POLICY BRIEF ON DIGITAL LENDING IN KENYA

The information contained in this publication has been prepared by the Institute of Certified Public Accountants of Kenya.

March, 2021

INTRODUCTION

Digital lending applications have provided platforms for convenient, private and short-term loans thereby meeting a demand for credit that had not previously been met by formal providers such as banks. The widespread use of mobile money has transformed the delivery of financial services in sub-Saharan Africa. The easy accessibility has led to rapid uptake of loans with data showing that as at November 2020, Tala had over 5 million downloads whereas Branch had over 10 million downloads on the Google Play Store in Kenya.

According to the International Monetary Fund (IMF) Financial Access Survey, mobile money accounts in Kenya had surpassed the number of traditional deposit accounts by 2015. A study by the Financial Sector Deepening (FSD) in 2018 reveals that usage of non-regulated digital credit has grown from 0.6% in 2016 to 8.3% in 2019 and that over 6 million Kenyans have taken at least one digital loan to meet day-to-day household needs or working capital requirements for small enterprises.

The pricing, marketing and potential misuse of these digital lending products however, coupled with the extensive negative reporting of borrowers who have failed to repay these relatively small loans has raised concern about their design and the adverse impacts they have on borrowers and the financial system at large.

Approximately 80% of Kenya’s adult population widely uses mobile banking for purposes such as opening a bank account, executing bank account transactions, purchasing pre-paid phone credit, obtaining micro-loans and short-term loans, paying utility bills, peer-to-peer lending and for purchasing groceries. Mobile banking transaction values declined by 6.98% between December 2019 and April 2020 and declined by 15.5% between March and April 2020. We also find that there is a 16% increase in mobile banking transactions and an 8% increase in the value per transaction between April and May 2020 following short-term regulatory measures. These measures include increase in daily limits and elimination of fees and charges. The government required that commercial banks eliminate all charges related to transfers between mobile money wallets and bank accounts and to also eliminate all charges for balance enquiries on all FinTech platforms.

Some governments are currently providing incentives to pay for goods or services digitally, through mobile money or e-wallets. For example, Uganda has cut mobile money transfer fees, Egypt, Liberia, and Myanmar have increased transaction size limits, while authorities in Bangladesh, Cameroon, the Democratic Republic of Congo, Ghana, Kenya, Mozambique, Pakistan, Rwanda, Senegal, and Zambia have taken both sets of measures (cutting mobile transfer fees and raising transaction size limits) in response to the pandemic. As the reliance on the online provision of goods and services increases during the pandemic, there will be a greater need for digital methods of payments that are compatible with online use. All of these take on added value during the response to the COVID-19 crisis, as governments seek ways to disburse funds to those in need quickly and effectively, and many households and firms aim to rapidly access online payments and financing. At the same time, digital financial services allow for social distancing, which is of particular value during the pandemic. More generally, digital financial services can promote financial inclusion in remote or poor areas where the physical presence of financial institutions is absent.

REGULATION IN OTHER COUNTRIES

In other countries, fintech innovations including digital lending platforms are regulated as follows;

1.	Japan	The Bank of Japan (BOJ) is neither regulating nor supervising fintech firms, but it established the Fintech Center dedicated to being a catalyst for promoting the interaction among financial practices and innovative technologies, research and study, and the needs of economic society. Money transfer services are regulated by the Banking Act and other legislation applicable to other depository institutions which require those who wish to provide such services to obtain the requisite license from the Financial Service Agency (FSA)
2.	France	The Autorité de Contrôle Prudentiel et de Résolution (ACPR) and Autorité des Marchés Financiers (AMF) hubs were set up in 2016 with primary responsibility for fintech and work most closely with the Banque de France and the Ministry for the Economy and Finance on fintech issues. The AMF has created a "coach system" consisting of regulatory support for new entrants, which leads to a better understanding and adoption of the applicable regulations and avoids non-compliant business models developing. The main regulators of Fintech are AMF and ACPR
3.	United Kingdom	The Bank of England's (BoE) Fintech Hub considers how fintech impacts the BoE's policies including the Prudential Regulatory Authority's (PRA) objectives and how fintech could be used to support the BoE's core functions, while the Financial Conduct Authority (FCA), whose mandate includes competition, has an Innovate Department that focuses on innovations of importance to consumers and investors. Fintech in the UK is regulated by either the FCA or the Prudential Regulation Authority (PRA)
4.	Singapore	The Monetary Authority of Singapore (MAS) acts as the central bank and is the integrated supervisor for the financial sector

		where responsibilities for supervision of fintech fall "under one roof." It revealed that it is developing a pilot program with the Singapore Academy of Law to connect fintech companies with legal service providers. The program, known as the Payments Regulatory Evaluation Program, launched in November of 2019, and targets fintech companies in payment services. Financial products and services are regulated by different laws depending on the types of services or products offered; Money Lenders Act – the law regulates money lending, designation and control of credit bureau and the collection, use and disclosure of borrower information and data
5.	United States of America	Two formal coordination mechanisms are prominent among US federal financial regulators, the Financial Stability Oversight Council (FSOC) and the Federal Financial Institutions Examination Council (FFIEC). Both take up fintech issues from time to time and have set up working groups to deal with particular fintech issues. In addition, the Financial and Banking Information Infrastructure Committee (FBIIC) has a role to play in improving coordination and communication among financial regulators, promoting public–private partnerships within the financial sector.

Source: IMF Fintech Notes 2019

From the above, it is worth noting that instead of setting up new agencies, these countries have assigned new responsibilities to existing institutions.

The OECD recommends the following approaches that have been adopted in different jurisdictions:

- Oversight bodies should ensure they have adequate knowledge of the financial services market.
- Oversight bodies should ensure existing regulatory and supervisory tools and methods are adapted to, and explore new avenues for operating effectively in, the digital environment.

- Oversight bodies have the right resources and capabilities to operate effectively and flexibly in the digital environment.
- Oversight bodies should be capable of dealing with technological innovation issues and developments in an effective and multidisciplinary way, while ensuring key consumer protections are maintained. In relation to licensing or authorization requirements, this can be done by establishing mechanisms or adopting proportionate approaches which allow businesses to be innovative, while maintaining relevant safeguards and protection.
- Creating internal working groups to deal with innovation issues (responding to requests for information from businesses, evaluating compliance with the existing legal and regulatory framework for new products and services, etc.) with the participation of relevant units/departments and, where relevant, oversight bodies responsible for data protection and competition.
- Providing advice or guidance to new entrants to the market about the application of the regulatory framework to innovative approaches or business models that may deliver benefits to consumers. Such advice or guidance could include lessons learned from dealing with innovative approaches e.g. via a regulatory sandbox.
- Existing regulations are evaluated and if needed redesigned, adapted or clarified.
- The provision of financial services through digital channels can facilitate cross-border transactions which can present particular risks, e.g., in terms of the ability to seek redress or take enforcement action if required. Given this, oversight bodies from different jurisdictions should cooperate to ensure that consumers remain adequately protected.

REGULATION OF DIGITAL CREDIT IN KENYA

Regulation of lending in Kenya (for which licensing is apart) is done by the form of the institution and not by the activities it engages in. Examples are the Banking Act for commercial banks; the Sacco Societies Act for deposit taking saccos; and the Microfinance Act for deposit taking microfinance institutions. The majority of digital credit providers do not take deposits, but instead lend their own funds against their balance sheets. As a result, most of these lenders are not regulated. Digital lenders are largely unregulated and there are no caps on interest rates, except those backed by banks that are supervised by the Central Bank. In April, Central Bank blocked unregulated loan companies from some credit-reference services after public complaints that some firms were misusing information.

The Digital Lenders Association of Kenya (DLAK)

DLAK is a new member organization incorporated in 2019 bringing together the leading digital-first loan providers and associated stakeholders to facilitate mutual growth in the digital lending sector in Kenya.

The main objective of the organization is to set ethical and professional standards in the industry, to collaborate with policy makers and other stakeholders in addressing industry issues, contribute to knowledge and learning and to drive the overall growth of the digital lending and fintech sector in line with the Economic Pillar of the Vision 2030, MTP III and the Big Four Agenda. The association is governed by its code of conduct.

Consumer Protection

Consumer protection is the practice of safeguarding buyers of goods and services, and the public, against unfair practices in the marketplace. Consumer protection measures are often established by law. Consumer protection in the DLAK Code of Conduct is guided by the following principles;

a) Presenting clear offers to Consumers;
b) Avoidance of use of advertising means and methods as well as other financial or insurance products aimed at forcing Consumers to conclude digital loan agreements;
c) Providing pre-contractual information and content of contracts on dates that allow Consumers to get acquainted with all their terms freely;
d) Providing information in a non-misleading way;
e) Providing reliable information, explanations and assistance to Consumers at the stage of applying for a digital loan;
f) Conclusion of contracts in accordance with the relevant regulations in force at the date of signing the contract;
g) Transparent, correct and full presentation of digital loan costs to Consumers and
h) Informing the Consumer about obligations related to borrowing.

According to FSD, digital loans accounted for 54% of the market yearly loans making consumer protection integral in regulation. In the study, it was found that several borrowers did not adequately understand the costs of borrowing which other than the interest, include; service fees, rollover fees and excise duty.

As seen in the table below, the monthly interest rates charged by these platforms are extremely high since when annualized they come to a rate of over 150% which is well over what commercial banks currently offer. This is exploitative to the consumers who may not otherwise be able to access more formal lines of credit from commercial banks or other financial institutions.

No.	Platform	Maximum Monthly Interest Rate	Maximum amount (Ksh)
1.	Mshwari	7.5%	50,000
2.	Eazzy Loan	14%	3,000,000
3.	KCB Mobi Loan	4.08%	300,000
4.	Timiza	14%	100,000
5.	Branch	16%	70,000
6.	Tala	15%	50,000
7.	Okash	14%	70,000
8.	Berry	16%	50,000
9.	IPesa	12%	50,000
10.	Zenka	30%	30,000

Conclusion

While there may be several challenges that are posed by the development of these platforms owing to the rapid changes in the tech industry, for effective regulation, the following should be met:

- ***Adopting a cross agency approach to regulation****:* A cross-agency approach will be needed to support consistency, limit regulatory arbitrage, and contain new risks and therefore enable a holistic approach to regulation.
- ***Flexibility:*** There is need to continuously reassess the appropriateness of the current structures and readjust to meet the changes in the industry.

Recommendations

In 2019, the Central Bank of Kenya sought to amend the Microfinance Bill in a bid to include non-deposit taking entities. The institute therefore gives the following recommendations;

I. The CBK should work together with digital platforms; for instance, DLAK; to strategize on better risk-based credit pricing methods that will lower the costs of borrowing to the borrower. This will in turn ensure synergies and best solutions that best serves interests of both investors and consumers.

II. Since there is no legal framework governing digital lending, there is need to amend the Microfinance Act or the CBK Act to give the CBK jurisdiction over companies offering financial products. This will ensure that digital service providers are under the same regulatory framework thus promoting greater harmonization of practices, transparency of pricing and interest rates, and useful data reporting.

III. Have regulations/ laws governing digital lending in Kenya.

REFERENCES

1. https://theconversation.com/mobile-based-lending-is-huge-in-kenya-but-theres-a-downside-too-124195
2. https://www.imf.org/~/media/Files/Publications/covid19-special-notes/en-special-series-on-covid-19-digital-financial-services-and-the-pandemic.ashx
3. https://www.cma.or.ke/index.php?option=com_content&view=article&id=531:cma-regulatory-sandbox-ready-to-receive-applications&catid=12:press-center&Itemid=207
4. https://iclg.com/practice-areas/fintech-laws-and-regulations/japan
5. https://iclg.com/practice-areas/fintech-laws-and-regulations/france
6. https://iclg.com/practice-areas/fintech-laws-and-regulations/united-kingdom
7. https://iclg.com/practice-areas/fintech-laws-and-regulations/singapore