KENYA BANKERS ASSOCIATION

PRESS RELEASE

RESTRUCTURING LOANS IN A REGIME OF HIGH INTEREST RATES

Commercial banks have in the recent past revised their lending rates upwards in reaction to the current economic environment where high inflation has occasioned tightening of monetary policy and thus affected short term interest rates. Whereas it is imperative that the rise in inflation be addressed by tight monetary policy, it is also critical that loans already contracted continue to be serviced and also remain affordable to sustain investments and reduce the risk of default.

A high interest rates regime presents three main problems: risk of default, increase in non-performing loans and slowdown in investments. The Monetary Policy Committee(MPC) following its' meeting of 1st December 2011 noted that several banks had commenced discussions with borrowers with a view to restructuring loans and refinancing arrangements to avoid any threat of default. The Committee agreed that this was an appropriate process to be formally encouraged to work out modalities that would enhance these short-run measures to protect borrowers and banks alike.

Taking the cue from the MPC, the Kenya Bankers Association (KBA) has taken steps with a view to protecting customers as well as commercial banks during this temporal period of macroeconomic challenges being experienced.

The KBA has looked at measures that can be availed to existing borrowers to help them ride over this period of tight monetary policy aimed at fighting inflation which has mainly been driven by spiraling food and energy costs. The KBA having consulted with the Central Bank of Kenya (CBK) and the Government will take the following measures:

1. **Loan Repayment Period:** To ensure that borrowers are able to continue servicing their loans during periods of upward revisions of interest rates, banks will negotiate with their customers to extend the loan repayment periods. This may entail extending the period to ensure that the repayments are retained at the existing installment amounts. Extending loan repayment periods will ease the sudden increase in loan repayment burden on the part of the borrowers. It may also serve as an impetus to borrowers to enhance their efforts to fully repay the loan.

2. **Capping the maximum increase in the loan repayment amount:** Banks will cap the increase in the installment repayment to a maximum of 20% of the current level of installment. The installments will then be spread out leading to extension of the repayment period. This is essentially a combination of spreading the repayment amounts and an extension of the repayment period to fit into the required installment repayment.

3. **Absorption of costs by banks:** Since interest rate adjustments may precipitate loan defaults, banks will absorb some of the additional costs from changes in the macroeconomic environment to the maximum extent possible without threatening their viability. This entails sacrificing a portion of their budgeted profit margin. This measure and the one immediately below are hinged on the premise that while short term interest rates will increase, lending rates are also driven by other factors. These factors include opportunities for investment and overpricing loans may kill avenues for investment. These factors will prevail and will be more important once the inflation war has been won.

4. **Banks will not raise interest rates despite the recent further increase in CBR by 1.5%:** On Thursday, 1st December 2011, the Monetary Policy Committee met and adjusted the CBR upwards by 150 basis points to 18%. Banks will absorb this increase and mitigate the additional burden on existing borrowers. This will apply only to existing borrowers. The interest rates for new loans will however not be accommodated within this measure.

5. **Penalty on Early Repayment of loans:** Where banks decide to increase the interest rates from the contracted rate, borrowers will have the discretion to repay the outstanding loan balance in full or in part without being subjected to early repayment penalties. Waiver of early repayment penalties will ensure that borrowers are not subjected to additional financial burden when interest rates are rising. This will also enable banks to minimize chances of default.

Borrowers should therefore approach their banks for discussions on how they can meet their increased loan repayment obligations while taking advantage of the measures we are announcing today. KBA is confident that these measures will protect the interests of both borrowers and banks. We will continue to take a proactive approach in consultation with CBK and the Government to ensure that investments in Kenya's growth continue being supported through affordable credit. Our efforts will also support the stability of the banking sector by reducing the risk of default.

RICHARD ETEMESI
CHAIRMAN
KENYA BANKERS ASSOCIATION

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