STERLING CAPITAL LIMITED

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CBK to determine bank dividend payouts in new rules

- Banks will have to get the approval of the Central Bank of Kenya (CBK) before declaring dividends for the current financial year, according to a new directive by the regulator that is focused on ensuring lenders have enough capital to ride out the Covid-19 pandemic.
- The CBK's directive, confirmed by multiple bank executives, indicates that investors on the Nairobi Securities Exchange will forego dividends running into billions of shillings.
- The regulator's order, coupled with banks' own risk aversion, is set to break most lenders' record of incremental dividend payouts.
- The regulator has given banks up to the end of October to submit their revised capital levels through changes to their ICAAPs (Internal Capital Adequacy Assessment Process).
- CBK introduced the capital-measuring process in November 2016, requiring banks to identify, measure and monitor risks and use this as the basis for allocating their funds.
- The CBK will now have the final decision on whether or not it agrees with the new capital levels that each bank will submit.
- This will then determine if it will endorse any board's decision to pay dividends.
- The CBK relies on ICAAP among other tools to assess whether a bank's capital levels are adequate and consistent with its business plans, strategies, risk profiles and prevailing operating environment.
- The CBK sees Covid-19 as a major disruption that requires banks to change their current models and assumptions by making them more conservative.
- The move by the CBK mirrors what has happened in markets such as South Africa where the regulator told banks to make capital preservation a priority by freezing dividend payment or bonuses to top executives.
- The pandemic and public health measures taken to contain its spread has already led to lower bank earnings and erosion of their capital from defaults and provisions for the same.
- The lenders restructured loans worth KES.844.4Bn between March when the first coronavirus case was reported in Kenya and June.
- Defaults over the same period stood at KES.29.9Bn and the strain on banks' balance sheets is expected to persist for months ahead.
- The regulator appears keen on avoiding scenarios where banks pay dividends on capital levels that soon turn out to be inadequate, leading to search of new funds and pleas for regulatory forbearance.
- Some lenders' balance sheets are already struggling to absorb the coronavirus fallout, exposing depositors to risk of losing their funds.

Our View:

- **We expect dividend droughts to be the new normal in the short-term due to reduced profitability and capital conservation strategies employed by the banks.**
- Some of the best capitalized and most consistent payers of dividends including KCB, Standard Chartered Bank Kenya and Absa Bank Kenya, have already skipped interim payouts for the half year ended June as their earnings contracted by double digits.
- At best, the dividends will be a fraction of what they were before and as a result, income investors will suffer losses in the short term.
- The CBK order risks depressing bank stocks which had started recovering from lows seen in the second week of August. Besides banks, other blue-chips including Bamburi have also suspended cash payouts, a signaling a historic dividend drought this year.
- The dividend freeze is expected to see some investors seek to raise cash by selling shares, putting new downward pressure on the stock market that is at a 17-year low as measured by the benchmark NSE 20 Index.

Source: Business Daily and Sterling Research