A Publication of **Credit Information Sharing Association of Kenya (CIS KENYA)**

Digest

Aug- Sept 2016 Edition

CREDIT SCORING

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Editor's note

I trust this edition is finding most of your goals are ripening in execution now that we have passed the half year mark.

As an industry, we have been receiving a lot of attention from the media. We were thrust into the lime light by a petition to parliament to disband CRBs. We responded to this petition by submitting a memorandum to Parliament and also coordinated similar submissions by some of our key members. In these memoranda, we reiterated the benefits of the CIS mechanism and therefore the CRBs give the economy, the lender and the borrower. Later the Cabinet Secretary in his budget statement gave mention to the CIS mechanism which has been instrumental in opening up our mechanism to cross border sharing. The statement also gave green light towards cross-sharing of SACCO data with bank data so that Sacco's can have a more comprehensive view of their borrowers at the Bureau thus incentivising their participation in the CIS mechanism.

The interest rate debate popularly referred to as the Jude Njomo Bill has also been intense with Parliament passing it and forwarding it to the President for assent. As an industry, we strongly oppose the capping of interest rates and instead endorse the use of credit scores to apportion risk in credit appraisal. We are certain that this is the position that will cushion lenders from runaway default rates and also reward the good repayer with relatively cheaper interest rates. We esteem this as the rational method of taming high cost of credit that has a direct impact to the borrower.

Find in this edition excerpts from the training on how to create internal scorecards that will be used in generating credit scores. Also an extract of the budget statement and its prospects for our industry. There is also a pictorial page for a consumer engagement forum with Mathare Youth under the CBK@50 series.

Towards an open credit market

Credit Bureau Reports and Scoring: Foundations for best practice underwriting workshop

In May 2016, CIS Kenya conducted a capacity building forum for its members in a bid to raise the appetite for bureau scoring products as a precursor to risk-based pricing. Capacity building is one of the key pillars of the Association and is a value-add to members.

Forty-two (42) participants, including 18 from commercial banks (a mix of large, medium and small), attended the training. Others were credit bureaus (3), Development Financial Institutions (6), Microfinance institutions (7), Saccos (3), State lender (1), development partner (1), CIS Kenya (8). The lead trainer, Jamal Rahal, is a renowned Digital Finance expert who has also worked extensively within the Credit Information industry. Two local credit bureaus also made presentations on their products and services.

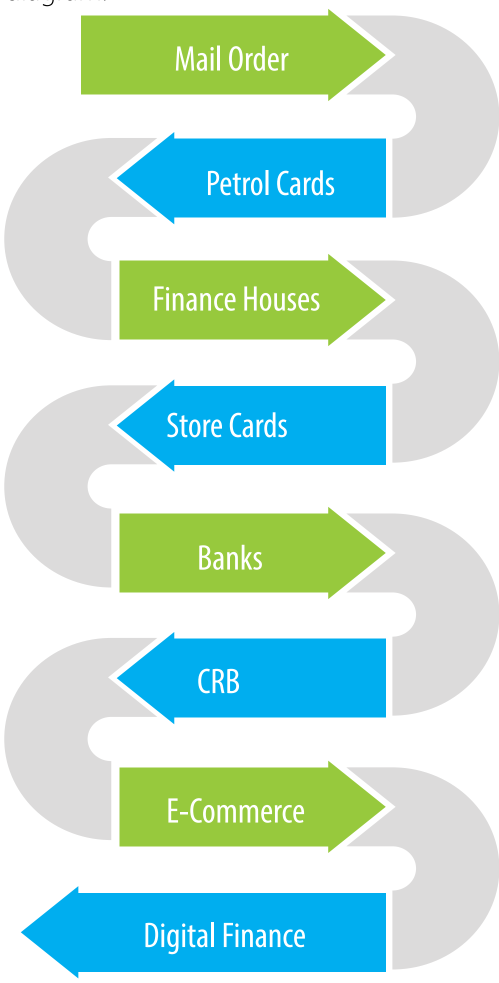
So why scoring? The lenders are doing fine just as they are already, they have enough systems running to support their *'Know Your Customer'* function, their risk management systems have been developed enough to cope with the industry demands. Or so you may assume but according to Mr. Rahal, the following are tangible and intangible benefits of scoring:

- 20-40% reduction of losses in bad debt recovery for first scoring implementations
- Boosts productivity and enables staff to deal with only difficult decisions/other roles
- homogenous decisions made which are crucial lenders with branch networks
- Makes automation rather simple

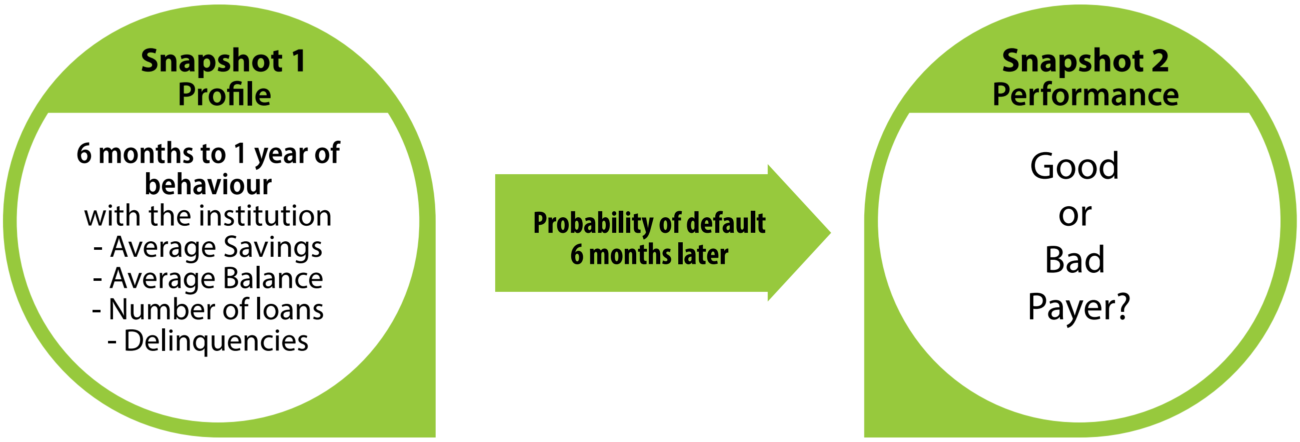
The history of scoring

Credit scoring began in the USA, in the 1950s' and is especially believed to have been based on Dr Solomon Kullbacks' theory of Information. Thereafter, Earl Isaac and Bill Fair created the FICO score which were then used in the 1960s' as the first scoring models. In the late 1970s the US fully embraced scoring models which was exported to other markets and today we have scoring based on big data, analytics and credit bureau data. They inform decisions on innovations such as Mshwari, Easy loan and KCB Mesa.

The progression through sectors of activity are: in the below diagram:



Scoring is not built only out of complex statistical algorithms, it takes into consideration factors such as: residential status, marital status, occupation and years on job. Scoring activity can be summarized into two snapshots as the diagram below shows whereby the credit information 'collector' shall have to wait for a period of 24 months between the snapshots of a credit life cycle.



How to create an internal scorecard
(scorecard creation recipe)

To create scoring models out of an existing loan book, there are two available approaches.

The first is: disburse loan, create profiles and then take snapshots or secondly, assess performance backward for 12 months, create snapshots based on historical data. Either way, scoring cannot be done in a hurry. However, it is very easy to create a scorecard. Use the data generated from above two snapshots, look for the predictors on the profile and finally assemble into a scorecard and Eureka!! Implement your internal scores.

For a more accurate scorecard, use predictors that correlate: residential status, years on job and marital status often have overlapping spheres in the data. This can give you a new and strong predictor while

building a score card.
Here is a simple behavioural scorecard

Residential Status	
Own	20
live w Parents	0
Rent	-35
Others	0

Marital Status	
Married	20
Single	-30
Divorced	0
Others	5

Nbr of Previous loans	
None	0
1 to 2	10
3 to 4	20
5 or more	40

Years on Job	
Less than 1 year	-10
1 to less than 2	0
2 to less than 5	20
5 to less than 10	30
10 and over	50

Occupation	
Manager/Exec	20
Employee	+10
Factory worker	0
Unemployed	-10

Previous delinquencies	
No Previous loan	0
No Previous Delq.	+20
Minor Delq.	-20
Average Delq.	-40

After building the scorecard, other factors are to be put in place:

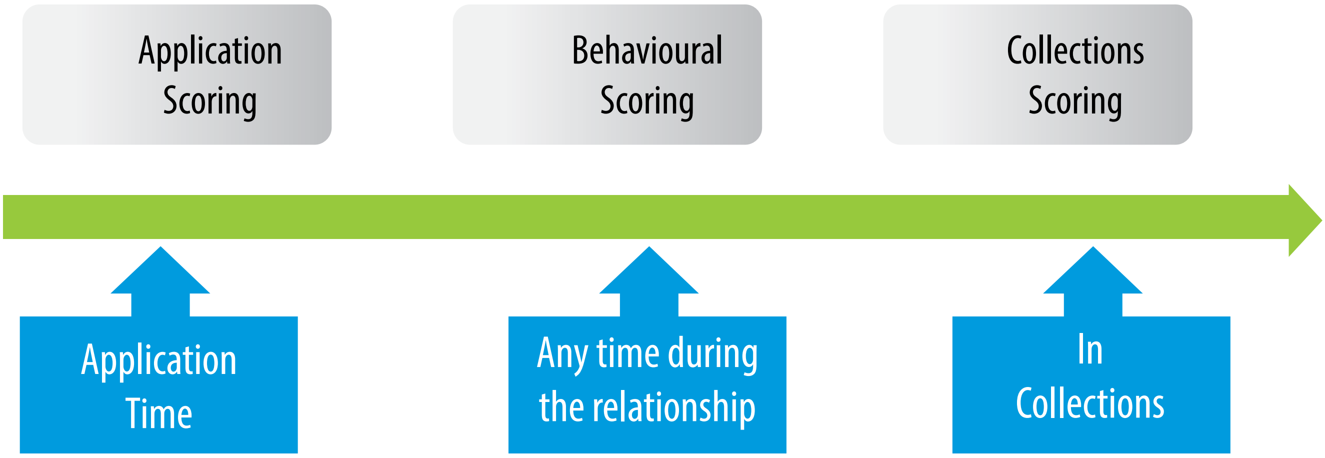
- Technically

1. Refine cut off's selection and include actual losses
2. Consider other business rules
3. Determine credit limits
4. Assess risk based pricing parameters

- Process side

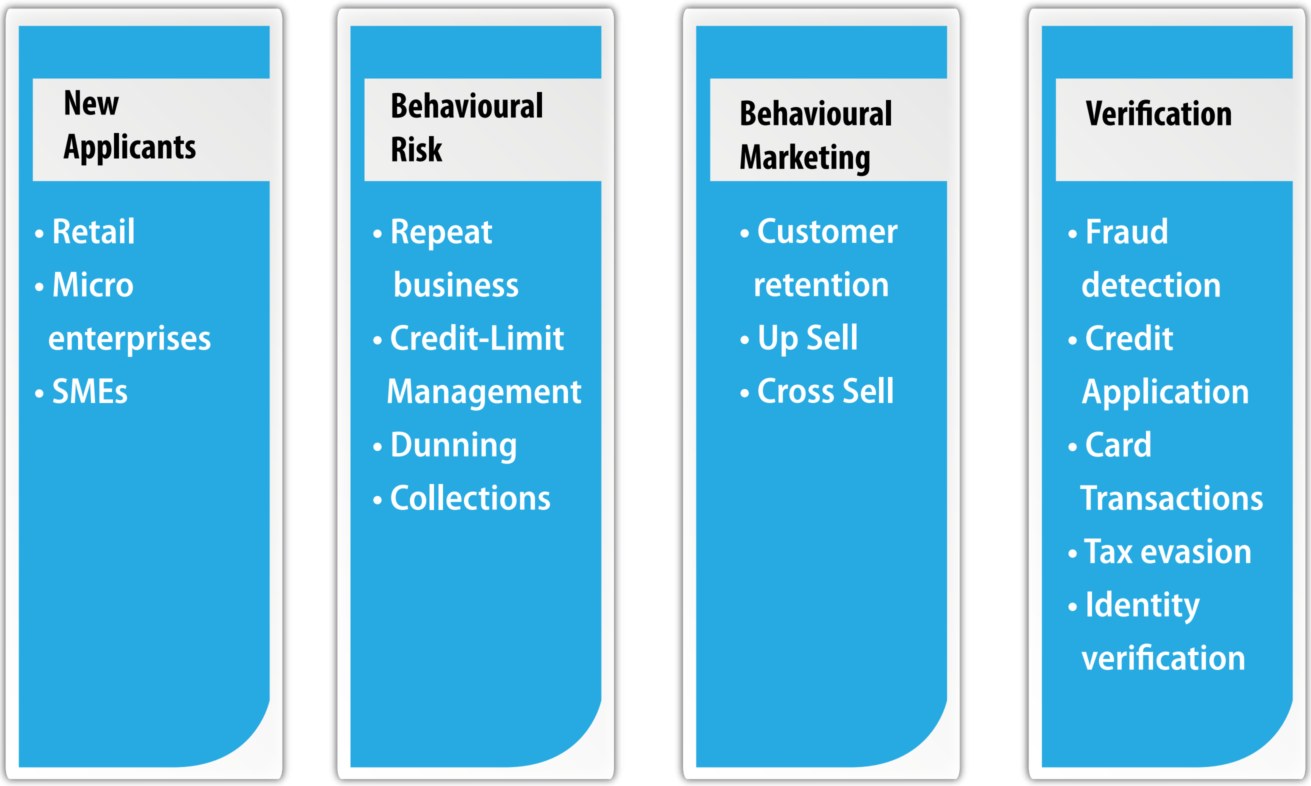
1. Assess impact on the credit process
2. Assess impact on the different credit committees
3. Assess how to integrate internal scoring and credit bureau products

The following diagram shows how scoring can be applied in the banking sector.



Scoring is also used in the following sectors:

Large Scope



Of note, internal scores are not a competitor to credit bureau products and services which includes a whole range of information products (see diagram below of typical bureau services).

Conclusion and Recommendation for future courses

At the end of the training, we received feedback form the attendants that they would like more on this scoring and on other subjects like:

1. Information Security/Risk
2. Digital Finance and legal framework - Financial Inclusion: products for non-served population
3. NPA management / Analysis of a Balance Sheet of a company
4. Lending Trends
5. Mobile money lending
6. Business score card models
7. Expand more on credit scoring i.e. Parameters
8. SME Lending & Recovery process
9. How to develop the scorecards

If you wish to receive the presentations and more information of upcoming courses, please contact: **info@ciskenya.co.ke**

What the Budget Statement means to our Industry

During the Kenya Budget Statement for 2016/2017, the Cabinet Secretary, National Treasury, Hon. Henry Rotich stated:

"158. Mr. Speaker, The Credit Information Sharing (CIS) framework in Kenya has continued to develop and increase its coverage as a result of facilitative reforms that we have put in place over the years. Indeed, the expansion of the CIS framework was one of the key factors behind the improvement in Kenya's ranking in the World Bank Ease of Doing Business indicators this year. Apart from the obvious benefits to the borrowers who maintain good credit history and to lenders who are able to get information on potential borrowers, the CIS regime is important to the economy as a whole in terms of increasing access to credit, reducing transaction costs, enhancing efficiency in financial intermediation and fostering financial sector stability through reduction in non-performing loans. To maximize on these benefits, I am today proposing additional amendments to the Banking Act as well as the Sacco Societies Act to facilitate cross border information sharing and to allow SACCOs and Utility Companies to more effectively participate in the CIS framework."

Prospects

In line with this policy direction, two bills will soon be debated in Parliament: One is The

Hon. Henry Rotich, Cabinet Secretary for National Treasury

Finance Bill 2016 that seeks to amend the Banking Act to introduce cross-border credit information sharing and open up sharing of data between banks and non-banks. The other Bill is the SACCO Societies (Amendment) Bill 2016. In the end, the amendments will have the following effect:

- Presently, the SACCOs Societies Act mandates SACCOS to share negative information amongst themselves as a closed user group, and the Cabinet Secretary responsible for SACCOs is expected to issue regulations guiding that process. Because the regulations have never been issued, these provisions have to be operationalised. The proposals in the SACCO Societies Amendment Bill 2016 are intended to allow SACCOs to share outside their silo and share both positive and negative data into a common database with banks. This means opening up the CIS mechanism for cross sharing and the silo effect is killed.

- Instead of duplicating effort by requiring separate regulations, the proposed law allows SACCOs to share under the Regulation already issued under the Banking Act. This will only require a few adjustments to existing regulations.
- Protection that is accorded to institutions participating in CIS in good faith was not previously available to the SACCO and Utility companies. The amendments will address this shortcoming by extending the protection to all institutions participating in CIS under any written law.
- Regarding cross-border CIS, The Banking Act will now give banks leeway to share data with counterparts across borders. This will open up access to credit information for lenders operating within the East African Community.

These legal reforms will strengthen both the local and international dimensions of credit reporting and ensure that harmonisation of the East African credit market with a total population of 146 million people is achieved.

We hope that with the implementation of these legal reforms we shall ensure an even more open credit market.

Upcoming Events

TransUnion
Advanced Credit Scoring Training

Dates: **19th-23rd September 2016**
Venue: **Villa Rosa Kempinski**

http://www.tutrainingafrica.com

CreditInfo Kenya
Advanced Credit Scoring Seminar

Venue: **TBC**
Start Date: **Wednesday, 12 October 2016 - 7:45am**
End Date: **Friday, 14 October 2016 - 4:45pm**

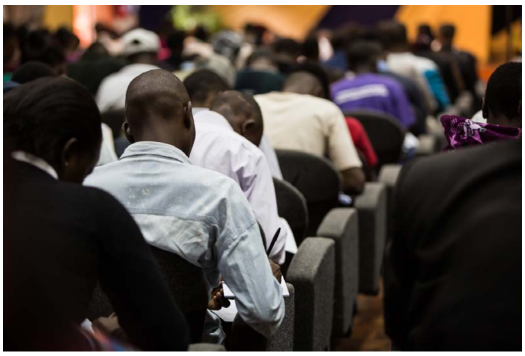
Pictorials

Consumer education

Portraits of guests and Mathare Youth during
CBK@50 program

Central Bank of Kenya is celebrating 50 years of existence in 2016. The series of high level events ***# CBK@50*** took an detour at KSMS to educate the Mathare Youth after their leader tweeted at the Governor, Dr Patrick Njoroge requesting him to meet the 200 plus strong group who are organized in chamas.

The Governor invited other respected members of the community to give the youth advice on money and servant leadership. Other than our CEO, Jared Getenga, in attendance was Joshua Oigara, KCB CEO, Dr Julius Kipng'etich, CEO Uchumi and James Mugambi, CEO, Premier Credit who all gave the youth tokens of wisdom in their professional and personal capacity.



CIS Kenya

Towards a more open credit market

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