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Rural Finance Policy Development in Eastern and Southern African Countries: Contribution of IFAD-Supported Rural Finance Programmes

Annex 2. Country report for the Republic of Kenya

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Annex 2. Country report for the Republic of Kenya

September 2014

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Chapter 1

Background to the study

In the backdrop of IFAD's effort to improve livelihoods by enhancing access to financial services among rural communities, the Rural Finance Knowledge Management Partnership (KMP) carried out a study to find out how IFAD-supported rural finance programmes contribute to policy development in the Eastern and Southern African region. The focus of the study was on countries with active rural finance programmes and components—Ethiopia, Kenya, Lesotho, Mozambique, Swaziland, Tanzania, Uganda and Zambia—where IFAD has been increasingly engaged in policy dialogue with a view to influencing policy. The IFAD programme also seeks to influence policy to minimize adverse effects of global trends and maximize incentives and opportunities for the rural poor. Apart from challenges in the area of rural infrastructure, capacity of financial service providers and clients, other factors such as legislative, regulatory, supervisory and overall policy constraints often stand in the way of delivery of need-based financial services in the rural area. IFAD has been supporting capacity building of policy-making bodies, development of appropriate decentralized policy and practices, evolving market-oriented research/studies and dissemination of learning.

Considering the critical importance of creating finance policies that are appropriate to rural settings, KMP proposed to undertake a region-wide *Study of Rural Finance Policy Development in the Eastern and Southern African (ESA) Countries—Contribution of IFAD-Supported Rural Finance Programmes,* and to determine the way forward to addressing the key constraint—insufficient skills in information technology and insufficient exposure to skills required for good information management—mentioned above. The study covered all the eight ESA countries where IFAD had been active. For the study, KMP identified a consultant, Biswa Bandhu Mohanty, on account of his expertise and wide experience in rural finance.

1.1 Purpose of the study

The study was undertaken with the following overall objective: To produce a KM document for use by the stakeholders of RF programmes being implemented by IFAD in the 8 selected ESA countries. The specific objectives of the study were to:

- Identify major policy issues in ESA countries which IFAD projects have enabled to sort out/address during the course of implementation in the countries;
- Bring out successful strategies adopted/institutional mechanism used to influence policy issues, leading to fulfilment of programme objectives;
- List out country-specific policy issues in ESA, which have regional and global implications/impact;

- Suggest sustainable institutional mechanisms that have to be put in place for policy exploration, research, debates and discussions for sharpening and furthering poverty reduction, access to financial inclusion, livelihood promotion and inclusive growth; and
- Suggest ways and means for enhancing knowledge management, sharing of experience/best policy solutions among the IFAD programme managers, partners and stakeholders for better programme implementation and speedier/effective policy development.

1.2 Target organizations for the study

In the 8 selected countries (Ethiopia, Kenya, Lesotho, Mozambique, Swaziland, Tanzania, Uganda and Zambia) the study targeted public and private institutions that have national responsibility for, as well as commercial interests in, rural development. They included Central Banks; Insurance Regulatory Authorities; Co-operative Regulatory Authorities; Ministries of the National Governments including Ministry of Finance (MOF), Ministry of Agriculture/Cooperatives (MOA); MF Associations, Co-operative Unions/Alliances; Apex Development Banks; Policy Research Agencies; and leading Civic Society Organizations (NGOs, CBO, etc).

1.3 Data collection methods and tools

Three main methods or tools were used in gathering data. (i) A questionnaire was designed to solicit views/inputs from the concerned IFAD officers at the project level in all eight countries targeted for the study. The questionnaire used a guide for data collection is given in Appendix 2.1. (ii) Interviews and consultations were used through face-to-face meetings and by e-communication. The consultant visited the capital cities of five of the target countries from 23 June to 9 July 2014; they, included Lusaka (Zambia), Dar es Salaam (Tanzania), Kampala (Uganda), Addis Ababa (Ethiopia) and Nairobi (Kenya). The visits facilitated interviews and discussions with officials of the institutions targeted in those countries. During the short period of 2-3 days at each centre, 84 persons from these select institutions were consulted. The list of institutions visited and persons met and consulted through face-to-face interviews in Kenya is given in Appendix 2.2. (iii) Intensive literature survey was used to collect information at country/institutional as well as regional and global levels. Documents spelling out regional, national and institutional RF policies, strategies and programmes were studied. In the case of Kenya the list of documents consulted is given in Appendix 2.3.

1.4 About this report

This report focuses on the study findings with respect to RF development efforts, the contributions of IFAD RF programmes and the emerging policy issues and challenges and recommendations for addressing them for furtherance of rural finance policy in Kenya. Although presented as a standalone report, it is intended that this report be read alongside the main study report which addresses RF issues that prevail regionally and globally.

It is also envisioned that the reader will seek to benefit from the following Case Study Reports attached to the main report as appendices: MFI Supervision

Directorate (MFSD) of the National Bank of Ethiopia (Appendix 7), Association of Ethiopian MFIs (AEMFI) (Appendix 8), Micro Finance Forum in Uganda (Appendix 9) and Developing Rural Finance Policy and Strategy in Zambia (Appendix 10). For the sake of comparison and regional learning, the reader should also seek to benefit from *Country Reports* for other ESA countries which constitute an important output of this study. The full list Country Reports includes Federal Republic of Ethiopia (Annex 1), Republic of Kenya (Annex 2), Kingdom of Lesotho (Annex 3), Republic of Mozambique (Annex 4), Kingdom of Swaziland (Annex 5), United Republic of Tanzania (Annex 6), Republic of Uganda (Annex 7), and Republic of Zambia (Annex 8).

Chapter 2

Study findings

2.1 Rural finance policy initiatives and positive developments

2.1.1 Socio-economic environment

HUMAN DEVELOPMENT SCENARIO

Agriculture is the backbone of the economy and the principal source of livelihood of Kenya's rural populations. Agriculture and agro-related activities account for more than 50% of GDP, generating employment for about 70% of the population. Kenya ranks 145th among 187 countries in HDI (UNDP, 2011), which measures development in terms of life expectancy, educational attainment and standards of living. Kenya has one of the World's highest rates of population growth. Nearly half of the country's 43 million people live below the poverty line. More than three-quarters of the population live in rural areas. Rural poverty in Kenya is linked to environment concerns which include poor soil management, soil erosion, etc. The country's prospects for long term economic growth are very favourable. However, poverty remains the major challenge.

KENYA VISION 2030

All developmental efforts are guided by the "Kenya Vision-2030", launched in 2008, which is a national long term development blueprint whose main aims are to create a globally competitive and prosperous nation with a high quality of life and to transform Kenya into a newly industrializing middle income country providing a high quality of life to all citizens in a clean and secured environment by 2030. The vision is anchored on 3 key pillars: economic, social and political governance.

FINANCIAL SECTOR SCENARIO

The expanding access to Financial Services has been measured by Financial Access Survey (Fin Access) in 2006, 2009 and 2013.Fin Access Survey 2013 reveals the following:

- Access to formal financial services has increased significantly with 32.7% of the adult population accessing financial services from the formal prudentially regulated financial institutions;
- 66.7% of the adults accessed financial services from any type of formal financial service providers;
- The proportion of the financially excluded dropped from 39.3% in 2006 to 25.4% of the adult population in 2013; and
- The proportion of the population using financial services had declined to 7.8% from 33.3% in 2006.

The Survey results are the outcomes of the developments in the wider economy, policy and regulatory reforms, increased competition and innovations and advances in the information and communication technology (ICT) including the expansion of mobile financial services in the country.

2.1.2 Legal and regulatory initiatives

SACCOs Society Act 2008 and its attendant Regulations 2010

The SACCOs Society Act 2008 and its attendant Regulations 2010 enshrine risk-oriented provisions that spell out the minimum operational regulations and prudential standards required of deposit-taking SACCO Societies to ensure financial stability of the SACCOs subsector. In 2012, SACCO Societies Regulatory Authority (SASRA) launched a Risk-Based Supervision (RBS) framework to guide the supervision of SACCO Societies. The RBS project was supported by the Government of Kenya and World Bank under the Financial and Legal Sector Technical Assistance Programme (FSLSTAP).

Credit information sharing (CIS) initiative

The credit information sharing (CIS) initiative was rolled out in July 2010 and the revised Credit Reference Bureau Regulations were brought out in 2013. Both the Banking Act and Micro Finance Act were amended in 2013 to allow the institutions licensed under the two Acts to share both positive *and negative* information with the Credit Reference Bureaus. The Banking Act permitted the Central Bank of Kenya (CBK), Deposit Protection Fund Board (DPFB) and the institutions licensed under the Banking Act and the MF Act to share credit information. The Association of Kenya Credit Providers (AKCP) which brings together different credit providers less than one umbrella body had been launched.

Amendments to Finance Act 2013

The following key amendments were made to the Finance Act 2013:

- Recognition of deposits held by Kenyan banks incorporated abroad as branches of the parent bank in Kenya;
- Enhancement of monetary penalty against institutions violating Banking Act; and
- Empowerment of the CBK to make regulations for carrying out the provisions of the Banking Act.

Amendments to MF Act 2013

Broad amendments made to the MF Act in 2013 were as under:

- It renamed the Deposit-Taking Microfinance (DTM) institutions as Micro Finance Banks (MFBs) to be licensed/governed under the MF Act and not the Banking Act;
- It permitted MFBs were permitted to engage agents (which could contract sub-agents) which could provide limited Micro Finance Banks' services on behalf of the institutions;
- It facilitated CBK to issue Prompt Corrective Action (PCA) measures;

- It mandated external auditors to draw the attention of the CBK to any area of concern as noticed during audit for appropriate supervisory intervention; and
- It allowed MFBs to issue third party guarantee, open current accounts and engage in foreign trade operations, thus facilitating their participation in the national payment system.

KENYA DEPOSIT INSURANCE ACT 2012

The Kenya Deposit Insurance Act 2012, establishing Kenya Deposit Insurance Corporation and setting up of Deposit Insurance Fund, was enacted. This paved the way for a deposit insurance system covering financial institutions, mortgage finance companies and MFBs and insuring their customers' deposits up to Kshs. 100,000.

2.1.3 Financial inclusion initiatives

LEGAL INITIATIVES ON LAND ACQUISITION AND SUSTAINABLE USE OF NATURAL RESOURCES

The Government of Kenya introduced several legislative and policy reforms having bearing on rural finance. The Government's initiatives for sustainable use of natural resource management are noteworthy. They include:

- The Land Act, 2012 mandated the National Land Commission to recommend policies on land acquisition for public purposes.
- The Agriculture Live stock, Fisheries and Food Security (ALFA) Act, an authority was established to oversee operation of the Agriculture Sector including licensing law enforcement and registration of farmers.
- Others included agriculture sector development strategy, bringing on board legal provisions such as – (i) the Act 2012 in agro forestry envisaging 10% of all agricultural land to be planted with trees, (ii) the Water Act aiming at water resource management through community participation, and (iii) the Forest Act providing for long term protection and conservation of farm resources.
- In addition, and in view of ongoing draughts, the Government introduced new legislative and policy reforms to coordinate ecosystem management, sustainable use of natural resources, etc in partnership with other developmental agencies.

EXPANDING INSTITUTIONAL ARCHITECTURE IN FINANCIAL SECTOR

Central Bank of Kenya (CBK), Insurance Regulatory Authority (IRA), Financial Sector Deepening Trust (FSDT), Kenya Institute for Public Policy Research and Analysis (KIPPRA), Development Alternative International (DAI), Kenya Bankers' Association (KBA), Association of MFIs (AMFI),Capital Market Authority (CMA), Retirement Benefits Authority (RBA), SACCOS Societies Regulatory Authority (SASRA), National Government of Kenya and donor agencies like World Bank ,IFAD, etc have been important players in the policy development in rural finance. The banks (43 Commercial Banks), MFBs (9 licensed), SACCOS (124 licensed out of 215 DTS), Mortgage banks, pension/insurance agencies and DFIs are major policy-making authorities/purveyors of financial services. The amendments to the Finance/Banking/MF Act allowed use of Agent Network Managers (ANM) or Agent Network Management Companies (ANMC) also known as aggregators, which helped in monitoring operation of agents, capacity-building of agents, besides providing critical information to the concerned financial institutions and deepening financial inclusion. As on 31 December 2013, 13 banks conducted agency banking and there were 23,477 approved agents .The diversity in delivery channels infrastructure including technology was one of the major contributory factors for expansion and deepening of financial inclusion.

Diversified financial services and capacity building for MFBs

The Central Bank's Banking Supervision Department has the responsibility in the development of policy and regulatory and supervision framework and undertaking offsite and onsite supervision of the licensed banks, CRBs, MFBs and Forex Business. The major initiatives in this regard include the following-

- Revising prudential guidelines under the Banking Act to enhance financial inclusion;
- Enhancing mobile banking policy and regulatory frame -work to address the challenges of growing mobile banking;
- Facilitating amendment of the MF Act 2006 through MF [amendment] Bill 2013 to increase the range of financial services through MFBs for enhancing financial inclusion;
- Conducting financial inclusion data gap analysis to assess the existing data sets and bring out the level and trends in financial inclusion;
- Enforcing Basle III supervisory framework for banks and accordingly carrying forward risk-based supervision of the financial institutions; and
- Participating in Kenya Financial Regulators' Forum comprising CBK, RBA, CBA, IRA and SASRA.

Thus, the initiatives of the Central Bank of Kenya in terms of formulating and operationalizing various regulations/prudential guidelines, bringing increasing convergence of banks and mobile platforms, financial education initiatives, policy dialogues in the global, national and regional fora with focus on financial inclusion, etc were witnessed.

Initiatives in micro insurance

Insurance Regulatory Authority [IRA] in Kenya was set up in 2002 for focused and exclusive regulation and supervision of insurance sector in the country, under the provisions of the Insurance Act 1986. Initiatives had been taken to review/revise the Insurance Act in 2014. However, no separate definition, policy, regulatory framework or Proclamation existed for micro insurance sub-sector, as sporadic micro insurance products were backed by miscellaneous provisions of the Act. The IRA had taken initiative to draft a Micro Insurance Policy framework in 2012. The IRA had commissioned a diagnostic study, with the support of ILO, UNCDF and FSDK to identify opportunities, challenges and scope of micro insurance market in Kenya in 2010. The study report described the landscape of micro insurance and brought out the issues and strategies from demand, supply and regulatory dimensions. The report and the proposed policy had focused on the need for micro insurance development by tapping uninsured population, addressing the anchor risks of health, funeral and agriculture, use of banking and emerging networks, enhancing consumer protection initiatives and education campaigns. The report concluded that developing micro insurance segment would be in tune with the national Financial Inclusion agenda, Vision 2030 and globally regional efforts for Access to Insurance Initiatives for access to financial services for the poor in rural areas.

Rural finance models

Various rural finance models had been evolved over time in the country giving different lessons; examples include the Community-owned RF model, PVT Commercial Banks-led models, Government-led RF, Credit-guarantee input-supply model and Beach Banking Model.

Market-oriented approach to agriculture and rural development

IFAD facilitated the introduction of market–oriented approach in agriculture and rural development, particularly in horticulture, diary production and rural finance. IFAD's initiatives include mobilizing resources for the Integrated Country Programme approach, recommending robust policy and institutional dimensions to increase impact, encouraging replication of the successful experience in the field, supporting access to technology, community-owned productive and social infrastructure and increasing access to financial services. IFAD's contributions to Rural Finance policy development are elaborated in the next Chapter.

2.2 Role and Contributions of IFAD's Rural Finance Programmes

2.2.1 Harmonizing / aligning RF with national sectoral development plans

The Government and other partner's value IFAD's participatory and bottom up approaches, its focus on small farmers, emphasis on community development and grassroots level institution building. IFAD had a comparative advantage at the country level. The COSOP 2013-18 drawn by IFAD enshrines the RF strategies and priorities, in alignment and harmony with the National Rural Poverty Reduction Strategy, as expressed in the Kenya Vision 2030 (Kenya Govt., Year??), National Policy for the Sustainable Development of Arid and Semi-arid Lands (Kenya Govt., 2007), Plan of Action (2008-12) for implementation of the National Policy on Gender and Development (Kenya Govt., 2008), Kenya's third National AIDS strategic Plan 2010-13 (Kenya Govt., 2009), Agricultural Sector Development Plan (ASDS) 2010-20 (Kenya Govt., Year?), Comprehensive Africa Agricultural Development Programme (CADP), 2010 and Kenya Joint Assistance Strategy (KJAS). For harmonization and alignment approach, 17 Sector Working Groups, Agriculture Sector Coordination Unit (ASCU), National Climate Change Steering Committee and UNDAF were formed and IFAD has been associated with these forums. Since 2000, IFAD had prepared 2 more COSOPs for Kenya in a consultative process.

2.2.2 Drawing and sharing lessons from Country Programme Evaluation

The Country Programme Evaluation (CPE) of IFAD projects in the country undertaken in 2011 (the first since 1979) found useful results in natural resources management and environmental conservation, community development and its introduction over time that favoured income generation and commercialization by small farmers as a means to rural poverty reduction. A number of innovations have been introduced through IFAD-supported projects and there are examples of scaling up. A variety of sub sector activities have been financed through IFAD-supported projects in Kenya, bringing in policy issues.

2.2.3 Support / facilitation through full-fledged Regional Office in Nairobi

IFAD placed the Country Programme Manager (CPM) and Associate CPM in Kenya, facilitating direct supervision and implementation support for all ongoing projects. Besides the pro-active Country Programme Management Team, it established its first regional office (RO) in Nairobi for ESA counties initially headed by Portfolio Adviser and then upgraded to fully-fledged RO in 2011. The Country Office has enabled better appreciation of the country context and developing greater communication and dialogues with various partners. The RO has facilitated greater technical cooperation and exchange in the region, with Nairobi as epicentre.

2.2.4 Promoting KM with Nairobi as epicentre

IFAD supported Knowledge Management Partnership (KMP) for ESA region through its agency KMP and in association with AFRACA, with headquarters at Nairobi. Through an IFAD-financed grant, programme KMP started operation in 2003, mainly targeting IFAD programmes. KMP Phase I and II were implemented with two objectives (i) strengthening IFAD engagement in RF service delivery in ESA through KM experience sharing and capacity building services within IFAD programmes and through direct technical and logistical support to IFAD-supported RF initiatives in the region; and (ii) developing new and innovative ways to provide services to rural poor through action research programmes for members of the partnership. KMP Phase III (2012-2015) is dedicated to intensifying and improving services to IFAD-supported RF projects and is engaged in strengthening action research and sharing and dissemination of lessons learnt and best practices in the region. RF policy development has also been one of its vowed objectives. Thus, Nairobi has become the nerve centre in KM interventions for the region under the aegis of IFAD. IFAD has set up a number of communities of practice (CoP) mostly with participation of the project staff including members of Kenya CPMT on specific themes (Groups on water development, rural finance, and financial management) which promote knowledge sharing across the country. CPMT is also a platform for knowledge-sharing. IFAD website also facilitates knowledge dissemination on country programmes and policy issues.

2.2.5 Promoting and participating in policy dialogues in priority areas

The 2002 and 2007 COSOPS had outlined priority areas in which IFAD would engage in policy dialogues in RF and natural resource management, especially related to rights of access to water resources, the Forestry Act, MF Bill, as well as flow of funds, project management and importance of M&E. The wide-ranging reforms were given a legal kick-start with enactment of the Water Act, 2002. The implementation of reforms by way of setting up of the Water Resources Management Authority, the Water Resources Regulatory Board, etc started subsequently. The policy dialogue activities have been linked to the experience emanating from IFAD-supported projects, especially dairy and horticulture sub sectors. At the national level, IFAD has contributed to rolling out of the national irrigation policy, by extending grant assistance for sensitization of Parliamentarians and others on the provisions of the policy.

2.2.6 Promoting Outreach for Financial Innovations and Technologies

IFAD's Programme for Outreach of Financial Innovations and Technologies (PROFIT) covering a 7-year period (Dec 2010-June 2017) was designed based on experience from earlier programmes on poverty reduction through agriculture, and was envisaged to address issues such as lack of value chain approach in financial services by MFIs, lack of sustainable approach for financial graduation and poverty reduction in ASAL, dearth of technical assistance for business services, risk perception of commercial banks for financing SF and rural sector, high cost of rural lending, etc, all of which hinder access to financial services in rural areas. The Project aims to support the development of a range of innovative financial products – such as savings and remittance services, community infrastructure loans, value-chain financing, medium-term financing for the agriculture sector, and index-based insurance and health insurance – and to improve the access of poor rural households to these services. It also seeks to help programme participants manage their assets, market their produce and increase their employment opportunities. The goal of this programme is to contribute to the reform of financial sector policy in Kenya.

The project has three major components - (i) Rural Financial Outreach (Sub components Credit Facility, Risk sharing Facility and Innovation Facility), (ii) Technical Support Services (Business Support Services, Financial Graduation) and (iii) Programme Management. Under the Project Management component, it is envisaged to identify opportunities for innovation, policy dialogue and knowledge management, measure the systemic changes in the rural financial sector and its social impact, capture the key lessons for rural finance policy refinement, and undertake Knowledge dissemination to a wider audience. The goal of this programme is to contribute to the reform of financial sector policy in Kenya. Although major portion of the funds is earmarked for the first component, there has been only substantial progress (92%) under its one subcomponent- Credit Facility, after 3rd year of operation. Activities under other components/sub-components are in various stages of implementation. Hopefully, the programme would, *inter alia*, impact positively rural finance policy development in due course.

2.2.7 Influencing paradigm shift in GOK approach

IFAD's thrust and developmental approach had brought about a paradigm shift in Government's role from that of service providers to facilitator, catalyst and regulator of various sector players.

Chapter 3

Emerging issues / challenges and recommendations

3.1 Issues, challenges and opportunities

- Implementation of various new legislations recently passed by the Government, and prudential regulations and policy guidelines issued by the Central Bank of Kenya, in rural finance.
- Fulfilling the stated objectives and achieving the envisaged outcomes under PROFIT, particularly with respect to rural finance policy and innovations within the timelines;
- Giving greater attention to policy dialogue, and partnership-building; Engaging the Government in policy dialogues, based on good practices, evidences and lessons emerging from the field;
- Supporting the organizations of rural people/communities to enable them to participate in policy dialogues;
- Intensifying Financial literacy interventions by the policy-makers and development agencies in rural areas, familiarizing the people to appreciate, assess and access financial services;
- Addressing high cost of delivering financial services to small, widely dispersed rural customers in difficult terrains characterized by high conversant risks, missing markets for risk management instruments and lack of suitable collateral;
- Popularizing various successful financial models/instruments in rural areas, including the Guarantee mechanism, being tried under PROFIT, based on evaluation;
- Development of ASALS, where poverty incidence is high; evolving context-based rural finance policy;
- Strengthening the regulation, supervision, risk management of the rural finance institutions and rural finance policy development as a focused and exclusive component in rural finance programmes;
- More efforts and robust policy for full financial inclusion, given the fact that 25% of the population remains totally excluded;
- Enhancing consumer protection and financial education policy solutions and initiatives to drive up the usage and quality of financial services and products;
- Expanding horizons of mobile banking and agent banking through banking system and sustaining regulatory safeguards;
- Rolling out of Full file credit information sharing (CIS) from 2014;
- The ongoing initiatives of the national Government, to automate the land registry and issuance of title deeds and prospects of mortgage markets; and
- Operationalization of the new money remittance regulation to also apply as

new regulations for the licensed SACCO Societies

3.2 Role expectations from CBK

CBK should direct its efforts and bestow greater policy thrust for enhancing credit flow for agriculture sector. The agriculture credit has only 6% share.

- Broad-basing sharing of Credit-information for better financial discipline with the financial institutions, exchange of information and experience among the regulators would enhance/enrich rural finance and agricultural finance interventions.
- Structured consultative mechanism with the stakeholders, as in case of Rural Finance Forum etc, in other countries, would open up participatory policy development in rural finance.

3.3 SASRA enables separation of regulatory mechanisms for SACCOs

The SACCO sub-sector comprises both deposit-taking and non-deposit-taking SACCOS. While deposit-taking SACCOS are licensed and regulated by SASRA, non-deposit-taking SACCOS are supervised by the Commissioner for Cooperatives. SASRA licenses SACCOS that have been registered under the Cooperative Societies Act. SASRA Board of Directors comprises the Permanent Secretary to Treasury, Commissioner for Cooperatives, the Governor of the Central Bank, four professional directors nominated by the Minister and the CEO.

SASARA has made tremendous strides for putting in place a sound regulatory and supervisory framework in the transition period of 4 years and is making efforts for addressing the challenges of bringing the non-regulated SACCOS under regulatory framework, their graduation under the regulating regime, improving performance of the regulated deposit-taking SACCOS, and marching towards accomplishing its vision of ushering world class SACCOS. With their leadership, SACCOS are expected to become the alternative rural financial services providers in the country’s competitive financial services environment.

A case study on SASRA is given in Text Box 6.1 to show case the Regulatory Authority as put in place under separate Act/Regulations, which is unique in AES countries.

3.4 Progress in performance of SACCOs

The SACCO sub-sector has registered improved performance since the setting up of SACSRA in 2010 and its implementation of regulatory and supervisory framework. The development of the SACCO Societies to offer ‘bank like’ services and expansion of the membership definition has brought in additional risks to the sub-sector. SASRA has put in place CAMELS evaluation framework to monitor financial soundness of the regulated entities. The licensed deposit-taking societies (numbering 124), account for a large portion of the SACCO sub-sector’s assets and deposits, bringing to the fore their importance systemically. The non-licensed deposit-taking SACCOS, which constitute sizeable portion of all SACCOS, need to be upgraded and transformed to licensed ones. SASRA has been exploring

Box 1. Best Practices of SASRA show the way to cooperative sector in ESA region

Kenya has made significant policy, legislative, regulatory and supervisory initiatives in financial sector. The institutions of CBK, IRA, CMA, SASRA and RBA and their initiatives are in evidence. Particularly, the setting up of SASRA in 2012, backed by the SACCOs Societies Act, 2008 and attendant regulations 2010 enshrining with risk-oriented provisions and prudential standards is something unique. The role of SASRA in orderly development of SACCOS and eventual growth and diversification of SACCOs in regard to the following are noteworthy;

- National Cooperative Policy on Cooperatives already in place; Cooperative Societies Act, 2008 and Cooperative Societies Regulations 2010 provided basis for setting up of SASRA in 2012 for ensuring financial discipline and stability of SACCO subsector;
- SASRA has been undertaking onsite and offsite surveillance on the SACCOS; It has introduced Risk-based Supervision;
- Ensuring high level compliance to regulatory prescriptions;
- Introducing CAMEL supervisory rating mechanism;
- Ensuring 100% audit of SACCOS by 30 April through the certified and qualified auditors;
- Prescribing standardized and obtaining electronically up loaded returns by 15th of the subsequent month from SACCOS; Full and Fair disclosures are in place;
- MIS is made up-to date and regular by ensuring up-to date reporting by SACCOS /up to-dateand reliable data-base; Information Management System is, thus, in place;
- Facilitation of growth of business and membership of the regulated entities-3 million members and 5 US $ of business;(growth of 13-15% per year); SACCOs are required to submit periodic Liquidity Statements to the Regulator; SACCOs providing quasi-banking services for their members (220 deposit-taking regulated SACCOs); SACCOs are being encouraged to pursue Front Office Savings Activity (FOSA). Efforts are on towards setting up of Deposit Insurance/ Guarantee Fund mechanism;
- SASRA has been supporting SACCOs' Information Technology infrastructure. Stand alone computerization of SACCOs has been put in place;
- SACCOS have introduced mobile banking and ATMs through SACCOs link network; Efforts are being directed to enable SACCOs to participate in the Clearing system;
- Operationalizing liquidity deposit @15% of deposit by the regulated swith the regulatory authority (Central Deposit Mechanism);
- Developing Corporate governance tools in collaboration(MOU) with the Cooperative College of Kenya and WOCCO;

- SACCO-owned Kenya Cooperative Bank providing services of clearing agent and parking of surplus deposits for all SACCOs;
- SACCOs undertaking loan services, mostly by the funds generated by the members, partly supplemented by sister SACCOs (SACCOs for SACCOs) and other authorities like CIC, Government and banks;
- Kenya Association of Rural SACCOs, Kenyan National Federation of Cooperatives, Cooperative Alliance of Kenya providing umbrella support to SACCOs;
- Constitutional amendments bringing in County Governments- ongoing efforts for convergence of the national and county governments; Supremacy of the national laws;
- Core Skill Survey 2012 undertaken to identify skill gaps in HR and to address capacity-building challenges; Six months' training introduced for professional enhancement(MoU) with the Cooperative College for customized training for SACCOs;
- Business Development Plan has been prepared by SACCOs;
- The Cooperative Societies Act contains provisions, barring members/ Board directors with political posts/affiliations;
- Government 's interference in Cooperatives minimized; No interest subsidy or waiver of loan by Government taken recourse to except in Coffee Sector;
- Department of Policy, Research and Development has been put in place in SASRA to focus on policy explorations and studies for Cooperatives; It has entered in to MoU with Strathmore University to facilitate policy research in SACCOs sub-sector;
- SASRA has Audit and Risk Management Committee as also Internal Audit and Risk-Management Department to spearhead risk-based audit and supervision. A corporate Communication Officer has been in place;
- It has got support from the World Bank and Government of Kenya under Financial and Legal Sector Technical Assistance Programme (FLSTAP) for risk-based supervision; Given the option, it would like to have support of IFAD for Central Liquidity Management Mechanism;
- SASRA is a member of the Regulatory Forum of Regulators- Central Bank of Kenya (CBK), Insurance Regulatory Authority (IRA), Capital Market Authority (CMA) and Retirement Benefits Authority (RTA); CBK is included in the Board of SASRA;

various policy and regulatory options to address the challenge by the end of the transitional period 30 June 2014.

SASRA developed and adopted a Risk-Based Supervision-frame work with focus on operational risks and ICT controls. SACCOS have continued to invest in robust ICT system to support their operations including provision of audit trail, catering for future expansion, generation of regulatory and management reports and provision of real time and relational data-base. SACCOS have been unloading regulatory returns to SASRA's servers by the stipulated dates. MIS, both at SASRA and SACCO levels, has been upgraded. SACCOs have been connected to the SACCO Link Network. They have continued to embrace the use of ICT to deliver services to members. The use of mobile phone platforms to deliver financial services has witnessed software vendors in the SAQCCO sub-sector partnering with mobile service providers to integrate mobile solutions to their core system.

3.5 More technical assistance needed in financial and legal sectors

The RBS project is supported by Financial and Legal Sector Technical Assistance Programme [F&STAP], a Government of Kenya and World Bank project. The project supported the development of a supervision policy and procedure Manual to guide the examiners in offsite and onsite surveillance functions. Regulatory compliance by the regulated entities, just like submission of data and returns, has been useful for the policy-makers, regulator and general public. Notwithstanding the above improvements within short time, the major challenges need to be addressed as under:

- KM, Skill and competence–building of SACCOS for efficiency and effectiveness;
- Governance enhancement of SACCOS for ensuring sound and prudent management; and
- Putting in place CBS and ensuring full connectivity with all branches, SACCOs and SASRA.

3.6 Sharing credit information

The current legal provisions in the SACCO Societies Act, 2008 are limited to inter-SACCO sharing of information on non-performing assets and recovery. Amendment needs to be made to enable SACCO societies participate fully in credit information-sharing system [CIS] to enhance credit management and improve asset quality.

3.7 MFIs industry association (AMFI) to influence policy

The Association of MFIs in Kenya [AMFI] is a member-funded and member-owned institution with a total membership of 62 institutions covering regulated MFIs, CBs, Non-Bank FIs [post bank], to-be-regulated MFIs/transformed MFIs under the MFI Act, non-regulated credit-only MFIs, financial wholesalers, insurance companies [micro insurance providers], and capacity development providers/development institutions. It pursues advocacy and lobbying, capacity building, performance monitoring of members including voluntary codes of conducts of conduct, studies

Box 2. Kenya introduces new rules for fixing interest rates

A new interest rate mechanism – Annual Percentage Rate [APR] has been introduced in Kenya with effect from July 2014 ,based on the study commissioned by CBK and FSD, Kenya on the issues of interest rate fixation norm. The standard pricing approach was recommended with a view to promoting greater transparency and consumer protection within the financial sector and to facilitate consumers to compare costs and take informed decision. APR mechanism is prevalent in USA, UK, Ghana, Ireland, Malaysia, Canada, Peru and South Africa. The banks are required to compute the Annual Percentage Rate [APR] taking into account the interest rate component, bank charges and fees and this party costs including legal fees, insurance cost, valuation fees and government levies. APR is envisaged to reveal the complete and true pricing of loans. The Central Bank is expected to guide and enforce the compliance and disclosures, especially in standardization and calculation of charges for the APR. The APR has the potential to reduce interest rates that customers pay on loans by fostering price competition. From July 2014, all lenders are to subscribe to the new formula – Kenya Banks Reference Rate and thereby recalculate to the existing loans in line with new framework and keep the borrowers informed.

and net- working. With heterogeneous memberships, divergent issues/interests of different sets of institutions need to be addressed / represented, through dialogues with the Regulators / Government. The strength and solidarity of the Industry Associations would be helpful in policy resolution. The participation of deposit-taking MFIs in the Clearing House is needed for issue of third party cheques, taxation exemption [VAT/dividends], resource support from CBs, etc. and is one of the emerging issues confronting the MFI sector.

3.8 New strategies needed for micro insurance development

The following strategies are required to upscale and deepen micro insurance coverage:

- Developing policy framework and incorporating adequate provisions by a separate Chapter on Micro Insurance in the Insurance Act.
- Developing comprehensive Micro insurance regulations;
- Taking capacity development measures for policy-making bodies, regulator/ supervisor and supervised entities;
- Taking consumer protection measures, education and awareness campaign;
- Exploring business models to have flexible and cost-effective intermediaries and distribution channels for insurance products and services;
- Supporting/encouraging product innovation in micro insurance and replication; and
- Putting in place a responsive and effective grievances re-dress mechanism for consumers.

Appendices

Appendix 2.1. Study questionnaire

1) Who are you? (Country Project Officer, Country Programme Manager, senior Policy Adviser, PTA, Policy researcher, etc).

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2) In which country are you working?

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   ....

3) Using the format given below, please name IFAD-supported projects in your country, segregating those in operation and the completed ones.

Project no.	Project title	Project period	Project's broad components

4) According to you which are the most successful IFAD's intervention in your country? Please specify reasons.

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   ....

5) Were there any major policy issue(s) pertaining to the project's implementation in your country/ESA?

   ....
   ....
   ....

6) If yes, what did the Government, regulatory agencies and other policy-making authorities do to resolve and subsequently improve the project's implementation. (Please mention the project, policy constraints and the improvement made as indicated in the table)

Project name	Policy constraints	Changes/improvements made

7) What methodology/approach was adopted to change/develop the *relevant* policy?

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8) Have there been any separate documentation done on new policy introduced, policy issues resolved and/or policy refinement/development contributed under the project implemented? If so, specify.

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9) Do you have any separate institutional mechanism in the project framework for review, debate, resolution and dissemination of policy issues? If so, specify.

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10) Was regulation and supervision of financial services institutions embedded within the Rural Finance Project as core component? If so, outline major interventions effected for improvement in regulatory and supervisory policy?

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11) How has regulation and supervision of financial services embedment in the Rural Finance Project been helpful in policy reforms in financial sector?

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12) What are the difficulties faced by IFAD in pursuing with policy-making authorities/promoting innovative policy framework?

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13) What could be the best/most feasible ways of bringing about necessary policy changes/reforms for a donor agency?

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14) Are there any seminar/ workshop, training, sensitization, exposure programmes which are organized for stakeholders' capacity to look into policy issues/ explorations as part of project implementation? If so, cite a few models.

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15) (a)What are the means adopted for dissemination of information/experience in policy issues at various levels including grass root level?

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(b)In your project, has there been a participatory approach as a method in making policy decisions? If so, cite instance(s)

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16) Is there any exchange forum(s) put in-place in your country/ESA for projects to exchange knowledge/experience? If so, how effective is the forum(s)?

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17) Is there any institution(s) in your country which can be banked upon for knowledge management in policy issues pertaining to project themes of IFAD? If so, give details.

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18) (a) Identify five major IFAD's contributions in policy areas/issues in your country?

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(b)Give brief outlines of the above identified policy areas/issues.

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(c) Do you think any of the above is/are best practices/innovative which can be replicated in other countries?

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19) Name five major unresolved policy issues (theme-wise) hindering project implementation in your country?

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20) Would you advocate for policy development in core areas of IFAD support framework in your country/ESA? Give reasons for your answer

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21) Do you have any other input having relevance to IFAD's policy contribution in your country/ESA?

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Appendix 2.2 References

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Appendix 2.3 Institutions visited and persons consulted

Sl. No.	Name	Designation	**Institution**	**Date**
1	Risper Gekanana	Project Asst	KMP IFAD, AFRACA	07.07.2014
2	Betty Mwakelemu Tole	Documentation & Learning Officer	IFAD, AFRACA	07.07.2014
3	Miriam Cherogony	RF Specialist & KM Coordinator	KMP, IFAD – AFRACA	08.07.2014
4	Saleh Usman Gashua	Secretary General	AFRACA	08.07.2014
5	Ali Mohamed Ali	Manager, Bank Supervision Dep't	Central Bank of Kenya	09.07.2014
6	Renben Chepng'ar	Manager, Bank Supervision Dep't	Do -	09.07.2014
7	Charles Mutua	Head, Micro Insurance	CIC Insurance Group Ltd	09.07.2014
8	John Mwaka	Manager, Policy Research & Development	The SACCO Societies Regulatory Authority [SASRA]	09.07.2014
9	Yuonne Gatobu	Corporate Communication Officer	Do -	09.07.2014
10	Henry Oketch	Consultant	Association of MFIs	08.07.14