



THE CONSTITUTION OF KENYA

REFUSAL TO ASSENT TO THE FINANCE BILL, 2019

MEMORANDUM

By His Excellency the Honourable Uhuru
Kenyatta, President and Commander-in-Chief
of the Kenya Defence Forces.

Submitted to the Speaker of the National
Assembly.

WHEREAS a Bill entitled “A Bill for An Act of
Parliament to amend the law relating to various taxes and
duties and for matters incidental thereto”, the short title of
which is “The Finance Bill, 2019”, was passed by the
National Assembly on the 26th September, 2019;

AND WHEREAS the Finance Bill, 2019, was presented to
me for assent, in accordance with the provisions of the
Constitution, on the 7th of October, 2019;

NOW THEREFORE, in exercise of the powers conferred
on me by Article 115 of the Constitution, I refuse to assent
to the Finance Bill, 2019 for the reasons set out hereunder:



CLAUSE 45:

The capping of interest rates was introduced on the 14th of September, 2016, through section 33B of the Banking Act (Cap.488) which capped the interest rates chargeable by banks at a rate not more than 4% of the base rate set and published by the Central Bank of Kenya. The purpose of the capping was to address the wide concerns about affordability and availability of credit especially to the common *mwanaanchi*. There was also a perception of the insensitivity of banks to customer needs. However, it is apparent that the capping of interest rates has caused unintended effects that are significant and damaging to our economy and in particular, the Micro, Small and Medium Enterprises (MSMEs) which are the hardest hit.

Over the last three years, the Government and the banking sector have initiated programmes and measures to deal with the concerns of affordability and availability of credit from banks and at the same time strengthen the vulnerable sectors especially the MSMEs, Women and Youth. While noting that significant progress has been made, these programmes and measures are yet to achieve the desired results due to the



negative effects caused by the capping of interest rates. It was this that prompted the proposal under Clause 43 of the initial Bill to repeal section 33B of the Banking Act. However, their re-introduction through Clause 45 of the Bill as passed by Parliament, will not only reverse the gains so far made but also exacerbate the unintended effects alluded to, which include the following:

1. The reduction of credit to the private sector, particularly Micro, Small and Medium Enterprises (MSMEs):

Most commercial banks adjusted their lending business models towards large corporates and the public sector and away from small-scale borrowers and individuals. As a result, credit to segments such as MSMEs, that are perceived as risky, declined after imposition of the controls. Recent studies indicate a decline of credit to MSMEs by 10% in the first year following the introduction of interest rate capping.



2. The decline in economic growth:

A study by the Central Bank of Kenya (CBK) showed that rationing out MSMEs from the credit market by commercial banks is estimated to have lowered the country's economic growth by 0.4 percentage points in 2017 and by a further 0.2 percentage points in 2018.

3. The weakening of the effectiveness of monetary policy, with evidence of perverse outcomes making CBK less effective in dealing with economic shocks and delivering on its mandate:

A recent analysis by CBK of the impact of interest rate capping showed a slowdown in monetary policy transmission to inflation and growth. The results show that monetary policy transmission to growth and inflation takes 3-12 months and 12-20 months, respectively, which is 3-5 months longer compared to the period before the introduction of interest rate capping. In addition, the analysis showed evidence of perverse outcomes following a monetary policy action,



particularly a reduction in loan advances by some banks after a lowering of the Central Bank Rate (CBR).

4. The reduction of loan advances by banks:

Studies indicate that the lending activity of smaller banks reduced with outstanding stock of credit declining by about 5 percent in the 12 months ending September 2017. Small banks have been disproportionately hit by capping due to their different business model of relying more on higher-risk/higher-return borrowers such as MSMEs.

5. The mushrooming of shylocks and other unregulated lenders in the financial sector:

Shylocks and other unregulated lenders have taken advantage of the effects of capping to lend to desperate citizens at exorbitant rates in a predatory manner compounding the already existing problem of lack of access to affordable credit facilities due to prohibitive costs.



6. In addition to the above, other effects being experienced in the banking sector include:
- (a) the withdrawal of banks' lending to specific segments of the market;
 - (b) the increase in average loan size, reflecting lower access by small borrowers and larger loans to more established firms; and
 - (c) the decreased diversity of loan products.
7. As stated earlier, and since September 2016, the Government and banks have initiated and implemented programmes and measures aimed at supporting greater access to credit at affordable terms by the vulnerable sectors. During the last three years, the Government has scaled up its interventions, particularly through the Women and Youth Funds, to meet the credit needs of these critical segments of the Kenyan economy. The Government is also working with development partners who appreciate the shortcomings associated with the capping of the interest rates and are willing to support the Government in enhancing the targeted programmes.



8. Banks have also been addressing the underlying concerns by reviewing their business models to be more customer-centric adhering to the Kenya Banking Sector Charter issued by CBK in February, 2019. The Charter seeks to promote a banking sector that is responsible and responsive to the needs of Kenyans. The Charter is anchored on the pillars of customer centricity, risk based pricing, transparency and ethics. Further, the banks have introduced new innovative products targeting MSMEs. These products leverage on innovative technology including mobile phone platforms to provide affordable credit to critical segments of the economy particularly MSMEs, Women and Youth. The products, which are in their nascent stages, have great potential to promote affordability and availability of credit particularly to MSMEs. Among the new products that target MSMEs include Stawi (Consortium of 5 banks), M-Jeki (Stanbic Bank), and Dare to Aspire, Dare to Achieve (DADA) (Stanbic Bank), targeting women, and KCB 2JIAJIRI, targeting the youth. Other banks, especially Citibank, Co-operative Bank and Equity Bank have also launched products targeting the financing of agricultural value chains including barley, coffee, dairy and wheat



sectors. KCB has launched the Jaza Duka partnership with Unilever and Mastercard to provide working capital to shopkeepers and small retailers. It should be noted that the success of the interventions by the Government and banks mentioned above, depends on the capacity to scale them up. This capacity, however, continues to be curtailed by the existing interest rate capping.

CONCLUSION

In conclusion, the capping of interest rates has not addressed the intended objective particularly in expanding credit access. The Government remains committed to addressing the underlying concerns that led to the capping. As mentioned above, the recently introduced programmes and measures will mitigate underlying concerns about affordability and availability of credit more effectively in an environment without the capping of interest rates.

RECOMMENDATION:

For the foregoing reasons, I recommend that the Bill be amended by deleting Clause 45 and substituting therefor the following:



Repeal of
section 33B of
Cap. 488

45. The Banking Act is amended by repealing
section 33B.

Dated the th 16th of October, 2019.

A handwritten signature in dark ink, consisting of a large, stylized 'U' followed by a long horizontal line that loops around the text 'President'.

UHURU KENYATTA,
President