Banking on lower cost of loans? Don’t hold your breath for too long

Njeri searched extensively around Nairobi looking to buy a flat. Following years of renting and dealing with all kinds of unscrupulous landlords, she finally desired to become a home owner and be her own landlord.

Njeri finally settled on a pleasant two-bedroom apartment off Kiambu Road in a new development. The next step for Njeri; pick a mortgage bank. She first looked at each prospective bank’s website and then followed up with phone calls and branch visits. Njeri settled on a bank with the lowest interest rate.

Pleased with her bank options, she applied for the mortgage, signed the sale agreement with the seller, and made a 20 per cent deposit. Njeri excitedly began to pick out furniture and curtains to put in her new flat. As time progressed, she became worried about how long it took the bank to actually approve her mortgage and provide her with the all-important offer letter.

She felt shocked when she finally received the offer letter and discovered multiple upfront fees that dramatically distorted the cost of borrowing. Given the sale agreement’s time had almost expired, Njeri had to unexpectedly sell her car in order to proceed with the transaction stuck with the unscrupulous bank’s offer.

Her predicament gets repeated over and over again throughout Kenya every week. Lately, Njeri and other distraught borrowers fill the airwaves with their experiences. Inasmuch, Business Talk readers requested analysis on interest rate regulations. So, Business Talk diverges this week and next from its organisation development series to address government standardisation issues.

As Kenyans we know that the Central Bank of Kenya (CBK) and Kenya Bankers Association (KBA) both agreed to standardise the way banks report their fees through one overall annual percent yield figure so prospective borrowers may compare different offers more easily. However, since Kenya birthed the genesis of inclusive access to financial services in Africa and given its high level of sophistication in our financial sector compared to the rest of continent, why did it take us so long to incorporate such a simple pro-consumer measure?

While we hold the most liquid securities exchange, most well-capitalised banks, and most technological payment systems in the region, Kenya’s financial structure does not rely on transparency as rule of thumb. Western countries have reported bank interest and fees in standard ways for decades.

In Uganda, it was the private industry association, the Association of Microfinance Institutions in Uganda, and not the government or central bank that decided to follow rudimentary transparency measures a decade ago and regularly publish in newspapers all institutions’ comparison interest rates and fees.

Even Zambia, whose financial sector lags Kenya’s sophistication, has posted comparisons of all institutional annual percentage yields in newspapers with side-by-side comparisons for years. Why did the powerful KBA and the Association of Microfinance Institutions not self-regulate and instead wait for government pressure?

Such selfish industry actions have led many Kenyans towards cynicism and strongly advocate for even stricter government measures to crack down on the sector.

Thankfully, the CBK announced a common base borrowing rate that all banks must quote their prices. In the US, the Americans utilise the “Federal Funds Rate” which banks may borrow from that country’s central bank.

Getting a variable loan in America, a borrower would know that their loan pricing would stand at the cost of funds federal rate, currently at 0.25 per cent, plus the risk premium, perhaps at three per cent depending on the borrower. So, consumers always know what to expect.

Further, international banks also utilise the infamous LIBOR, London InterBank Offered Rate, which currently totals 0.23 per cent for three months. In contrast, CBK’s Central Bank Rate stands at 8.50 per cent. Requiring all banks to quote prices based on a common figure may disadvantage banks that receive funds and investment from outside the country, but it still moves us a giant step forward towards the greater pro-consumer transparency that Kenyans crave.

However, consumer advocates and some government officials clamour for additional banking regulation in the form of interest rate caps. Some propose the limit for bank interest charges at 9.9 per cent, others say 14 per cent.

What do you think? Would you appreciate a lower interest rate on your loans? Obviously we all want lower interest rates. But, could such an arrangement actually work?

The Chairwoman of the Association of Microfinance Professionals of Kenya, Pauline Ndirangu, states that interest rate caps may be necessary, but only for the medium term of five years or less, to force culture change and compel the industry to become more efficient and creative in how it services clients.

Kenyan entertainer Edwin Ngootho humorously proclaims that CBK “interest rate caps are a shyster’s dream come true”. The joke seems to allude to credit rationing that other nations have experienced when any restriction on interest rates by regulatory bodies gets implemented.

When banks stop lending to average citizens, dangerous loan sharks and gangs come in and fill the void. Kiva.org’s Africa Regional Representative, David Kitusa, asserts that while Kiva’s Zip product provides Kenyans with 0 per cent interest loans, he does not support interest rate caps.

He fears that limits to interest rate charges would cause banks to focus lending primarily on middle and higher income borrowers and neglect poorer and rural citizens that cost more money per shilling amount to approve and monitor.

Further, economists ponder whether banks would even lend money at all as long as Treasury Bill rates remain high fluctuating around 9 per cent.

Any cap not measurably higher than 9 per cent that does not take into account Kenyan borrowers’ poor repayment rates and subsequent bank losses would lead banks to simply invest client savings into government Treasury bills instead of onward lending to clients directly.

Similarly, banks would advocate for an improvement in the efficiency of Kenya’s judicial system in order to collect bad debts faster before any forced interest rate takes effect.

Where do you stand? Would you rather have fewer loan options available, but have those options at drastically lower interest rates? Would you fear the crowding out of non-prime borrowers?

Have you experienced any bank loan horror stories? Want to impart bank advice to fellow Business Daily readers? Share your experiences at #KenyaBankDisaster on Twitter.

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