

## TERMS OF REFERENCE

### RESEARCH CONSULTANCY ON CURRENT AND PROSPECTIVE EFFECTIVENESS OF CREDIT INFORMATION SHARING IN KENYA

#### 1.0 INTRODUCTION

##### 1.1 Background

Since the rollout of Credit Information Sharing (CIS) in Kenya five years ago, a number of efforts have been made to strengthen the operations of the mechanism. The aim of these initiatives, structured in 3 phases, is to achieve a full-file comprehensive system that supports the use of credit reports and scores in credit risk management and increased access to credit for low-risk borrowers.

Prior to 2013 when the Credit Information Sharing Association of Kenya (CIS Kenya) was established, coordination of these efforts was in the hands of the Kenya Credit Information Sharing Initiative (KCISI), a project jointly run by the Central Bank of Kenya (CBK) and Kenya Bankers Association (KBA) and funded principally by the Financial Sector Deepening Trust (FSD Kenya). CIS Kenya is a member-based Association that brings under one umbrella all parties interested in promoting the extension of CIS in Kenya beyond CBK-regulated entities - namely commercial banks and microfinance banks (MFBs).

FSD Kenya was established in early 2005 to support the development of financial markets in Kenya as a means to stimulate wealth creation and reduce poverty. It has played a significant role in supporting the development of CIS in Kenya by contributing to the budget of each of the three phases. FSD's interest in this process stems from the recognition that CIS is a fundamental piece of infrastructure that minimizes information asymmetry between suppliers and consumers of credit, thus promoting access to credit by Small and Medium Enterprises (SMEs).

One of the turning points in the CIS journey in Kenya was the publication, in January 2014, of amended regulations that ushered in full-file CIS, with more explicit provisions allowing participation by non-bank credit providers. This has led to positive data sharing by commercial banks and microfinance banks, as well as the entry of many third party credit providers in the CIS mechanism. As a result, the amounts of data being submitted to the credit reference bureaus (CRBs) has increased significantly; which presents opportunities to study various trends in the credit market.

##### 1.2 Rationale for Research

Financial sector providers have organized their credit processes and procedures to comply and make effective use of the newly available consumer data obtained through the CRBs. The process of adaptation to the CIS system however is not without difficulties: CIS requires a combination of market awareness, adequate technologies and data availability which cannot be achieved overnight. It also requires a sentiment of trust and confidence in the system that takes time to consolidate. Initial assessments of the CRB data shows that credit providers see value in CIS but face several challenges submitting and using data. Many credit providers are providing only

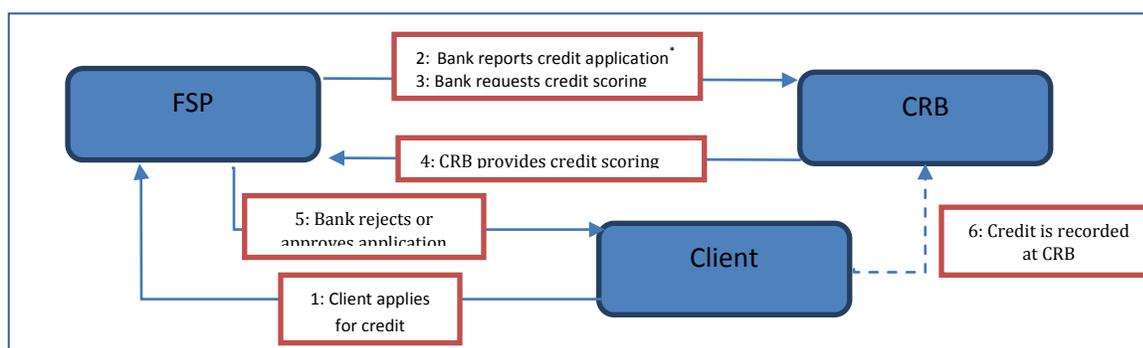
mandatory data and very little of the non-mandatory data, limiting the effectiveness of CIS. Data submissions to the CRBs are sometimes rejected due to errors and inconsistencies. While the magnitude of the problem is unknown, it is important to assess how financial institutions are integrating CIS in their credit processes and intervene promptly in case of inefficiencies. This would avoid a vicious cycle where individual institutions do not share quality data because other institutions do the same. This could be a classic example of a coordination failure: credit providers could achieve a more desirable equilibrium but fail to do so due to a lack of coordination in their decision making.

There are several strategies to tackle coordination failures: the key requirement is to understand the dynamics and root-causes of the problem. The research objective is therefore to understand the key interactions among stakeholders in the CIS mechanism and how financial institutions have organized their credit departments to submit data to the CRBs and comply with the CBK regulations. The goal is also to identify the difficulties that credit providers face in the process and the quality of engagement with CRBs. This will determine whether credit providers are receiving the necessary support to implement full-file information sharing and how to increase the value proposition of CRB's services.

### 1.3 Integration of CIS into the Credit Cycle

The core approach of this research is to understand credit cycles and CIS as part of a single process. Each stage of the credit process (e.g. application, appraisal, disbursement and repayment) relates to CIS in different ways, and could be hindered by different types of inefficiencies. For simplicity we divide in two main phases: before disbursement and after disbursement.

Figure 1: CIS process BEFORE disbursement



\* Note that it is not mandatory to report credit applications to the CRBs. The research will assess to what extent banks are submitting this data and the difficulties in the process.

Figure 2: CIS process AFTER disbursement

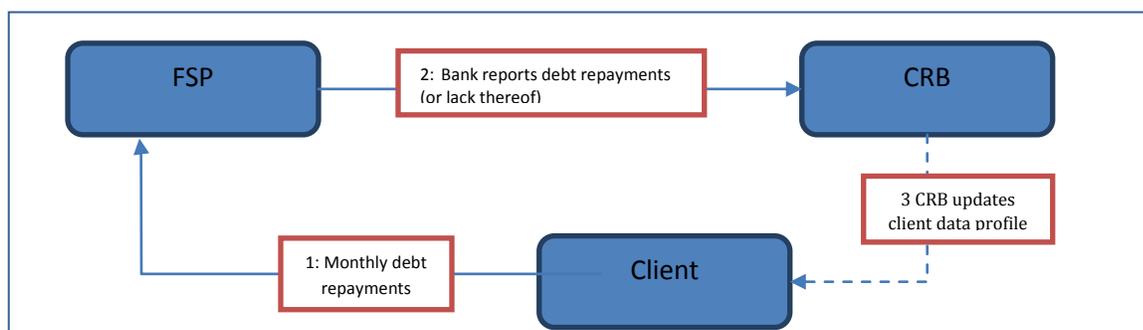


Figure 1 and 2 represent in very simple terms the key actors in CIS and the basic interactions among them. The figures however simplify a much more complex reality where each arrow involves different organizational processes, personnel and technology needs. Mapping the credit appraisal processes and their integration with the CIS mechanism will reveal crucial information about the obstacles to full file information sharing. The stakeholders of the CIS: credit providers, CRBs and credit consumers will be analysed individually to address gaps, perceptions and opportunities at each level.

## 2.0 OBJECTIVE

CIS Kenya would like to procure consultancy services to undertake a survey on a number of research questions to establish the level of integration of the CIS mechanism into the credit cycle of lending institutions, quality of services offered to credit providers by CRBs and extent to which borrowers are benefiting from the CIS mechanism.

The analysis will focus on both the process of data submission and utilization of CRB reports in credit appraisals and identify key areas of improvement in the near and long term.

## 3.0 SCOPE OF WORK

In order to map the full CIS process and identify the key gaps in the system, the study will be composed of three levels of analysis: credit provider level, CRB level and client level. Each level has different interactions and experiences with CIS while facing distinct challenges along the way.

### 3.1 Credit Provider level: Integration of CIS into credit processes

The core objective is to understand how the CIS is integrated in the credit processes of credit providers in order to identify core gaps. The research will address the following questions:

- a. Seek to map out the credit process within different credit providers such as:
  - i. Organization of the credit appraisal processes within credit providers.
    - How and when appraisal data is electronically captured during the appraisal process.
    - What the CIS touch-points are within the appraisal process.
  - ii. Data submission:

- Determine how data is extracted, reviewed and submitted to the CRBs.
  - Establish the technology needs and key challenges.
- iii. Use of CRB Products
- Establish the extent of use of credit reports within the credit cycle (both the appraisal and collection phases).
  - Establish the extent of use of CRB credit scores within the credit cycle (both the appraisal and collection phases).
  - Establish the existence of institutional credit score cards, the extent of their usage; and the extent to which CRB data is incorporated in development of these score cards
- b. What are the key challenges in reporting data to the bureaus?
- i. Technical capacity of the MIS systems and staff concerned
  - ii. Inefficiencies in the regulatory framework
  - iii. Trust in the system: “Will good borrowers be poached?”
  - iv. Legacy debt problem: addressing the magnitude of the problem

### 3.2 CRB level: providing quality reports to financial institutions

In order to enhance the value proposition of CRBs, the study will analyse the quality of engagement of CRBs with credit providers and the challenges faced in providing meaningful credit reports and scores.

- a. Determine the level of engagement with credit providers, and establish the existence of a feedback mechanism on their product offering
- b. Obtain an opinion from the CRBs on the adequacy and quality of data for provision of rich credit reports and for credit score development.
- c. Establish the extent of usage of alternative data (including non-credit data) in the development of credit scores
- d. Determine the frequency of reviews of credit scores and if credit providers are consulted in such reviews
- e. Establish linkages of different data sets within a credit report, such as corporate information appearing in a directors report; or details of loans guaranteed in a guarantors report.

### 3.3 Clients: benefitting or not?

CIS is expected to reduce the non-performing portfolio by awarding borrowing customers with a good repayment record, while offering those with poor repayment profiles an opportunity to improve their credit score. Since the CIS in Kenya is in its initial stages, it is important to understand the perceptions and core problems of CIS from a customer point of view; and determine solutions to ensure that CIS meets its ultimate goal.

- a. Generate statistics on the credit market in Kenya and the general awareness and perception of the CIS mechanism. This could be supported by making reference to nationally representative statistics from the Kenya Bureau of statistics, FinAccess or other sources.
- b. Establish whether credit providers are passing the benefits of the CIS mechanism to good borrowers and the modalities of this transmission mechanism. This might occur through

- preferential interest rates, reduced security requirements, and automated loan processing, among others.
- c. Determine the frequency of credit-worthy applicants being denied or delayed access to credit due to CIS inefficiencies
  - d. Determine the general experiences and perceptions of CIS amongst in the public domain; such as on data retention periods.
  - e. Establish if customers are duly informed on their credit reports by credit provider Credit Staff immediately after they are generated; especially for customers with a good credit record.

#### **4.0 METHODOLOGY**

The research will be composed of the following:

1. Use of a brief questionnaire ( filled in within 10-15 minutes by credit staff) administered to all banks and MFBs
2. Sampling of a subset of 4-5 banks and 1-2 MFBs by tier (i.e. large, mid-sized, small) and governance characteristics (i.e. Local versus foreign)
  - a. Mapping the credit appraisal process and points of interaction with CIS
  - b. Interviews with banks staff in charge of CRB reporting
  - c. Interviews with bank staff using CRB reports
  - d. Interviews with senior management on their policies towards usage of CIS, and obtain opinions on any development to the mechanism that they desire to have to effectively utilize the mechanism.
  - e. Identification of key challenges amongst these credit providers.
3. Interviews with all the CRBs to ascertain:
  - a. The quality of data submissions
  - b. Key challenges in their relationship with the banks
  - c. Their opinion on the legal and regulatory framework
  - d. Their understanding on credit scoring (internal and CRB scoring)
4. Interviews with regulators (CBK, SASRA) to ascertain
  - a. Challenges faced in their CIS regulatory function
5. Progress and future plans of the mechanism. With cooperation from banks and (or) CRBs, Track a sizeable number of applicants whose applications have been rejected due to low credit scoring and/or negative record on their report to:
  - a. Ascertain the common reasons for rejection
  - b. Identify “false negatives” - credit worthy applicants denied or delayed credit due to CIS inefficiencies
  - c. Determine customer perception of CIS
  - d. Understand the awareness and usage of alternative dispute resolution mechanisms.

#### **5.0 CONDUCT OF WORK**

The consultant or team of consultants will formally report to the Chief Executive Officer – CIS Kenya; based at the Kenya School of Monetary Studies. Progress on implementation will be monitored by a Steering Committee consisting of relevant representatives of the CBK, KBA and FSD Kenya. CIS Kenya will take charge of logistics including organizing meetings with stakeholders. The consultant will manage their own timeline in consultation with CIS Kenya

especially where field visits are to be planned and adapt their schedule in light of availability of stakeholders, unforeseen opportunities and constraints and other factors.

## 6.0 OUTCOME AND DELIVERABLES

The deliverables of this consultancy are:

- 6.1 An inception report, within 7 working days of commencement of the consultancy containing - draft work plan of this consultancy, including survey tools approved for use by the Steering Committee for the field work in Section 3.1 and 3.2 above.
- 6.2 Within 30 days of the commencement of the consultancy, a draft report on findings from the initial findings of the research; that will form the basis of deliberations at a stakeholders workshop
- 6.3 A final report consolidating all the findings of this research, including a summary of stakeholder deliberations (done at a workshop); within 40 working days of commencement of the consultancy.

Payment under these Terms of Reference shall be made according to the following guidelines;

- a. Upon acceptance of the inception report, FSD will authorize payment of 30% of the agreed fee together with all expenses incurred to date
- b. Upon acceptance of the draft report of the initial findings of the research, FSD will authorize payment of 30% of the agreed fee together with all expenses incurred to date
- c. Upon acceptance of the final report, the remaining 40% of the agreed fee shall be paid after all substantive comments from CIS Kenya are submitted and finalized with the consultants. Should CIS Kenya not provide comments within 14 days of the submission of the draft (or subsequent redrafted) report, then the report will be deemed to have been finalized to CIS Kenya's Satisfaction and payment will be due.

The copyright for all material printed under these Terms of Reference will pass to CIS Kenya and FSD Kenya. It is FSD's practice to publish the reports it commissions in its own house style. There is therefore no requirement for material to be extensively formatted beyond that required to indicate how material should be logically presented in the final report. All final reports should be presented in an electronic format allowing the text and graphics to be manipulated in preparation for publication. Where a final report is presented in a portable document format (pdf) generated from another format (such as Microsoft Word) it should be accompanied by the original file from which it is generated. All representations of graphic material (tables, figures, drawings, charts, graphs and photographs) must be able to be reproduced at high print resolution. Tables, figures, drawings, charts, graphs should be provided in Microsoft Excel or Adobe Illustrator format. Photographs must be provided in high-resolution JPG images set to minimum of 300 dots per inch (dpi). Any technical questions regarding these requirements should be addressed to FSD's Communications Officer.

## 6.0 REQUIREMENTS

Mandatory requirements
Experience in Research work and Knowledge Generation
Good understanding of principles of CIS, with special emphasis on emerging country implementation
Experience in working with huge data sets
Understanding of financial sector systems and operations

Assessment criteria	Weight (%)
Experience in Research work and Knowledge Generation	35
Good understanding of CIS principles and practices, with special emphasis on emerging country implementation	25
Experience in working with huge data sets	20
Understanding of financial sector systems and operations	15
Cost	5
<b>Total</b>	<b>100</b>

7.0 TIMETABLE 40 working days spread out within two months.