audit the IT systems of bank. Going forward, emphasis will be placed on auditing of IT systems as a bare minimum in the audit.
D. When the CMA was approving issuance of Bonds by Imperial Bank, it (CMA) was not aware of the manipulations of the balance that had been done. CMA was made aware of the same in the evening of 12th October 2015. It was on the basis this that the CMA deferred trading of the Bonds that was meant to start on 13th October, 2015.
E. The Governor admitted that the CBK website had been having challenges in the recent past but assured the Committee that matter was being addressed and the Process of recruitment of staff wiii not in any way be negatively affected.

F. The Institution will impose enforcement action and more information will be provided to the lenders, depositors and investors.

MIN.NO. DCF/038 /2016: BANKING (AMENDMENT) BILL, 2015 BY HON. JUDE JOMO

On the banking amendment Bill, 2015 that is currently before the Committee, the Governor opposed its enactment on the following grounds:-

- It will lead to credit crunch – discourage supply of funds to the financial systems, SMEs, and the poor
- It will discourage innovations
- It will lead to concentration of credit on low risky ventures such us TBs
- It will regress the economy
- Banks may introduce additional fees to customers to cover for the reduced interest that they could have forgone
- It will lead to reduced profitability of Micro finance institutions

MIN.NO. DCF/039 /2016: ANY OTHER BUSINESS

There being no other business, the meeting adjourned at 12:15pm.

Signed..**date** 8-03-2016...

Chairperson

MINUTES OF THE 24TH SITTING OF THE DEPARTMENTAL COMMITTEE ON FINANCE, PLANNING & TRADE HELD ON THURSDAY 14TH APRIL, 2016 IN COMMITTEE ROOM, 5TH FLOOR CONTINENTAL HOUSE, PARLIARMENT BUILDINGS AT 10:00AM.

PRESENT

1. Hon. Benjamin Langat, MP - **Chairperson**
2. Hon. Dr. Oburu Oginga, MP
3. Hon. Anyanga Andrew Toboso, MP
4. Hon. Mary Emase, MP
5. Hon. Sammy Mwaita, MP
6. Hon. Ogendo Rose Nyamunga, MP
7. Hon. Daniel Epuyo Nanok, MP
8. Hon. Kirwa Stephen Bitok, MP
9. Hon. Sammy Koech, MP
10. Hon. Jones Mlolwa, MP
11. Hon. Abdul Rahim Dawood ,MP
12. Hon. Ronald Tonui, MP
13. Hon. Timothy Bosire, MP
14. Hon. Eng. Shadrack Manga, MP
15. Hon. Patrick Makau, MP
16. Hon. Sakwa John Bunyasi, MP

ABSENT WITH APOLOGIES

1. Hon. Nelson Gaichuhie, MP - **Vice-Chairperson**
2. Hon. Jimmy Nuru Angwenyi, MP
3. Hon. Shakeel Shabbir, MP
4. Hon. Alfred Sambu, MP
5. Hon. Abdullswamad Shariff, MP
6. Hon. Sakaja Johnson, MP
7. Hon. Dennis Waweru, MP
8. Hon. Iringo Cyprian Kubai, MP
9. Hon. Joash Olum, MP
10. Hon. Sumra Irshadali, MP
11. Hon. Lati Lelelit, MP
12. Hon. Tiras Ngahu, MP
13. Hon. Joseph Limo, MP

IN ATTENDANCE
NATIONAL ASSEMBLY

1. Mr. Evans Oanda - First Clerk Assistant
2. Mr. Fredrick Otieno - Third Clerk Assistant
3. Mr. Erick Ososi - Research Officer

MIN.NO. DCF/096/2016: PRELIMINARIES

The Chairperson called the meeting to order at 10:35am followed by a word of prayer from Hon. Sakwa John Bunyasi, MP.

MIN.NO. DCF/097/2016: Consideration and adoption of the report on the public petition by residents of sigowet/soin constituency on privatization of Muhoroni Sugar Company limited (in receivership)

After some discussions, this matter was deferred to a later.

MIN.NO. DCF/098/2016: Consideration and adoption of the report on the public petition by the Consumer Federation of Kenya (cofek) on operationalization of section 94 of the Consumer Protection Act, 2012 and amendment of section 16(3) of the Finance Act, 2013

The Committee considered and unanimously adopted the draft report.

MIN.NO. DCF/099/2016: consideration and adoption of the report on the Banking (Amendment) Bill, 2015

The Committee considered and unanimously adopted the report on the Banking (Amendment) Bill, 2015

MIN.NO. DCF/100/2016: consideration and adoption of the report on the Controller of Budget Bill, 2015

The Committee considered and unanimously adopted the report on Controller of Budget Bill, 2015. It was agreed that the amendments to the bill would be discussed at a later date.

MIN.NO. DCF/101/2016: Challenges facing the Banking Sector

The Committee considered the Memo from the Directorate of L& P conveying the resolution of the House requesting the Committee to investigate the matter. In the Memo, the Committee was required to investigate the matter under the following terms of reference:-

1. Role of the CBK as a regulator in the Financial Sector;
2. Legal framework governing the financial sector
3. Governance issues in CBK of Kenya Prior to June, 2015
4. Role of auditors in auditing financial institutions
5. Any other issue incidental to the inquiry

The Committee resolved to invite the Parliamentary Budget Office and the Legal Department to its meeting scheduled for Tuesday 19th April, 2016to brief it on the above matter.

MIN.NO. DCF/102/2016: ANY OTHER BUSINESS

There being no other business, the meeting was adjourned at 1:55pm.

Signed.. **Date**. 19-04-2016 ....

Chairperson

DEPARTMENTAL COMMITTEE ON FINANCE, PLANNING & TRADE

MEMBERS ATTENDANCE REGISTER

DATE	14/04/2016	**TIME**	10.00 AM
AGENDA	CONSIDERATION AND ADOPTION OF REPORTS ON PETITION AND BILLS		

	NAME	TITLE	SIGNATURE
1	Hon. Benjamin Langat	Chairman	
2			
3	Hon. [illegible] Bosire	Member	
4	Hon. [illegible] Ogingo	"	
5	[illegible]	"	
6	[illegible]	"	
7	[illegible]	"	
8	Hon. Jones Mlolwa	"	
9	Hon. Eng. S.R Manga	"	
10	Hon. Patrick Makau	"	
11	Hon. Anyanga Andrew Toboso	"	
12	Hon. Daniel Epuyo Nanok	"	
13	Hon. Mary Emaase	"	
14	[illegible]	"	
15	HON RONALD TONUI	"	
16	Hon Rose Nyamunga	"	
17	Hon. Sammy Mwaita	"	
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