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# Digital lending in Kenya; the case for regulation

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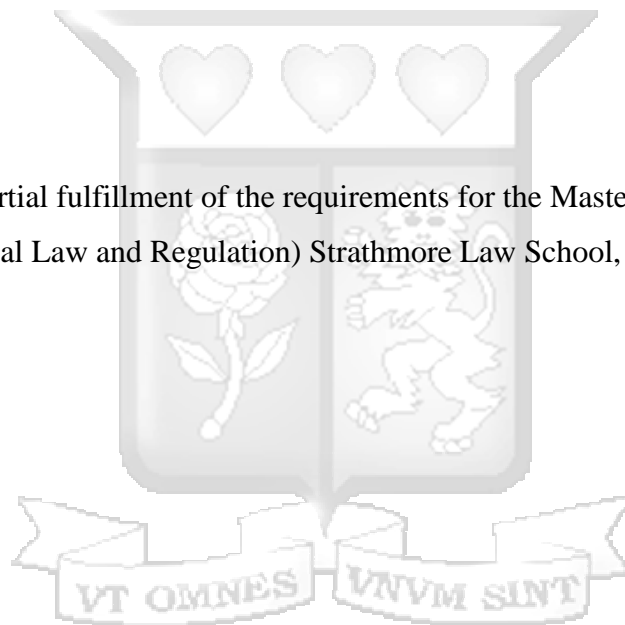
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# DIGITAL LENDING IN KENYA; THE CASE FOR REGULATION

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Submitted in partial fulfillment of the requirements for the Master of Laws Degree  
(International Financial Law and Regulation) Strathmore Law School, Strathmore University.



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**September, 2020**

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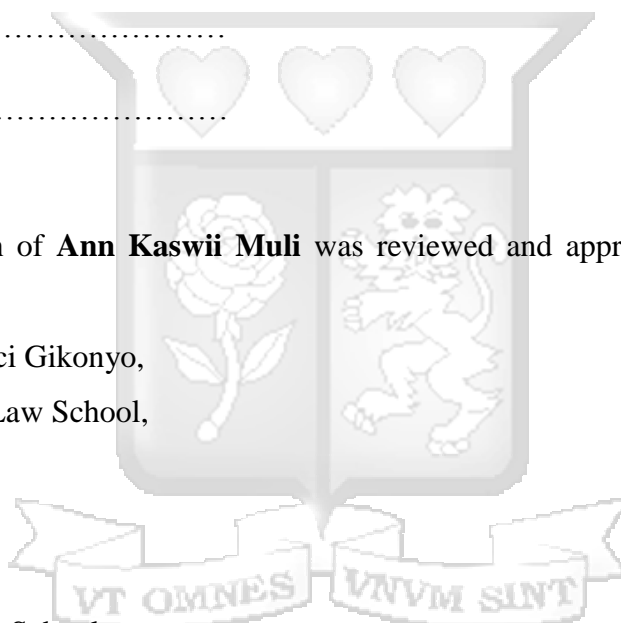
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## DEDICATION

To the memory of my late parents, Michael Mule Muli and Grace Wairimu Muli who sacrificed all they had to ensure I got an education; you were amazing parents and I am honored to have been your daughter. Whatever good I am, is because of you both.



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## ABSTRACT

Digital lending has become an important trend in increasing financial access to Kenyans who need access to short term finances. The expansion of technological options in the country has seen the proliferation of smart phones and in their wake, an increasing number of digital lending apps. The challenge seen is that the sector has grown significantly without a proper regulatory framework, a fact that is associated with growing cases of predatory lending as competition for customer's increase. This study sought to critically review the challenge of digital lending from a legal perspective with the intention of proposing a regulatory framework. The study relied on a variety of sources including primary sources such as acts of parliament from various jurisdictions, as well as case law. It also relied on secondary sources such as journals, online sources and legal literature discussion the issues. The main issues explored were the existing legal framework in Kenya under which digital lenders operate. Some consideration was also given to the reported practices of digital lenders especially relating to unfair trade practices. The study then focused on a benchmarking study of the regulatory framework governing digital lending in India and Nigeria, India being a more developed financial economy, while Nigeria offering an African perspective on digital lending. The key findings made included the following; First, there is no unified law or single regulator with a clear mandate to regulate the digital lending sector in Kenya, but there are several relevant regulators and laws that in total provide partial regulation of digital lending in the country. Secondly, it was determined that due to the gaps in regulation, digital lenders were infringing the rights of the mobile loan customers in Kenya, who are mostly the low income earners and with low levels of financial literacy. The third finding made in the comparison with India and Nigeria is that both countries had regulators with a clear mandate on digital lending, but in the Nigerian case, the presence of a strict regulatory climate seemed to stifle the growth of the sector. The main recommendations offered from the study were the enactment of an enabling law to establish a regulator for the sector or the amendment of existing laws to accommodate the issues arising from digital lending. The use of regulatory sandboxes was encouraged to reduce the negative impact of regulation on innovation.

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## LIST OF DEFINITIONS

### **Mobile Lending**

The process of using the mobile phone device to apply for and get a loans issued by a loan service provider to a borrowing customer.

### **Digital Lending**

The act of offering a loan to a customer using online technology without the use of physical intermediation in order to deliver faster and effective outcomes.

### **Digital Credit**

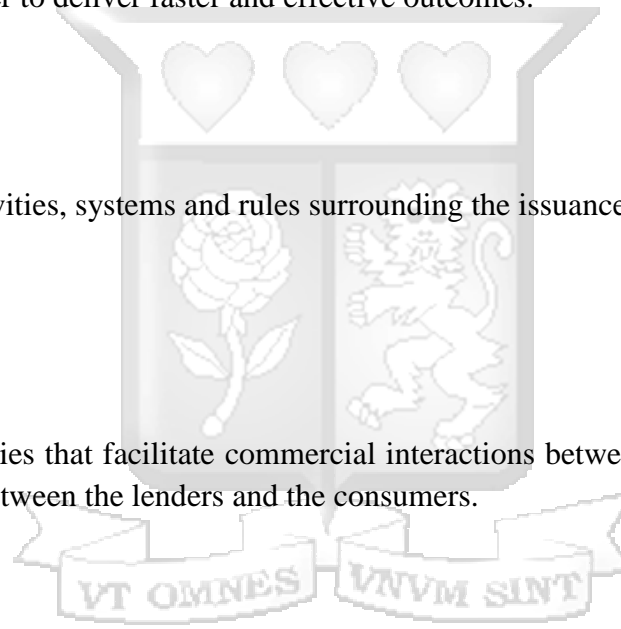
The collection of activities, systems and rules surrounding the issuance of loans using digital tools.

### **Digital Platforms**

These are online entities that facilitate commercial interactions between at least two different groups, in this case between the lenders and the consumers.

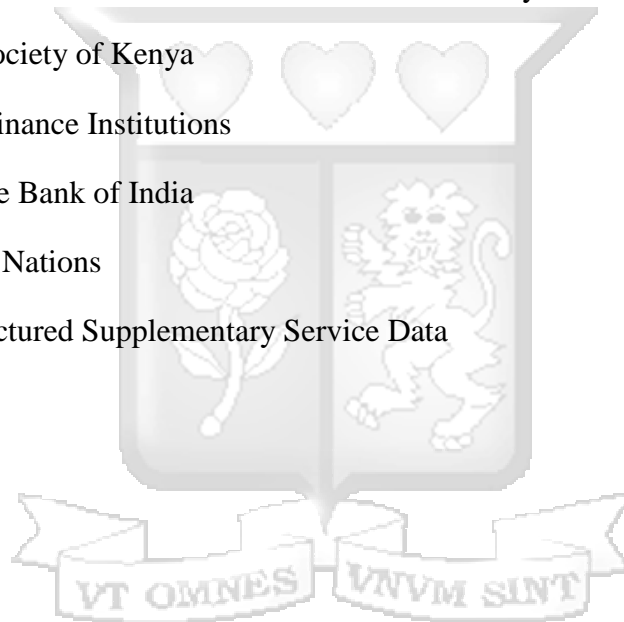
### **Fintech**

Collective term referring to financial technologies including digital lending.



## LIST OF ABBREVIATIONS

CA	Communications Authority
CBK	Central Bank of Kenya
CBN	Central Bank of Nigeria
CGAP	Consultative Group to Assist the Poor
CFI	Center for Financial Inclusion
DLAK	Digital Lenders Association of Kenya
EU	European Union
ICPAK	Institute of Certified Public Accountants of Kenya
LSK	Law Society of Kenya
MFI	Microfinance Institutions
RBI	Reserve Bank of India
UN	United Nations
USSD	Unstructured Supplementary Service Data



## LIST OF STATUTES

### Kenya

1. The Constitution of Kenya (2010)
2. Banking (Amendment) Act (No. 10 of 2018)
3. Capital Market Act (No.15 of 2018)
4. Central Bank Act (No. 10 of 2018)
5. Companies Act (No. 17 of 2015)
6. Data Protection Act (No. 24 of 2019)
7. Digital Lenders Association of Kenya (DLAC) Code of Conduct
8. Financial Markets Conduct Bill (2018)
9. Kenya Information and Communication Act (No. 25 of 2015)
10. Law of Contract (No. 2 of 2002)
11. Microfinance Act (No.4 of 2012)
12. National Payment Systems Act (No. 39 of 2011)

### India

1. Banking Regulation (Amendment) Act (No 30 of 2017)
2. Information Technology Act (No 21 of 2000)
3. Reserve Bank of India (Amendment) Act (No.9 of 1940)

### Nigeria

1. Banks and other Financial Institutions Act, (BOFIA), 1991
2. Cybercrime (Prohibition, Prevention) Act, 2015
3. Evidence Act, 2011
4. Money laundering (Prohibition) Act, 2011
5. Terrorism (Prevention) Act, 2011

## LIST OF CASES

1. *Desires Derive Limited v Britam Life Assurance Co. (K) Ltd*, (2016)
2. *K. S Puttaswamy (Retd.) & Anr. v. Union of India & Others* [Writ Petition (Civil) No. 494 of 2012] (India)
3. *Misore & Anor v. Aregbesola & Others.* (2015) 7 SCM 92 at 157 (Nigeria)



# CHAPTER 1

## INTRODUCTION

### 1.1 Background to the problem

In the last decade, many financial service providers in developing countries have adopted digital lending through mobile applications. Digital lenders in Kenya include Branch, Equitel Eazzy Loan, Jumo/ Kopa Cash, KCB-M-Pesa, Kopa Chapaa, Micromobile, Mjiajiri, M-pawa-Sacco, M-Shwari, Okoa Stima, Pesa na Pesa, Pesa Pata, Pesa Zetu, Saida, Tala, and Zindisha.<sup>1</sup> It is to be noted that some of these digital lending products like KCB-M-Pesa and Mshwari are offered by banks. However, most of the other digital lenders are independent and the distinction between them is not very critical for this study since the same concerns exist for all digital lending entities, whether they are banking or non-banking institutions.

The market for digital credit in Kenya is estimated at 6 million unique potential borrowers.<sup>2</sup> The digital lending services are conveyed by a range of providers and target all individuals who have the ability to utilize them, which includes the unbanked, the disadvantaged in the society like the poor, the disabled and other excluded populations.<sup>3</sup> It is to be noted that the traditional banking business was only accessible to the financially stable and those who had collateral and could access the bank branches and afford to repay the loans together with the interest and fees chargeable.<sup>4</sup>

The key players in the mobile lending market based on the levels of loan disbursements, are as follows; Mshwari has disbursed over Kshs. 230 billion since its inception in 2012, Equity bank has disbursed a reported Kshs. 60 billion through digital lending since 2014, and Kenya commercial bank, the largest bank by assets base, provides 90% of its loans through KCB-Mpesa.<sup>5</sup>

Despite the above success of the digital lending disbursements, there are inadequacies that have also been reported. The inadequacies are driven by issues such as consumer exploitation, exorbitant interest rates, data privacy infringement on account of the vast quantities of personal

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<sup>1</sup> Kaffenberger M and Chege P, *Digital credit in Kenya, time for celebration or concern?* CGAP 2016 - <<http://www.cgap.org/blog/digital-credit-kenya-time-celebration-or-concern>> on 23 January 2017.

<sup>2</sup> Gubbins, P. & Totolo, E. *Digital credit in Kenya: Evidence from demand-side surveys*. Nairobi, Kenya: FSD Kenya. 2018, 69.

<sup>3</sup> Kendall J, Nataliya M and Ponce, *Measuring financial access Around the World*.13.

<sup>4</sup> Totolo, E. *The digital credit revolution in Kenya: an assessment of market demand, 5 years on*. Nairobi, Kenya: FSD Kenya, 2018, 2.

<sup>5</sup> Paul Gubbins & Edoardo Totolo, 69.

information found in handheld devices, and lack of clear redress mechanisms for aggrieved consumers who are mostly low income earners with poor financial literacy. This explains why offering of loans through digital platforms is described by the World Bank both as a resounding success and at the same time, a regulatory minefield.<sup>6</sup> The reported inadequacies arise due to the fact that the digital lenders are not regulated by any financial regulator. Further, there is the absence of a substantive law to regulate the digital lending sector and effect of this includes the absence of clear offences that may be committed in situations unique to digital lending, and hence lack of a remedy in law for any aggrieved consumers. The lack of a regulator and the lack of substantive digital lending law will be discussed in detail in this paper.

The main features of the digital loans are; loan eligibility assessment, loan appraisal, loan disbursement, and short loan tenures. Loan eligibility assessment is facilitated through the existing digital platform and therefore there is no need for a customer to have an existing account with a bank to receive the loan requested.<sup>7</sup> Most lenders have designed their products in such a way that they only require the borrowers to have active mobile phone subscriptions.

Secondly, loan appraisal and the resultant decisions on lending are automated and are based on data that is not the normal credit information used by banks.<sup>8</sup> The approach adopted by these lenders is that all data is considered relevant for lending purposes and there is the reliance on alternative algorithms in determining whether or not to lend to borrowers. The data that is commonly used includes mobile phone utilization, mobile payments usage, airtime usage, data obtained from the borrower's digital networking websites accounts. Typically, digital lenders do not require any collateral to offer loans. Rather they use the data provided by the user to assess their viability and their risk status. Thirdly, the loans are disbursed automatically as the resultant resolution to issue the loan is automated. This is the key distinguishing factor from the traditional bank loans which takes some time to be approved as the loan appraisal undergoes a human facilitated process. The loans are disbursed using mobile money services which currently include Mpesa, Airtel Money, and others. This creates an additional layer of terms of service (from service vendors) that digital lenders must deal with. Mobile money transfer service

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<sup>6</sup> Klein M and Mayer C. 'Mobile banking and financial inclusion: The regulatory lessons', *Policy research working papers*, 2011.

<sup>7</sup> Wang JC, 'Technology, the nature of information, and FinTech marketplace lending', *Current policy perspectives* (18)3, 2018, 3.

<sup>8</sup> Hurley M and Adebayo J, 'Credit scoring in the era of big data', *Yale journal of law and technology*, 2016, 148.

providers set their terms of service and establish their own fees, which are not regulated and usually vary from one provider to another.<sup>9</sup>

The fourth characteristic is that due to the target market, the loans have a short tenure and are of high risk to the lender.<sup>10</sup> The lender usually compensates for this risk through high pricing rate to ensure there is a high return, noting that the products have a high chance of default as the target clients are the cash strapped and underprivileged borrowers.

The interest rates charged in mobile loans is unregulated and varies, with the lenders having the discretion to set their own interest rates as the existing regulatory framework does not prescribe the interest rate to be charged on digital loans. For instance, borrowing Kshs. 100 from Mshwari and Fuliza would attract a monthly interest of 7.5% and an annual interest of 135%, but if one borrows Kshs. 2,500 from Fuliza, the annual interest is only 17%.<sup>11</sup> The effect is that smaller borrowers are charged exorbitantly high interest rates, which in turn deepens their indebtedness and reduces their ability to get out of debt. Other offerings are as high as 620% per annum from Kopa Chapaa as reported by CGAP.<sup>12</sup> This problem occurs as a result of the fact that the digital lenders are not regulated as discussed above and are free to charge any interest amounts.

The pricing model for these mobile loans involves charging of interest rates either weekly or monthly, and there is the inclusion of facility fees and/or commissions. For the mobile loans platforms that are backed by commercial banks, there is the charging of a monthly facility fee; for instance, M-Shwari charges a 7.5% facility fee, which when computed adds to an annual rate of 90%. It is noted that even for these bank products which are regulated by the CBK, the banks charge a facility fee which then cannot be argued to be interest rate, noting that the CBK has power to limit the amount of interest rate payable but does not limit facility fees.<sup>13</sup> Lending companies that are more established such as Branch and Tala normally charge 14% and 15% monthly interest rates, respectively, which if computed annually amounts to 168% and 180%, respectively, which is way higher than the set average of commercial banks' of approximately 13% per annum.<sup>14</sup>

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<sup>9</sup> Watima T, 'Self-regulation key in digital lending' Business Daily, 17 June 2019.

<sup>10</sup> Kaffenberger M and Chege P, *Digital credit in Kenya, time for celebration or concern?*

<sup>11</sup> Sunday, F and Kamau M. Mobile loans: *The new gold rush minting billions from the poor* , 25th Jun 2019 , <https://www.standardmedia.co.ke/business/article/2001331308/mobile-loans-the-new-gold-rush-minting-billions-from-the-poor>.

<sup>12</sup> Michelle Kaffenberger, Patrick Chege.

<sup>13</sup> Refer to *Consumer Federation of Kenya (COFEK) v. CBA & others* , 2018.

<sup>14</sup> Kaffenberger M, and Totolo E and Soursourian M, 'A digital credit revolution; insights from borrowers in Kenya and Tanzania' CGAP, working paper, 2018, 14.

The default rate associated with mobile lending is one of the key concerns that point towards the need for regulation. A report published by TransUnion, one of the three Credit Reference Bureaus in Kenya, indicated that there were 2.7 million persons having non-performing loans.<sup>15</sup> It was also noted from the report that out of this number, 400,000 of them were for loans valued at less than Kshs. 200. The 2019 Fin access survey puts the default rate of Mobile Lending at 18%, which is higher than the default rate for commercial banks which stands at 2.2% and this is therefore excessive. In contrast, Banks are governed by the in duplum rule which puts a ceiling on the interest a bank can charge on a loan by limiting the overall possible interest to the value of the loan. The clarity on the application of this rule was provided in **Desires Derive Limited v Britam Life Assurance Co. (K) Ltd**, where Justice Tuiyot ruled that the In Duplum Rule is applicable to banks only and not to other lenders.<sup>16</sup> In this case, the court stated that these provisions of the rule are applicable to the list of banks and financial institutions that are contained in the Schedule of the Central Bank Act, and any institution not listed in the schedule is not bound to comply with the act. In this case, Britam Life Assurance is not classified among the institutions that are included in the central bank schedule that are then subject to the in duplum rule.<sup>17</sup> From the above decision, it is clear that digital lenders are not subject to this rule and there is no law barring them from charging excessive interest to customers.

With respect to collection of overdue amounts, the debts are outsourced to debt recovery firms which are known to send incessant text messages to consumers, whether designed for their nuisance value or to intimidate customers into paying the loans.<sup>18</sup> Some debt recovery firms have been known to call people in the lenders phonebook as part of the debt recovery process to compel them to pay. Some have even threatened to call the employers of a particular person in a bid to threaten them to pay back their loans.<sup>19</sup> Some of the practices such as transfer of consumer data from the digital lender to a debt recovery firm, may need judicial determination in regards to their legality.

On the uses of mobile loans, borrowers indicate that they use their digital loans for their business and farm activities, to meet day to day needs, to purchase airtime, for personal emergencies and for educational needs.<sup>20</sup> These loans seem to be useful as a means of managing cash flow

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<sup>15</sup> Paul Gubbins & Edoardo Totolo, 44.

<sup>16</sup> (2016) eKLR.

<sup>17</sup> Section 2, *Central Bank Act* (Act No. 10 of 2018).

<sup>18</sup> Sunday, F and Kamau M. Mobile loans: *The new gold rush minting billions from the poor*, 25th June 2019.

<sup>19</sup> Ogola, F. Why your favourite loan app might turn you into a pariah, 9 Dec 2018 <<https://www.standardmedia.co.ke/article/2001305624/why-your-favourite-loan-app-might-turn-you-into-a-pariah>> 2019.

<sup>20</sup> Paul Gubbins & Edoardo Totolo 41.

challenges by businesses. The main concern with digital loans is that it is resulting in the vulnerable members of the society ending up in debt traps. The debt traps are the result of high interest rates, low capacity to services debts usually because of little or no income. This usually brings about a debt cycle where one borrows from one lender to pay off a loan on another.

There are also concerns on infringement of consumer's right of data protection arising, as the mobile applications that are relied on for digital lending collect and rely on the customer's personal data, including extremely sensitive personal data to enable scrutinizing of their digital footprints for purposes of marketing and credit scoring. This mostly occurs without the knowledge and consent of the customer, thus breaching the consumer's right to privacy and the right to information privacy guaranteed in the Constitution of Kenya.<sup>21</sup> Such usage of data without the customer consent also contravenes global data privacy practices<sup>22</sup> which issue will be discussed further in this paper.

On the terms and conditions of the digital loans, consumers have expressed concerns that the terms are not clearly communicated at the time of the disbursement of the loan. According to the 2016 FinAccess survey, 19% of the respondents in the survey expressed concerns over unforeseen charges and unclear costs of loans. This is in contravention with the Consumer Protection Act, 2012 which requires that all credit providers disclose all the prescribed information relating to a credit agreement. The Central Bank of Kenya (CBK) also issued consumer protection guidelines, which require that all lenders should fully disclose the total cost of credit to their customers.<sup>23</sup> It is noted that the digital lenders do not adhere to the consumer protection guidelines based on the 2016 FinAccess survey that borrowers are susceptible to exploitation by the digital lenders.<sup>24</sup> There is therefore the need for the regulator to further assess how to protect consumers from the various forms of exploitation that they are likely to face from the digital lenders.

This study therefore attempts to provide an assessment of the regulation governing digital lending in Kenya with the view of proposing stronger regulatory involvement of the government.

## **1.2 Statement of the Problem**

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<sup>21</sup> Article 31, Constitution of Kenya (2010).

<sup>22</sup> Intersoft Consulting, The general data protection regulation, Intersoft Consulting, 2019, <<https://gdpr-info.eu/>> 18 Sep 2019.

<sup>23</sup> Central Bank of Kenya, Prudential Guidelines, 22.

<sup>24</sup> FinAccess, *2016 FinAccess household survey*, 2016, 13.

Digital lending services have improved the credit market landscape. However, the fintech sector faces many challenges and requires regulatory intervention. Exploitation of borrower by digital lenders is a concern, and the interest rate charged to the customers who take digital loans is exorbitant. Concerns also exist on the privacy of personal data collected from customers and how well the data is protected from misuse. From the above, there is need for a regulatory framework to guarantee better protection for consumers in order to provide a conducive and enabling environment for access to credit facilities to the public through these digital lending services. The problem this study intends to address is the need for regulations to address digital lending in Kenya. Therefore, this study will explore the issues surrounding the lack of the regulatory oversight on digital lending as the basis for proposing a fitting regulatory framework for the fintech sector.

### **1.3 Justification for the Study**

The study is necessitated by the need to carefully examine the contribution that regulations aimed at the mobile lending sector would bring to the country in the context of the role mobile lending plays in providing access to credit for individuals. The study will identify the existing gaps in law and regulations and examine why they need to be addressed from a legal perspective. The findings will be important to regulators as they will help clarify the problems and the regulatory gaps that exist. The findings will also be important for the legislature in its efforts to create enabling laws for the fintech sector in general. The implications of the study will be that the case for regulation in the digital lending sector will have been established or disproved; hence it will be possible for interested parties to move forward based on an informed position.

### **1.4 Statement of the Objective**

The aim of this study is to present the case for regulation in the fintech sector, specifically in the area of digital lending. The objectives of the study are;

1. To examine the existing regulatory framework governing the digital lending sector in Kenya.
2. To explore whether inadequacy of regulation is a contributory factor in exploitative lending practices in the digital lending sector.
3. To benchmark digital lending regulations from India and Nigeria and issue proposals for reform of the digital lending practices in Kenya based on the lessons learnt from the jurisdictions.

## 1.5 Research questions

The research questions undergirding this study are;

1. What is the current regulatory framework available to digital lending?
2. How does the lack of an adequate regulatory framework contribute to exploitative lending practices by digital lenders in Kenya?
3. What lessons from other jurisdictions on regulations be used to improve digital lending practices in Kenya?

## 1.6 Hypothesis

This will proceed with the following hypothesis;

1. Digital lending services in Kenya are exploitative to consumers because of lack of an adequate regulatory framework.

## 1.7 Theoretical Framework

### 1.7.1 Public Interest Theory

Regulation is defined as the reliance on the statutes or mechanisms of law to implement social and economic policy.<sup>25</sup> Regulation is also defined as the public administrative policing of a private activity, with respect to a rule prescribed in the public interest and serves as its main purpose to protect the vulnerable borrowers whose bargaining power is insignificant compared to the lenders.<sup>26</sup>

The Public Interest Theory of regulation emerged from the works of A.C. Pigou in 1932 to cater for circumstances where authorities need to intervene in markets to ensure that the common good of the public is defended. Pigou argued that when private enterprises are left to operate unfettered even with competition, the result is always a skewed distribution of resources favorable or unfavorable to what he calls the national dividend. The remedies he proposes are taxes, price regulation or subsidies to balance out the benefits as related to public interest and the interest of the firms.<sup>27</sup> Usually, businesses have asymmetrical power in the marketplace

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<sup>25</sup> Hertog J, *General theories of regulation*, Economic Institute/ CLAV, Utrecht University, 1999, 224.

<sup>26</sup> B. Mitnick, *The Political Economy of Regulation: Creating, Designing, and Removing Regulatory Forms* Columbia University Press, New York 1980, 7.

<sup>27</sup> Picou AC, *The Economics of Welfare*, Palgrave-MacMillan, New York NY, 1932, 381

when they are offering a unique product or when they occupy a monopolistic position. In this case, the business can take advantage of the public since the public has no alternative.

Public interest theory addresses the challenges associated with market imperfections (such as positive and negative externalities) and market failure.<sup>28</sup> Market imperfections characterized by excess costs paid by society as a result of the activities of an enterprise, or the excess benefits accrued to society at the expense of an enterprise. In each of these cases, the cost is transferred, meaning that the right party is not meeting its costs in the business transaction. With respect to market failure, the issue at play is lack of perfect competition. This situation is characterized by the presence of monopolies, oligopolies, monopsonies and oligopsonies. In these cases, there are either a single or a small number of large consumers or sellers. This situation affects free markets since influence is controlled by a few parties who can dictate market conditions such as pricing of goods and services.

In the context of a study on regulation, it is clear that the presence of market imperfections and market failure are ideal conditions to put forward the case for regulation. In this case, digital lenders have near full control of the digital lending space since there are a small number of firms active in the sector, and they can collude to monopolize prices. There is also the issue of Information asymmetry, which is a position where one party in a transaction has better information than the other. In financial services like digital lending, information asymmetry occurs as the lenders have more information than the borrowers about the products being offered and their cost implications.<sup>29</sup> As a result of the asymmetry, the consumers are uninformed about the risks that the contractual terms assign and are unable to choose terms that are favorable to them.<sup>30</sup> Further, the lack of understanding of language used including the financial terms may give companies an incentive to exploit the ignorance by using sophisticated and unclear terms that would place the customer at a disadvantage.<sup>31</sup>

Therefore, public interest theory provides a straightforward framework for assessing whether the conditions that should be met for regulation to be an option, have been met in the digital lending space.

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<sup>28</sup> World Bank, Public Interest Theory of Regulation, Body of Knowledge on Infrastructure Regulation, <http://regulationbodyofknowledge.org/glossary/p/public-interest-theory-of-regulation/> 26 October 2019.

<sup>29</sup> Veljanovski C, 'Economic approaches to regulation' in Baldwin R and others, The Oxford handbook of regulation, Oxford University press 2010, 20

<sup>30</sup> Schwartz, A and Wilde, LL, 'Imperfect Information In Markets For Contract Terms: The Examples of Warranties and Security Interests'. Yale Law School, Faculty Scholarship Series. Paper 1119, 1983, 1389

<sup>31</sup> Schwartz, A and Wilde, LL, 'Imperfect Information In Markets For Contract Terms: The Examples of Warranties and Security Interests', 1389

Public interest theories have been criticized by different scholars.<sup>32</sup> One of the key criticisms of public interest theory is that it leaves open the determination of when public interest has been met, or it leaves that decision in the hands of regulators who may well be acting in their own interest.<sup>33</sup> In case of a monopoly, there is also the risk of regulatory capture where public interest cedes ground to the interests of the regulator. Regulatory agencies such as the Central Bank of Kenya which exist for legitimate public purposes like protecting the public from exploitation, are then either mismanaged or become complacent resulting in failure to achieve these purposes.<sup>34</sup> To prevent this, it is important for the financial services sector to ensure that principles of a sound regulatory framework, which include proportionality, certainty, flexibility, durability, transparency and accountability, are adhered to, regardless of the form of regulation.<sup>35</sup> Noting that regulation may be costly, it is critical that regulators ensure that the price of regulation is not too costly and that the regulations are not too stringent to prevent innovation and product development.<sup>36</sup>

There are four models of financial supervision currently employed across the world. These include institutional regulation, functional regulation, twin peaks regulation and integrated approach to regulation.<sup>37</sup> The selection of a specific regulatory model by a country is dependent on different factors, some of which may be unique to a specific country like its economic, political, legal and historic considerations.

The institutional approach to regulation is where the legal status of an organization determines the regulator which is tasked to exercise oversight over its activities. In this model, there is the establishment of a regulator who strictly supervises all the activities that the institution engages in.<sup>38</sup> The key benefit of this model is that the regulator is more knowledgeable in the specific field and they continue to acquire a deeper expertise in the sector that they regulate. The major criticism for this approach is that it is not suitable for modern financial firms which perform a variety of functions.<sup>39</sup> For instance, financial services offered by an entity like Safaricom may

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<sup>32</sup> Posner RA, 'Theories of Economic Regulation', *The Bell Journal of Economics and Management Science*, 1974, 5

<sup>33</sup> Price ME and Verhulst SG, *Self-regulation and the Internet*, Kluwer Law International B.V., 2005, 4

<sup>34</sup> Posner RA, *Theories of Economic Regulation*, 5

<sup>35</sup> New Zealand Treasury, *The Best Practice Regulation Model: Principles and Assessments*, 2012.

<sup>36</sup> Veljanovski, *Economic approaches to regulation*, 21

<sup>37</sup> Mwenda KK, *Legal Aspects of Financial Services Regulation and the Concept of a Unified Regulator*, World Bank, Washington DC, 2006. 23

<sup>38</sup> Luis Garicano, 'Towards a New Architecture for Financial Stability; Seven Principles', *International Economic Law*, 2010, 606.

<sup>39</sup> Taylor M, 'Institutional structures of regulation' in Caprio G *Handbook of Safeguarding Global Financial Stability: Political, Social, Cultural and Economic Theories and Models*, 2013, 473

fall in the financial services sector and also in the communications sector, leading to a regulatory overlap and there may be confusion and contradiction on compliance.<sup>40</sup> This model has been adopted in China and Mexico.<sup>41</sup>

The functional approach on the other hand centers on the specific tasks of institutions and assigns a different regulator for each of the different tasks being carried out, without regard to its legal status.<sup>42</sup> The key benefit of this approach to supervision is that there is consistency, as a single regulator will apply consistent rules to the same activity regardless of the legal status of the entity in which it is conducted. This is the approach in use in Kenya where there are various sets of laws with different regulators.<sup>43</sup> For instance, the activities of Safaricom are supervised by several regulators. Its telecommunications activities are supervised by the Communications Authority of Kenya (CAK) with the Central Bank of Kenya (CBK) supervising digital financial services functional responsibilities.<sup>44</sup> There are still other laws that are applicable over certain functions that Safaricom is obligated to comply with. For instance, issues of competition under the mandate of the Competition Authority of Kenya, Consumer Protection compliance as per the Consumer Protection Act and compliance with the provisions of the Data Protection Act.<sup>45</sup>

The benefit of the functional approach to supervision is that there is consistency in supervision as a single expert regulator will apply the same rules to the same activities across board. The regulator is also able to engage people with expertise who can interpret the rules in relation to similar activities and apply them consistently across board, while also conducting adequate research on emerging technological issues.<sup>46</sup> The key disadvantage of this approach is duplicity of regulation due to the existence of disparate regulators and potential inconsistency in the application of rules and regulations.<sup>47</sup> This disadvantage can be addressed through co-ordination by various enforcement agencies with areas of cooperation including joint inspections, sharing of risk assessment tests and collaboration in research.<sup>48</sup>

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<sup>40</sup> Malala J, *Consumer Protection for Mobile Payments In Kenya: An Examination Of The Fragmented Legislation and The Complexities It Presents For Mobile Payments*, 2013, 15

<sup>41</sup> Mwenda KK, *Legal Aspects of Financial Services Regulation and the Concept of a Unified Regulator*, 23

<sup>42</sup> Samuel J, *The Institutional Structure of Financial Regulation in the UK: The Final Reforms*; 2016.

<sup>43</sup> Gibson E 'Regulating digital financial services agents in developing countries to promote financial inclusion' *Singapore Journal of Legal Studies*, 2015, 28

<sup>44</sup> Malala J, *Consumer Protection for Mobile Payments In Kenya*, 215

<sup>45</sup> Malala J, *Consumer Protection for Mobile Payments In Kenya*, 230

<sup>46</sup> Taylor M, 'Institutional structures of regulation'<sup>432</sup>

<sup>47</sup> Mwenda KK, *Legal Aspects of Financial Services Regulation and the Concept of a Unified Regulator*, 23.

<sup>48</sup> Mwenda KK, *Legal Aspects of Financial Services Regulation and the Concept of a Unified Regulator*, 24.

The twin peaks regulation model entails the separation of regulatory functions between two regulators, where one is responsible for prudential guidelines and another responsible for the conduct of business regulation. It is argued that this separation approach makes prudential regulation more intensive and it is an effective means of ensuring that issues of transparency, market integrity, and consumer protection receive sufficient priority.<sup>49</sup> On the other hand critics argue that the model is inefficient as it suffers from inadequate communication between the two regulators hence may be inefficient.<sup>50</sup> This model has been adopted in Australia, Netherlands and the United Kingdom.<sup>51</sup>

The fourth and final model of regulation is the integrated approach to regulation. This is where a single or unified regulator oversees both the prudential and conduct aspects for all the sectors of financial services.<sup>52</sup> Some of the countries which apply this approach include Germany and Canada. The approach can be effective and efficient in smaller markets with the advantage of lower institutional and overhead costs of maintaining multiple regulatory agencies.<sup>53</sup> Critics argue that there is lack of competition to ensure that the regulator is challenged to outperform its competitors.<sup>54</sup>

When regulating financial services, two major approaches that are employed by countries in regulating the financial services industry are; the risk based approach to regulation and the principle based approach to regulation.<sup>55</sup>

With the risk based approach to regulation, the object of regulation therefore is defined in terms of the risk posed and the regulation is justified in terms of its role in minimizing the risk.<sup>56</sup> In the present case of digital lending, there is exploitation of vulnerable consumers by profit seeking lenders. Government intervention through well detailed regulation is therefore a necessity in order to minimize or prevent these consumer risks. The risk based approach is advantageous as it helps regulators to prioritize and allocate scarce resources strategically and adjust the intervention according to properly assessed risks.<sup>57</sup>

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<sup>49</sup> Mwenda KK, *Legal Aspects of Financial Services Regulation and the Concept of a Unified Regulator*, 25.

<sup>50</sup> Taylor M, 'Institutional structures of regulation' 435

<sup>51</sup> Taylor M, 'Institutional structures of regulation' 432

<sup>52</sup> Mwenda KK, *Legal Aspects of Financial Services Regulation and the Concept of a Unified Regulator*, 30

<sup>53</sup> Taylor M, 'Institutional structures of regulation' 475

<sup>54</sup> Taylor M, 'Institutional structures of regulation' 475

<sup>55</sup> Mwenda KK, *Legal Aspects of Financial Services Regulation and the Concept of a Unified Regulator*, 23

<sup>56</sup> Mwenda KK, *Legal Aspects of Financial Services Regulation and the Concept of a Unified Regulator*, 27

<sup>57</sup> Izaguirre JC and Jenik I, 'Risk-based supervision in the digital financial inclusion era' 2016 GPF White Paper-Standard-Setters and Inclusion, 2016, <<https://www.cgap.org/blog/risk-based-supervision-digital-financial-inclusion-era>> on 23rd April 2020.

On the other hand, the principle based approach to regulation relies more broadly on principles to set the parameters within which regulated firms must carry out their business.<sup>58</sup> They are written in a very general way so that they can be adaptable to different situations especially with technological innovation. The principles allow the regulated a discretion to choose the means that best achieves the outcome sought by the regulator. For innovation, the principle based approach is ideal as it is flexible and is therefore able to deal with future issues of technological advancements as well as product development.<sup>59</sup>

The principle based approach has several criticisms. First, there is no certainty on how the firms are to measure their compliance and what the exact expectation of the regulator is as there is no prescriptive rules and directions. Secondly, due to the lack of certainty, enforcement of legal rights for an aggrieved party may be problematic. The counter argument for this criticism however is that certainty of a rule is not dependent on whether a rule is general or detailed, but on whether there is an agreement on what the rule means and its intended outcome by all who are applying it.<sup>60</sup>

## 1.8 Literature Review

Regulation refers to rule making usually in the context of industry, and is usually a function of the government.<sup>61</sup> In a synthesis of various definitions of regulation, Koop and Lodge found that there is scholarly consensus that regulation involves direct and intentional interventions with specific objectives.<sup>62</sup> However, there are great disparities around how derivative definitions are developed to fit their conceptual context. Price and Verhulst conceptualized regulation as a continuum stretching from statutory activity (command and control) on one end, self-regulation in the center, and market regulation (*laissez-faire* approach) on the other end.<sup>63</sup> This view uses the level of formality and legal effect as the scale for categorizing the nature of regulation. The authors point out further that in reality, regulatory environments have varying amounts of the three types of regulatory systems since they each have their advantages and disadvantages.

It is noteworthy that on the aspect of self-regulation, that Digital lenders in Kenya came together to form the Digital Lenders Association of Kenya partly in response to the threat of statutory

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<sup>58</sup> Black J, 'Making a success of principles based regulation' *Law and financial markets review*, 2007, 191.

<sup>59</sup> Black J, 'Making a success of principles based regulation' 192.

<sup>60</sup> Black J, 'Making a success of principles based regulation' 191

<sup>61</sup> Kern A, *Principles of banking regulation*, Cambridge university press, New York, 2019, 4.

<sup>62</sup> Koop C and Lodge M, What is regulation? An interdisciplinary concept analysis, *Regulation and Compliance*, 2017, 95-108

<sup>63</sup> Price ME and Verhulst SG, *Self-regulation and the Internet*, Kluwer Law International B.V., 2005, 4.

regulation that would have introduces external controls to their industry.<sup>64</sup> Rahim, while appreciating that self-regulation is not an exact concept, discusses four basic forms of self-regulation which are mandated self-regulation (government defines the norms and framework for development of regulations), sanctioned self-regulation (industry made, government approved), coerced self-regulation (made in response to threat of statutory regulation) and voluntary self-regulation (no state involvement).<sup>65</sup>

Lodge and Wegrich described the three cornerstones of regulation as standard setting, behavior modification and enforcement.<sup>66</sup> Standard setting is the prescriptive component of regulation as outlined by the regulatory objectives and captured in legal statutes while behavior modification refers to the adoption of new requirements as set out by regulation, and where lack of compliance may lead to enforcement activity by the prescribed regulator. Koop and Lodge, while concurring with the three cornerstones proposed by Lodge and Wegrich, use the term sanctioning as opposed to enforcement.<sup>67</sup> This presents a less invasive view to regulatory activity but still communicates the authority usually associated with regulators,

Important concepts related to regulation include deregulation and non-regulation. Deregulation usually addresses the rolling back of state instituted measures intended to control the activities of an industry, while non-regulation refers to a situation where there does not exist regulatory dictates. Lodge and Wegrich add to the discussion of concepts in regulation by identifying the twin issues of regulatory failure, where existing regulation fail to achieve the intended objectives, and regulatory burden, which refers to the costs associated to compliance usually incurred by the regulated entities.

One of the key issues driving need for regulation to protect consumers is information asymmetry, which essentially means that customers have much less information as compared to business enterprises such as digital lenders, and as such, regulation is required to ensure consumers are protected.<sup>68</sup> Where digital lenders are not heavily regulated, they do have costs

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<sup>64</sup> Muchira, N. Should digital lenders worry as clients struggle? July 2 2019<<https://www.theeastafrican.co.ke/business/Should-digital-lenders-worry-as-clients-struggle/2560-5179802-fs8a8qz/index.html>> 2019.

<sup>65</sup> Rahim MM, *Legal Regulation of Corporate Social Responsibility: A Meta-Regulation Approach of Law for Raising CSR in a Weak Economy*, Springer Science & Business Media, 2013, 28.

<sup>66</sup> Lodge M and Wegrich K, *Managing Regulation: Regulatory Analysis, Politics and Policy*, *The Public Management and Leadership Series*, Macmillan International Higher Education, 2012, 14

<sup>67</sup> Koop C and Lodge M, What is regulation? An interdisciplinary concept analysis, 11(1) *Regulation and Compliance*, 2017, 95-108

<sup>68</sup> Department of Economic Affairs, Ministry of Finance, Government of India, *Report the steering committee on fintech related issues*, 2019, 23.

associated with regulatory requirements and as such are able to offer higher interest to lenders and lower interest rates to borrowers. Cartwright found that the common justification for the regulation of financial services is due to the need to protect the consumer, particularly the vulnerable consumer.<sup>69</sup> Blechman supports the view that to enable access to credit facilities for the poor and vulnerable, consumer protection policies are critical. The availability and accessibility of mobile credit products bring new risks to the most vulnerable and unsophisticated financial consumers and therefore sound regulation protecting the consumer is critical.<sup>70</sup>

It has been observed that digital lending platforms in Europe are not regulated in a similar manner as banks since they do not take deposits.<sup>71</sup> The situation in the American digital lending space is that there has been little regulatory activity, but there is a growing case for regulation as digital lending becomes more prevalent in the country.<sup>72</sup> A study conducted in Ukraine by Lavryk found that the increase in the volume of lending in Peer to Peer platforms coincided with a decline in bank lending.<sup>73</sup> It may indicate a preference for digital loans compared to traditional loans issued by banks. These jurisdictions in Europe and America indicate that there still lacks a unified approach to digital lending across these areas.

In India, fintech evolved faster than regulators could keep up, driven by innovation in the sector on one hand, and on the other the reluctance of regulators to create rules which may have preempted innovation.<sup>74</sup> Biscaye found that Indian digital loan products typically have longer repayment periods and lower interest rates compared to Africa mobile loan products.<sup>75</sup>

In the Nigerian case, it is reported that there has been a misconception that the Nigerian Fintech sector is not regulated because there are no laws or statutes that expressly state the word “fintech”.<sup>76</sup> However, the situation is such that there are several laws that address different parts of the fintech industry. Existing regulations address sectors such as digital payments (including

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<sup>69</sup> Cartwright P ‘The vulnerable consumers of financial services’ *Law, policy and Regulation*, 2011, 46

<sup>70</sup> Jason G, Blechman ‘Mobile credit in Kenya and Tanzania: *Emerging regulatory challenges in consumer protection, credit reporting and use of customer transactional data*, 2016, 43.

<sup>71</sup> Kern A, *Principles of banking regulation*, 5.

<sup>72</sup> Wilson JD, *Creating strategic value through financial technology*, John Wiley & Sons, New York, 2017, 78.

<sup>73</sup> Lavryk A, P2P Lending as an alternative to banks’ lending in Ukraine, 11(4) *Bank and Bank systems* 2016, 20

<sup>74</sup> Patel M and Murthi R, ‘Regulation in the fintech era’ *Fortune India*, 2019<<https://www.fortuneindia.com/opinion/regulation-in-the-fintech-era/103450>>, 19 Sep 2019.

<sup>75</sup> Biscaye, Review of digital credit products in India, Kenya, Nigeria, Tanzania and Uganda, *EPAR Technical Report #351a*.

<sup>76</sup> Oтуру D, Dan-Habu H, and Ojeshinagram K. Nigeria: Fintech Regulations In Nigeria - An Overview (Part 1), Last Updated: 8 April 2019,<<http://www.mondaq.com/Nigeria>>2019.

digital lending), data protection and cyber security.<sup>77</sup> Fintech players formed the Fintech association of Nigeria, a self-regulating body that draws its membership from firms active in the fintech industry.<sup>78</sup> Nigeria, just like Kenya, lacks a unified regulatory framework to govern the fintech sector, but instead relies on myriad laws and regulations that leaves regulatory gaps in the sector.<sup>79</sup> This lack of coherent regulations is thought to stifle the development of this sector in a country that has the potential to become one of the largest fintech markets in the world.

Didenko, in a study of fintech regulations in Kenya and South Africa concluded that the main barriers to effective fintech regulation are legal in nature and are not the result of technical challenges.<sup>80</sup> This conclusion underscores the evolving challenge of regulating the digital lending sector in Kenya. A study by Lebu looked at the challenges facing financial services regulation in Kenya and concluded that no regulatory model is ideal under all circumstances hence all new regulations should be made to meet the specific intended objectives for that industry.<sup>81</sup>

## 1.9 Research Methodology

The study is a doctrinal legal research. This study depends on the review and examination of primary and secondary sources of literature. The primary sources to be relied on include case law, statutes and regulations. The secondary sources to be used include encyclopedias, treatise and law journals, among others. The study shall achieve its objectives through an evaluation of the current laws and regulations affecting mobile lending in Kenya. There will be a review of academic journal articles, and reports concerning the issue of digital lending.

There will be reliance on comparison with two jurisdictions, specifically India and Nigeria, which have existing mobile lending regulatory framework, with a view to highlight best practices. India was chosen due to the fact that it has a fintech industry with numerous players which is highly regulated and having gained independence earlier than Kenya, the country has more experience in the development of regulations. Nigeria was chosen because it will provide an African experience in Fintech regulation and it will also provide contextual value.

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<sup>77</sup> Oturu D, Dan-Habu H, and Ojeshinagram K. Nigeria: Fintech Regulations In Nigeria - An Overview (Part 1).

<sup>78</sup> FAN, *Welcome to the fintech association of Nigeria*, October 28 2019. <<https://fintechng.org/>>2019.

<sup>79</sup> Anichebe, U, *How Regulations Can Define Fintech in Nigeria* Feb 26, 2019, Available at SSRN: <<https://ssrn.com/abstract=3354278>>

<sup>80</sup> Didenko A, *Regulating Fintech: Lessons from Africa*, *San Diego International law Journal*, 2018, 320.

<sup>81</sup> Lenu AL, *Financial services regulation in Kenya: An analysis of the proposed unified regulator*, University of Nairobi, Nairobi 2014, 47.

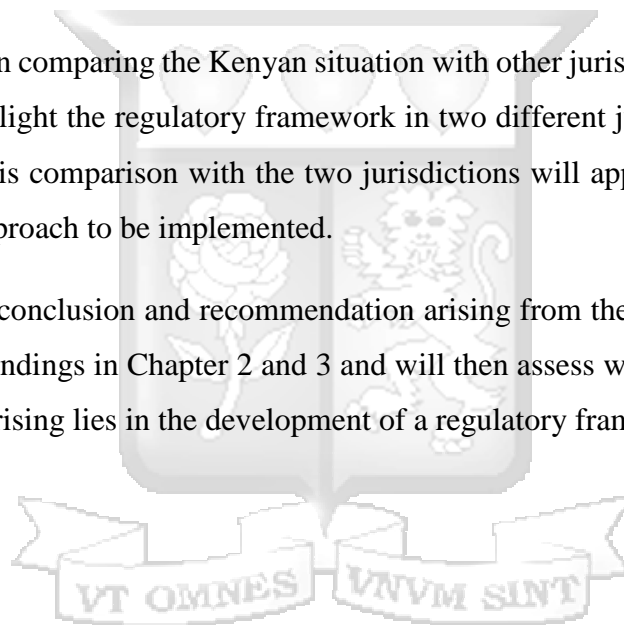
## 1.10 Chapter Breakdown

Chapter 1 is the introduction and it presents the background of the problem, the hypothesis, the questions answered through this research and the research objectives. It also sets out the methodology and reviews the available literature relevant to the study. It also provides the theoretical framework through which to examine the research topic and relies on the public interest theory of regulation.

Chapter 2 analyzes the digital lending sector in Kenya. This chapter will review digital lending regulatory framework and digital lenders practices in the Kenyan context. This chapter also analyzes the current position and efforts made to date in addressing the issues arising, either through the statutes or regulation and will identify the existing gaps.

Chapter 3 will focus on comparing the Kenyan situation with other jurisdictions being India and Nigeria, and will highlight the regulatory framework in two different jurisdictions with regard to mobile lending. This comparison with the two jurisdictions will apprise the Kenyan policy makers on the best approach to be implemented.

Chapter 4 will be the conclusion and recommendation arising from the study. The discussions will be based on the findings in Chapter 2 and 3 and will then assess whether the solution with respect to the issues arising lies in the development of a regulatory framework.



## CHAPTER 2

### DIGITAL LENDING FRAMEWORK IN KENYA

#### 2.1 Introduction

In the previous chapter, it was established that there is a need to examine the existing legal and regulatory framework surrounding the digital lending sector to determine the gaps that exist currently. It was also determined that the best approach to do this is to first examine all the laws and regulations that have relevance to the digital lending sector in Kenya.

Digital credit in Kenya is normally offered through four business models. First, there is the pioneer business model where the mobile network operators (MNO) partner with banks or other financial institutions.<sup>1</sup> In such cases the MNOs are the channel of disbursing the loans while the financial institutions operate the borrowers' accounts and offer the funds and they bear the default risk for the loans. Examples of this model includes the partnership between Safaricom M-Pesa and Commercial Bank of Africa (CBA) to issue the MShwari product. In such cases, the products are normally approved by the CBK and the banks are allowed to impose a facility fee on the product which is not considered to be an interest rate to be regulated by the CBK.<sup>2</sup>

The second business model is reliance on applications to issue digital credit. This is where the companies offer loans from their existing funds without entering into any agreements with a financial institution. The borrowers are required to install an app on their mobile phones which collects data on the borrower's mobile money usage as well as social media usage. It is through reliance on this data that the lenders assess and make decisions on whether the borrowers are creditworthy.<sup>3</sup> Such lenders in Kenya include Brach, Saida and Tala loan facilities.

The third business model is that of a bank offering digital services, where the banks develop their own digital infrastructure and therefore there do not partner with mobile network operators. An example is Equity Bank, through the Equittel product, where their telecommunication infrastructure is from Airtel Kenya.<sup>4</sup>

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<sup>1</sup> Francis E and others, Digital credit in emerging markets: a snapshot of the current landscape and open research questions, *Bill and Melinda Gates foundation*, 2017, 5.

<sup>2</sup> Central Bank of Kenya, *Banking Supervision Annual Report*, 2018.

<sup>3</sup> Hurley M and Adebayo J, 'Credit scoring in the era of big data', *Yale journal of law and technology*, 2016, 148.

<sup>4</sup> Mugo M and Kilonzo E, Community- level impact of financial inclusion in Kenya with particular focus on poverty eradication and employment creation, *Central Bank of Kenya*, 2017, 13.

The fourth business model in Kenya is Peer to peer lending (P2P). This model is a form of direct lending of money to customers without the participation of financial institutions. It is not as prominent as in other countries like India. P2P lenders provide the digital platform that links the customers to the lenders and they do not normally lend their own money as their role is limited to facilitating the lending process. In Kenya such companies include UbaPesa and Pezesha Loans.

This chapter reviews the various laws and related regulators whose mandates cover elements of digital lending in an effort to find out where the regulatory gaps exist. The complexity of regulating digital lending institutions is that their business model spans so many traditional economic sectors. They are part technological companies and part financial service providers. Regulations in the digital lending sector should not only be driven by the need to protect consumers, but also the need to encourage the sector to achieve a greater good for society by playing a constructive role in creation of access to credit beyond profiteering, and also to show support for innovation in general.

This chapter will begin by conducting a review of the existing legal framework governing digital lending, which in this case, refers to the key laws and regulations with some relevance to digital lending. The chapter then discusses the efforts made the digital lenders in self- regulation. The chapter concludes by summarizing the regulatory gaps identified in the preceding sections.

## **2.2 Digital Lending Regulatory Framework in Kenya**

The digital lending sector in Kenya occupies a unique position in as far as its regulatory framework is concerned. The sector is currently not governed by any specific Act of Parliament. It operates within a plethora of laws that touch on different aspects of their operations. Existing legislation and regulations offer some form of legal reference to the firms by providing a reasonable basis for their operations. However, it is easy to see that their operations, being by their nature innovative, have elements that were not contemplated by existing laws. The need of regulation is underscored by Bratasanu who sees regulation as a necessary step in the digital innovation process to maximise the benefits of the digital revolution.<sup>5</sup> In this section, the laws that have some relevance to the operations of businesses in the digital lending sector are identified and discussed with the view of identifying any existing legal and regulatory gaps. In this context, the laws that were seen to be of relevance to the operations of the digital lending

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<sup>5</sup> Bratasanu V, Digital innovation the new paradigm for financial services industry, Journal of Theoretical and Applied Economics, p 87.

sector were the Constitution of Kenya, The Companies Act, The Law of Contract Act, The Central Bank of Kenya Act, The Banking Act, The Microfinance Act, The Consumer Protection Act, The Competition Act, Capital Markets Act, Kenya Information and Communication Act, National Payment System Act, and the Data Protection Act. These Acts may be classified into Commerce legislation, Finance sector legislation and Information technology legislation. A mention is made of the Financial Markets Conduct Bill of 2018 that is still under discussion in parliament. It should be noted that it is not just digital lending institutions that operate under the purview of these Acts, but any business operating in Kenya would need to make reference to them, if their operations include activities that are regulated under these Acts. These Acts will now be reviewed in the specific context of digital lending institutions firms.

In 2010, the Constitution of Kenya was promulgated and it recognized the rights of consumers. Specifically, Article 42 of the Constitution of Kenya 2010 states;

(1) Consumers have the right-

- (a) to goods and services of reasonable quality;
- (b) to the information necessary for them to gain full benefit from goods and services;
- (c) to the protection of their health, safety, and economic interests; and
- (d) to compensation for loss or injury arising from defects in goods or services.<sup>6</sup>

The constitution provides the basis for all other acts that deal with matter related to consumer protection and fair business practices.

Further the Constitution of Kenya also provides for the right to privacy and guarantees the right to information privacy under This article states that;

"Every person has the right to privacy which includes not to have; information relating to their family or private affairs unnecessarily required or revealed; or the privacy of their communications infringed." It is on this basis that the need to safeguard the privacy of consumer's data in the digital lending market.

### **1.2.1. Commerce based legislation**

The first act with relevance to the operations of digital lenders is the Companies Act. The act provides the legal framework for the registration of companies providing different forms of company structures as well as the set of requirements a company must conform to legally

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<sup>6</sup> Article 47, Constitution of Kenya (2010).

operate in Kenya.<sup>7</sup> The significance of the Companies Act in this review is that each digital lender registers its entity with the registrar of Companies and makes declarations in regard to the nature of business they intend to conduct. The company in presentation of its articles of association makes decisions on the nature of business they intend to conduct. For instance, the decision not to engage in the business of taking customer deposits is made at this stage, since taking of customer deposits would bring them under the control of the Central Bank of Kenya which is a regulator for deposit taking institutions.<sup>8</sup> The registrar of Companies will not accept the incorporation of a deposit taking institution without an authority letter from Central Bank of Kenya confirming that they may proceed to incorporate the entity. This issue and the relevant legal provisions will be discussed subsequently in this chapter.

Secondly, the Law of Contract Act is applicable to digital lenders as it provides for the elements that constitute a binding contract between two parties. The existence of a valid and enforceable contract is a fundamental characteristic of the act of lending and borrowing. While the law is fairly straight forward, it has very interesting implications for the digital lenders and the fintech sector in general. The law states that for a contract to be binding, the parties must append their signatures in the presence of a witness. The main issue this raises is that the nature of digital lending does not allow for a third party in the transaction between the digital lender and the borrower. This is because the service is fully online and hence the traditional form of the Law of Contract Act is not a feasible option for handling the agreement between the parties. The other implication is that it brings into doubt the ability of digital lenders to recover their money in the traditional ways, which would involve recovering money from guarantors as spelt out in section 3(2) of the Law of Contract Act.<sup>9</sup> Since there are no guarantors involved and mobile loans require no collateral, digital lenders have developed their own means of ensuring lenders pay back. It is to be noted that without executed guarantees, a lender cannot attach the property of a guarantor. The principles of this law remain sound, but a proper application of these principles in digital lending may require the input of and alignment with the Information and Communication Act. It is noted that sections 83G and 83P of the Information and Communications Act gives electronic records the same status in law as material provided in writing and recognizes electronic signatures.<sup>10</sup> This is discussed in more detail in subsequently.

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<sup>7</sup> Section 5, *The Companies Act* (Act No. 17 of 2015).

<sup>8</sup> Section 4, *Central Bank Act* (Act No. 10 of 2018).

<sup>9</sup> Section 3, *The Law of Contract* (Act No 2 of 2002).

<sup>10</sup> Section 83, *Kenya Information and Communication Act* (Act No. 25 of 2015).

The Competition Act 2012 also has relevance to digital lending as it provides protection from unfair business practices which are defined as false, misleading or deceptive representation that may affect consumers or put them at an economic disadvantage.<sup>11</sup> Section 56 of the competition Act lists a set of unconscionable conduct that businesses should not engage in, and they include; unreasonable conditions imposed on the consumer, customers' ability to understand the conditions imposed on them, undue influence or pressure, and whether the pricing of the product was fair based on market rates. These circumstances were discussed in section 1.2, and it is clear that some digital lenders contravene sections of this Act especially when awarding loans, and when pursuing defaulters.

Section 56(3) of the Competition Act in particular gives provisions specific to banking, microfinance, insurance and other services. It provides that the institutions;

Shall not levy unilateral fees and charges, by whatever name called or described, where the charges and the fees in question had not been communicated to the consumer prior to the provision of the service or their imposition.

Consumers of digital loans have expressed concerns that the terms are not clearly communicated at the time of the disbursement of the loan. According to the 2016 FinAccess survey, 19% of the respondents in the survey expressed concerns over unforeseen charges and unclear costs of loans.<sup>12</sup> Based on the above, this is therefore in contravention of the provisions of the Competition Act.

The Competition Authority has developed consumer protection guidelines that have specific consumer protection in part VI of the act. In addition, the Authority is mandated to handle consumer complaints through its consumer protection department and gives specific directions to a supplier in the event of infringement of consumer rights. Section 22(b) 2 of the competition act prohibits trade associations, from colluding on elements such as prices charged for services, interests, pricing formula, and other charges associated with their business. The act considers this a restrictive business practice.

The act does not have specific provisions applicable to digital lending and from interpretation, it is applicable to digital lending business noting that Section 5 of the act states that its provisions are applicable to all persons and corporations that engage in trade.

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<sup>11</sup> Oraro C and Barasa J, Consumer protection law in Kenya, < <https://www.oraro.co.ke>>

<sup>12</sup> 2016 FinAccess Household Survey accessible on [www.centralbank.go.ke](http://www.centralbank.go.ke).

So far, the acts reviewed above were all developed to cater for traditional sections of the finance sector. They did not take sufficient account of the fast paced changes in financial technology in the country. That is why the next four acts are particularly important in this discussion because they were all developed with a strong technological theme and intended to take advantage of technology to introduce efficiencies in the areas they regulated. These acts were developed largely in response to the requirement for a regulatory framework to govern digital commerce.

In addition, Kenya enacted the Consumer Protection Act 2012, which provides protection for consumers from varied infractions that may come to them from the activities of business entities. The act provides legal remedies to consumers which include the option to sue businesses if they commit an array of offences such as overcharging a consumer, providing misleading information regarding a product, and among others.

In line with the Consumer Protection Act, in 2014 the Communications Commission of Kenya produced a customer infomercial that elaborated on consumers rights as they access information technology products and services based on the Consumer Protection Act 2012.<sup>13</sup> For instance, in relation to communications products, the Communications authority states that customers have, “The right to full pre-contractual information, which is clear, helpful, adequate, and which allows the consumer to make an informed choice”, What this indicates is that the Communications Authority looks at information technology products and services with the same eyes that would be used when looking at goods and services. The act does not have any express provisions applicable to digital lending but based on interpretation of its provisions, it is argued that, digital lending, being a technology-based service, is regulated under the Consumer Protection Act.

### **1.2.2. Finance Sector Legislation**

The Central Bank of Kenya Act <sup>14</sup> is of relevance to the digital lending sector. The Central Bank of Kenya is the primary regulator in the financial sector and is charged with the development of financial policies that encourage growth in the Kenyan economy. Section 4 (1) of the Central Banks Act specifically states, “The principal object of the Bank shall be to formulate and implement monetary policy directed to achieving and maintaining stability in the general level of prices”.<sup>15</sup> This indicates that at its core, all financial regulatory activities in the country are

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<sup>13</sup> Communications Authority of Kenya, *Consumer rights and responsibilities*, 2010, 2.

<sup>14</sup> Section 4, *Central Bank Act* (Act No. 10 of 2018).

<sup>15</sup> Section 4, *Central Bank Act* (Act No. 10 of 2018).

set on the policies formulated by the Central Bank of Kenya (CBK). Section 34(2) of the Central Bank Act provides that CBK may provide any services to any institution that it considers desirable, and the article further specifically lists the institutions to include Banks, Microfinance institutions and financial institutions any other person or body of persons which the Minister, on the recommendation of the Bank may by notice in the Gazette prescribe as indicated in section 2(b) of the Banking Act. From the above list of financial institutions to be regulated, it has been argued in the past that CBK has no power to regulate digital lenders as they do not fall under the list of the institutions. The discussion on why they do not fall in the lists of the above institutions is discussed in more detail subsequently.

It is important to note that the same Section 34(2) of the act also provides for the minister to recommend to the CBK any institution where such regulatory services may be needed. In this way, there is a leeway for the minister to recommend to the Central Bank of Kenya to introduce services that would target the Fintech sector.

The Banking Act can be argued to be of some relevance to digital lending institutions. This is the anchor law for all banking operations in the country and provides the legal basis for lenders to operate. In the definition of what constitutes a bank, one of the characteristics identified by the Banking Act is “lending”.<sup>16</sup> It is argued that digital lenders are not banks per-se, based on the definition of what a bank is. This is because a bank is defined as a company which carries on, or proposes to carry on, banking business in Kenya but does not include the Central Bank. Banking business is then defined as the acceptance of deposits. As digital lenders are not deposit takers, they therefore do not qualify to be defined as Banks, and therefore the CBK cannot regulate them.

An argument may be raised that digital lenders are partially involved in banking due to their lending business. However, this argument would affect the operations of financial institutions that are in the lending business, such as SACCOs, deposit taking and non-deposit taking Micro Finance Institutions (MFIs) among others which are currently not regulated by CBK. Each of these institutions are regulated by specific regulators which include the SACCO Societies Regulatory Authority, and the Microfinance Unit within the ministry of finance.<sup>17</sup>

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<sup>16</sup> Section 2,1,(a) to (d), *The Banking Act* (No 10 of 2010).

<sup>17</sup> Ali AEE, ‘The Regulatory and Supervision Framework of Microfinance in Kenya’, *International Journal of Social Science Studies*3(5), 2015, 123.

The Central Bank of Kenya directly regulates deposit taking microfinance institutions, but has places limits on the scope of activities they can engage in. Ali states, “They (deposit taking microfinance institutions) are not allowed to invest in enterprise capital; undertake wholesale or retail trade; underwrite place of securities; and purchase”. On the other hand, non-deposit taking microfinance institutions are required to lend their own money<sup>18</sup>. This makes them similar to digital lenders who are currently lending their own money for interest. However, one of the key differences between digital lenders and registered microfinance institutions is that the MFIs are required by section 11(a) of Microfinance Act to maintain a minimum capital base before licensing. On the other hand, digital lenders have no such requirement. As such, it is clear that being in the financial services sector doesn’t qualify an organization to be classified as a bank automatically and hence may not necessarily fall under the regulation of the Central Bank of Kenya.

The Microfinance Act is of interest too in the discussion of the regulation of the digital lenders. In fact, this act defines a microfinance business, among other things, as one involved in, “providing loans or other facilities to micro or small enterprises and low income households”.<sup>19</sup> Again, there is some area of overlap between the business of digital lenders and the law in regards to what constitutes a microfinance institution vis-à-vis a digital lender. Some digital lenders such as M-shwari allow for their users to save and to withdraw money at will, which then leaves the question of whether it should be considered as a microfinance institution. In some ways, digital lenders are completely involved in what would be considered microfinance, but with the single exception that they do not use the same methods as conventional microfinance institutions. They advertise, they accept loan applications, they make determinations in regards to the eligibility of the lender, they issue loans and they handle defaulting customers. Their practices therefore are all the same, save for their processes. Microfinance companies use traditional marketing methods and business process while digital lenders have deployed technology to reduce or eliminate human involvement in the loaning process.

The Capital Markets Act, recognizes technology driven finance and is of relevance to digital lenders as and when they grow to be listed companies. While there are no listed digital lenders as yet, it is projected that their inevitable growth will lead to a demand for more capital which will inevitably lead to them to the Capital Markets. At present, the Capital Markets Act

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<sup>18</sup> Ali AEE, ‘The Regulatory and Supervision Framework of Microfinance in Kenya, 124.

<sup>19</sup> Section 2, Microfinance Act (Act No 4 of 2012).

recognizes the role of technology and in section 11(1)(f) lists the development of an electronic commerce platform for the purposes and uses of the capital markets as one of the principal objectives of the Authority.<sup>20</sup> Further, in section 11(3)(s), the Capital Markets Act states that the Authority may “regulate the use of electronic commerce for dealing in securities or offer services ordinarily carried out by a licensed person”.<sup>21</sup> In effect, the act recognizes that in the current business climate, person to person interactions, and even human mediation is no longer necessary for the conduct of business. This stance is more in line with the business model used by digital lenders when compared, say, to the stance taken by the Law of Contract Act, that requires a physical signature, complete with a witness, for a contract to be considered binding. Therefore, the Capital Markets Act is relevant to the discussion of digital lending regulations in two ways. First, the act is in the direct path of the natural progression of digital lending firms, and hence its provisions will have an effect on the future operations of the firms. Secondly, the act provides a more progressive view of e-commerce and technology and the role they play in business. This stance would be useful in any discussion regarding the best approach towards the regulation of digital lenders.

### **1.2.3. Information Technology Legislation**

The Kenya Information and Communications Act (KICA) is a critical legislation that must form the regulatory framework for digital lending in Kenya, at least in part.<sup>22</sup> The law effectively equates hard copies of critical information, including contracts, with electronic copies and gives them the same legal standing.<sup>23</sup> The implication of this is that an electronic agreement between a digital lender and borrower is enforceable as would a paper based form filled and deposited by a bank. The broad based act came into force to provide an enabling environment for the development of a digital economy and to take into account technological changes that promised more efficient delivery of services through media broadcasting, multimedia and telecommunications as well as electronic commerce.

In 2010, the Kenya Information and Communications (Consumer protection) Regulations were passed by the Minister of Information and Technology in consultation with the Communications Commission of Kenya, pursuant to the powers to formulate regulations under the KICA.<sup>24</sup> Specifically, regulation 3 gives the consumer of the services the right to receive clear and

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<sup>20</sup> Section 11, Capital Market Act (Act No.15 of 2018).

<sup>21</sup> Section 11, Capital Market Act (Act No.15 of 2018).

<sup>22</sup> Kenya Information and Communication Act (Act No. 25 of 2015).

<sup>23</sup> Section 83, Kenya Information and Communication Act (Act No. 25 of 2015)

<sup>24</sup> Communications Authority of Kenya, Consumer rights and responsibilities, 2010, 2.

complete information about rates, terms and conditions for available and proposed products and services. The consumer also has the right to be protected from unfair trade practices, including false and misleading advertising and anti-competitive behavior of the licensee. In 2016, the Competition Authority of Kenya issued an order that required all lenders to declare their fees to a client before they advance a loan, as a response to findings that lenders, including digital lenders, had hidden fees in their financial products.<sup>25</sup> Licensees are required under the Communications Authority regulation 5 to make inquiries and lodge complaints regarding the services. What this indicates is that the Communications Authority looks at information technology products and services using the same criteria that would be used on goods and services.

The National Payment Systems Act was developed to address the gaps that were seen to emerge in the era of mobile payments and online payments and sought to ensure that the sector was well governed and to prevent money laundering. The act defines a payment system provider as “a person, company or organization acting as a provider in relation to sending, receiving, storing or processing of payments or the provision of other services in relation to payment services through any electronic system”.<sup>26</sup> The act seems to come close to the regulation of digital lenders since it was developed mainly to regulate the conduct of mobile money transfer services, hence mobile money transactions. Its key shortcoming is that it preceded digital lending, and therefore did not anticipate that activities of digital lenders since at the time it was not an issue. The existence of the law is nonetheless an important signal that the legislature was taking into account the changing landscape in the financial services sector, and as such was working to ensure that the sector was well regulated in line with the then most recent changes in the sector.

Most recently the Data Protection Act came into effect in 2019. The Data Protection Act seeks to give effect to article 31 of the Constitution of Kenya which states, “Every person has the right to privacy, which includes the right not to have ... (c) information relating to their family or private affairs unnecessarily required or revealed; or (d) the privacy of their communications infringed.”<sup>27</sup> In so doing, the act provides express provisions regarding the handling of data collected from members of the public and puts in place checks and balances that will ensure personal data collected in Kenya, or relating to Kenyans even if collected overseas is protected.<sup>28</sup>

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<sup>25</sup> AFI CEMC, 'Digitally delivered credit: Consumer protection issues and policy responses to new models of digital lending', 2017, 8.

<sup>26</sup> Section 2, National Payment Systems Act (Act No 39 of 2011).

<sup>27</sup> Article 31, Constitution of Kenya (2010).

<sup>28</sup> Section 3, Data Protection Act (Act No 24 of 2019).

This act has crucial implications to the operations of the digital lenders and all app-based businesses since they largely deal with data provided by consumers. Some of the digital lending apps also ask users for permission to access their financial data such as mobile money balances, records held by the CRBs, and personal contacts. While it addresses some of the key loopholes that digital lenders may have used for some of their more extreme business practices especially in violation of consumer's data, the question of a unified regulatory regime for digital lenders remain, and requires a more definitive answer.

The review of the above various acts that bear some relevance to the regulation of digital lending in the country brings into realization the following issues. It is clear that there is no law or regulation that has been developed to deal directly with the legal issues arising from the operations of digital lenders. In other words, digital lenders “operate in a regulatory lacuna with no bespoke legislation”.<sup>29</sup> While this point is taken into account, it is important to note that there has been progressive development of laws and regulations to accommodate the market dynamics that are associated with the increasing role of technology in the Kenyan economy. Acts like the Capital Markets Act, the Information and Communications Act, and the National Payment Systems Act, and most recently the Data Protection Act, already have the principles that may be advanced towards the development of a fitting regulatory regime for digital lenders. This is welcome news in the sense that while there may lack bespoke regulations for digital lenders, the principles required are already laid out in other laws and may only require customization to address the unique environment of digital lending.

The national assembly is currently has the Financial Markets Conduct Bill of 2018 pending before it, which bill proposes various initiatives to regulate, among other things the digital lending business in Kenya.<sup>30</sup> The bill intends to establish the Financial Markets Conduct Authority which is an institution designed to regulate credit in the country. It has a strong emphasis on retail credit and its objectives span the key activities of lending organizations such as setting the cost of credit and information provided to consumers. The bill also creates the office of the Financial Sector Ombudsman, Financial Sector Tribunal (the Tribunal) and the Conduct Compensation Fund Board, which will be responsible for policing and oversight of the financial sector generally. The Financial Sector Tribunal's main mandate is to hear applications for review of the decisions of the Financial Markets Conduct Authority while the mandate of

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<sup>29</sup> MMAN Advocates, Regulation of Mobile Lending Entities in Kenya, 13 August 2019 <<https://mman.co.ke/content/regulation-mobile-lending-entities-kenya>> on 8 December 2019.

<sup>30</sup> Section 12, Financial Markets Conduct Bill (2018).

the Ombudsman is to resolve complaints and disputes between customers and lenders in relation to the provision of financial products and financial services. The Conduct Compensation Fund Board is mandated to remit compensation to customers once their claims are successful. The sources of the funds for the Board include amounts appropriated by Parliament, amounts paid by Lenders into the Levy Account and administrative penalties imposed in respect of contraventions of the law.<sup>31</sup> These institutions proposed in the bill will to a great extent will take away the supervisory powers of the Central Bank in relation to provision of retail credit facilities. The CBK has been opposed to the bill, saying that the bill infringes on its mandate and may weaken its ability to execute its functions as the bill creates the office of another regulator.<sup>32</sup>

An important development to the digital lending space internationally is a recent update on the terms of service affecting digital lenders by Google, the dominant player in the App delivery business. Google announced that it will no longer allow Apps that offer loans which should be repaid in 60 days or less on Google play store. Most lending Apps are hosted on Google play, and without it, digital loan institutions will not be able to access customers. Google's move has been seen as a foray into the regulatory space and has been met with skepticism by digital lenders. The fact that Google has to make a decision like this further indicates that there is a significant legal regulatory gap at the international level for digital lending institutions. This decision by Google is therefore expected to force some changes to the operations of digital lenders both locally and internationally.

### **2.3 Movement toward Self-Regulation by Digital Lenders Association of Kenya**

Players in the digital lending space have recently started examining ways of self-regulation to try and address the regulatory challenges and the consumer public outcry that they are currently experiencing. Self-regulation is not a unique concept in the Kenyan legal system. For instance, one of the best developed self-regulatory systems is the one used by accountants under ICPAK and the International Accounting Standards Board.<sup>33</sup> The legal profession also carries out self-regulation through the Law Society of Kenya, while the Banking sector achieves the same goals through the Kenya Bankers Association. It may however be argued that these bodies are

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<sup>31</sup> Section 153, Financial Markets Conduct Bill (2018).

<sup>32</sup> Alushula P, 'We are under attack-Central bank boss claims over bill' The Standard, 30 May 2018-<<https://www.standardmedia.co.ke/business/article/2001282264/we-are-under-attack-central-bank-boss-claims-over-new-bill>> on 6 January 2020.

<sup>33</sup> Watima T, 'Self-regulation key in digital lending' Business Daily, 17 June 2019 - <<https://www.businessdailyafrica.com/analysis/columnists/Self-regulation-key-in-digital-lending/4259356-5161086-ugju5cz/index.html>> on 5 December 2019.

successful largely because they have an anchor law to regulate their sector. In addition, there is a concern that fintech firms are very sophisticated players while borrowers generally lack the sophistication needed to understand the full import of their borrowing hence the need for regulatory protection.<sup>34</sup>

Digital lenders have recently begun the journey towards self-regulation through the Digital Lenders Association of Kenya (DLAK). This move to self-regulate may have been motivated in part by the realization that the government was actively pushing for regulation of the digital lending sector. DLAK states in its websites that its aim 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”.<sup>35</sup>

DLAK has developed a code of conduct for its members and is available through its website. The very development of the DLAK code is a laudable step since it creates a semblance of regulation and provides an option for the regulation of digital lenders in the absence of a legally instituted regulator of the sector. DLAK, as a sector representative, is a good indication that the players in the sector are aware of the need to formalize the regulation of the sector. The efforts included in the code to offers some types of remedies for bad business practices by its registered members is also welcome since these are among the chief goals of regulation. The remedies include mediation. In these ways, DLAK Code is a welcome addition to the efforts towards the formalization of regulation of digital lenders.

One of the key problems associated with the DLAK code of ethics is that it is not mandatory for all players in the digital lending business to follow and subscribe to it. In fact, in the statement of objectives of the code, DLAK states that its members “are entitled to voluntary application of this code”.<sup>36</sup> This gives the members the power to choose whether to apply the code to their business or not. While the practicality of this approach can be appreciated seeing that DLAK is not a statutory body, it does not serve to generate the confidence that would be needed for the complete protection of consumers from predatory lending practices and other malpractices.

Further, it is noted that the entire DLAK code of conduct does not refer to any specific law as the basis for any of its provisions, but only addresses the law in general terms. A deeper look at

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<sup>34</sup> A Didenko, *Regulating Fintech: Lessons from Africa*, San Diego International law Journal, 2018, 312.

<sup>35</sup> DLAK, ‘Home’ 5 December 2019-<<https://www.dlak.co.ke/>> on 5 December 2019.

<sup>36</sup> Digital Lenders Association of Kenya (DLAK) Code of Conduct, 2.

the DLAK code of ethics demonstrates that there is a legal and regulatory gap under review. Section 2(II) of the DLAK code states;

Digital Lending Institutions (DLIs) will conduct their activities in accordance with the law, complying with the regulations governing their functioning, established jurisprudence, as well as binding decisions, instructions and guidelines of supervisory institutions such as the Treasury, Communications Authority, Central Bank of Kenya, Competition Authority of Kenya and any other regulator in the Financial Services Sector in Kenya in the scope of duties performed by these institutions.

As such, there is no native law under which this sector operates, and as such, it is forced to draw from the existing legal framework that generally governs the operations of businesses and financial institutions to find principles that are relevant to it. While the stated goal of conducting their activities in accordance with relevant laws is laudable, it is still not an ideal situation since there would be no remedy in law for activities of the members that violate the set code.

In the DLAK code, the most severe form of punishment a digital lender may suffer is the cancellation of their membership from the association. It is important to note that said membership to DLAK is voluntary and as yet only 11 out of an estimate of about 50 digital lenders are registered as members of DLAK<sup>37</sup> and therefore cancellation of membership may be argued not be an effective deterrent factor as it lacks the firepower needed to constrain misconduct effectively and to incentivize compliance.

Some other disciplinary measures listed in the code include various warnings, compulsory training, public denouncement of an entity, and suspension of membership.<sup>38</sup> All these measures would only be significant if the association already had a strong influence in the market. As such, this leaves the consumers still exposed to predatory practices from the digital lenders which will persist until the association gathers the stature needed to be effective in its self-regulatory function among its members.

The association has attempted to address the various customer grievances by making specific provisions that lenders should comply with. For instance, one of the provisions included in the DLAK code of conduct section III (3.3) states;

Digital Lending Institutions (DLIs) should ensure consumers have access to clear pricing and are empowered to make informed decisions on the loan product that best meets his or her needs. DLIs should separate key terms such as principle, interest, fees, tenure and other items into separate line items. DLIs should include visual representations (such as

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<sup>37</sup> DLAK, 'Home' 5 December 2019-<<https://www.dlak.co.ke/>> on 5 December 2019.

<sup>38</sup> Section VIII (II)8.2, Digital Lenders Association of Kenya (DLAK) Code of Conduct.

calendars) to indicate due date(s) for payment, when past-due periods begin and other key timelines.<sup>39</sup>

The fact that the recently publicized code of conduct presents these requirements in such detail indicates that the general practice in the industry may not been up to these standards. It can only be hoped that moving forward, every digital lender who subscribes to this code of conduct will abide by these practices which seem intentioned on empowering the consumer. The key outstanding regulatory issues that arise under these terms are what needs to be communicated to a digital lender, and what shall be taken as adequate proof of such communication. As with the other issues associated with digital lending, there is no legal fallback position for any customer who may feel defrauded by accepting terms to a loan that they were not aware of, either because they were not informed, or the terms were not presented in a form that made it easy for them to access it.

On the matter of debt collection practices, the DLAK code of Conduct section VII provides guidelines the members should use in the case of default. The guidelines are developed to encourage an “amicable resolution of the case”.<sup>40</sup> The process in the code includes communication with the consumers to determine cause of delay and proposing ways of repayment. In addition, the code requires the member of the association to ensure that their preferred debt collection agency abides by the best practices of the industry in the course of their duties. In addition, the digital lending institution is required to supervise the work of the debt collection agency. A question may be raised in regards to what the supervision would entail, and whether such supervision is practical, effective and acceptable in law.

With respect to the issue of customer data, the DLAK code of conduct section IV(4.2)c allows its members to share consumer data with “authorized persons”, but does not indicate who these persons may be, and who would authorize them.<sup>41</sup> This still leaves room for them to share consumer data with entities that may be authorized by the digital lenders themselves. An attempt is made in section IV(4.2)d of the code of conduct to ensure that this will be done under the law, but the language seems to leave it open to a digital lender to decide in who an authorized person is.<sup>42</sup> This indicates that there is a need for a regulatory provision with legal effect that will cover

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<sup>39</sup> Section III (3.3) DLAK Code of Conduct.

<sup>40</sup> Section VII(7.1) DLAK Code of Conduct.

<sup>41</sup> Section IV(4.2)c DLAK Code of Conduct.

<sup>42</sup> Section IV(4.2)d DLAK Code of Conduct.

who digital lenders can share their information with, especially in the context of the newly enacted Data Protection Act.

The CBK Governor's response to the formation of DLAK is as telling as it is cautionary. The Governor stated "Voluntary industry standards still allow the bad actors to stay out of an entity like DLAK and do business as usual," and he further added that regulation could be "implemented by an independent consumer protection agency or at least an independent department in a regulator with an expanded mandate to cover non-banks."<sup>43</sup>

From the above, it is therefore arguable whether self-regulation is an effective regulatory tool for the digital lenders. Critics of self-regulation in the financial services industry argue that the private enterprises cannot be trusted to regulate their own activities in a manner conducive to promotion of publicly desirable goals, noting that their main focus is to make profits. In addition, the critics point to its intrinsic inadequacies, including lack of effective enforcement capabilities, inability of self-regulatory organizations to gain or maintain legitimacy, and ultimately, the failure of accountability.<sup>44</sup> It has also been noted that fintechs generally position their businesses in ways that avoid regulatory oversight, usually by citing the restrictive nature of regulatory oversight when applied to innovation.<sup>45</sup> It is therefore clear that a more effective legal regime is needed to ensure that players in the sector are legally liable and are held accountable for clearly defined offences committed in the digital lending space.

## 2.4 Conclusion

Based on the review above, the following are some of the gaps in the existing legislation that have been identified. First, there is the absence of a substantive law to anchor the digital lending sector. The effect of this includes the absence of clear offences that may be committed in situations unique to digital lending, and hence lack of a remedy in law for any aggrieved consumers. This is in contrast to most other players in the financial sector who operate under the guidance of a substantive law which has expressly listed offences and penalties. In addition to this, there is the absence of a fintech-specific regulator, with the sector finding itself at the

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<sup>43</sup> Dahir AL 'Digital lending apps are coming under scrutiny in East Africa for predatory practices' Quartz Africa 20 September 2019 -<<https://qz.com/africa/1712796/mobile-loans-apps-tala-branch-okash-face-scrutiny-in-kenya/>> on 4 December 2019.

<sup>44</sup> Braithwaite J ,Responsive Regulation in Australia, in Business Regulation And Australia's Future, 1993, 1.

<sup>45</sup> Bagby JW, Reitter D, Anticipatory Fintech Regulation: On deploying big data analytics to predict the direction, impact and control of financial technology, Journal of Innovation Management, 2019, 1.

mercy of various regulators whenever an element of their businesses activity falls within the role of that regulator.

The other key issue arising is in the lack of a substantive definition of what constitutes a contract between a digital lender and the borrower in the context of the Law of Contract Act and the Kenya Information and Communication Act, and the associated enforceability of the rights of the lender during loan recovery based on the lending process that does not seem to require a signature, whether physical or electronic. The other gap seen in this review is that the provisions in the consumer protection laws need to be enhanced in the context of digital lending. There is need for clear regulatory provisions and set mechanisms to ensure proper redress on issues arising between lenders and borrowers in the digital lending space.

There is also the insufficiency of the provisions of the Central Bank of Kenya Act as it deals only with deposit taking institutions and hence digital lenders do not fall under the robust regulatory regime that covers other financial institutions. This gap is further demonstrated by the differences between commercial banks and digital lenders as defined by the Banking Act, which excludes digital lenders from regulation by the CBK, as the lenders do not take deposits. On the aspect of the possible regulation by the Communications Authority (CA), there lacks sufficient overlap between the business of digital lenders and the mandate of the CA, hence they are not subject to regulation as communications companies.

In summary, there are two broad regulatory gaps in the digital lending sector. Firstly, there is the absence of a dedicated digital lending regulator, while the second one is insufficiency in laws in regards to existing regulators to completely cover the operations of digital lenders.

## CHAPTER 3

### DIGITAL LENDING REGULATION IN INDIA AND NIGERIA

#### 3.1 Introduction

In the previous chapter, the focus was on the mobile lending sector in Kenya. The key discussions in that section were centered on an analysis of the regulatory environment of the Kenyan mobile lending sector. Key laws that are of relevance in the regulation of the digital sector were analyzed. The role of the Digital Lenders Association of Kenya was also considered in the context of the self-regulation and its shortcomings assessed. The section also considered the ongoing practices of digital lenders and helped to demonstrate that there are insufficiencies in the existing regulation that lenders in the digital lending market may exploit to circumvent the law and to sustain unethical business practices.

This chapter analyses the digital lending regulations in two jurisdictions as the basis for making comparisons with the Kenyan situation, with a view to draw lessons that can be to inform the case for digital regulation in Kenya. The chapter looks at digital lending regulations in India, to learn from its highly developed fintech sector which is reported to have over 1000 digital lenders with funding of more than USD 2.5 billion.<sup>1</sup> The chapter also looks at the digital lending sector regulations in Nigeria primarily for its contextual value since Nigeria shares many socioeconomic similarities with Kenya. Being an African country, regulations in Nigeria are implemented in an environment that bears similarities with the Kenyan Context. This makes it an ideal comparison to Kenya's environment. The discussions on the regulations in both India and Nigeria are based on a review of their legal documents such as laws and regulations, as well as scholarly articles and significant opinions on the issues touching their respective regulatory environment.

India is the world's largest parliamentary democracy with a federal system. This is similar to Nigeria's federal governments which both have parallels to Kenya's devolved system of government composed of a national and county governments.<sup>2</sup> India has a population estimated at 1.38 Billion, while Nigeria has a population 200 Million people compared to Kenya's population of 53.6 Million. This means that India's population is approximately twenty six times

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<sup>1</sup> KPMG, *Fintech in India powering mobile payments*, 2019,12.

<sup>2</sup> Ganguly S, Diamond L and Plattner MF, *The state of India's Democracy*, JHU Press, New Delhi,2007,89.

larger than Kenya's while Nigeria's population is about four times larger than Kenya's population. The differences in population size means that Kenya can learn from India and Nigeria in regards to how fintech industries operate at scale. In 2018, the World Bank estimated India's per capita GDP at \$2,099 and Nigeria's GDP at \$2028, compared to Kenya's per capita GDP of \$1710 in the same period.<sup>3</sup> Kenya, India and Nigeria are former British colonies and therefore share a common legal heritage based on common law. This means that there it the laws in these jurisdictions will share similarities and are easy to domesticate in the context of mobile lending regulations.

### 3.2 Digital Lending Regulations in India

The role of technology in India's financial services sector has been increasing significantly, and is one of the well-known countries with a strong fintech sector. India's approach to fintech regulation and by extension digital lending makes it a fitting country to make a comparison for assessing the need for regulation for digital lenders in Kenya.

The first element that needs to be noted with the Indian fintech system is that there is a regulator whose mandate includes the regulation of Fintech firms alongside the entire Indian Banking system. The Indian banking system, part of which is the digital lending sector, is governed by the Reserve Bank of India <sup>4</sup>using the Banking regulation Act of 1987.<sup>5</sup> The Reserve Bank is given power to manage the financial affairs of the country in ways that are thematically similar to the role of the Central Bank of Kenya. It is noted that while the Central Bank of Kenya is constituted as an independent body free from political interference, the Reserve Bank of India operates under the instructions of the central government. The Reserve Bank of India Act states as follows; "The Central Government may from time to time give such directions to the Bank as it may, after consultation with the Governor of the Bank, consider necessary in the public interest".<sup>6</sup>

This influence by the central government may have the benefit of ensuring the reserve bank works in greater harmony with other state departments in the implementation of the policies of the central government, but it can also expose the bank to unwanted political influence, or may water down its ability to make the best monetary policy decisions if the central government does

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<sup>3</sup> World Bank, 'GDP per Capita', 16 May 2020.

<<https://data.worldbank.org/indicator/NY.GDP.PCAP.CD?end=2018&locations=NG&start=1960/>> on 16 May 2020.

<sup>4</sup> Section 3, *The Reserve Bank of India Act 1934* (India).

<sup>5</sup> Section 36AB, *The Banking Regulation (Amendment) Act, 2017* (India).

<sup>6</sup> Section 35, *The Banking Regulation (Amendment) Act, 2017* (India).

not approve. As a result of the above, India may have a strongly regulated financial services sector based on the power given to the Reserve Bank of India over other banks, and then the power of the central government over the Reserve Bank of India. In this aspect India is different from Kenya because its fintech industry came up in an environment that was more regulated compared to the Kenyan financial services sector where regulations attempt to catch up with innovation.<sup>7</sup>

On the matter of fintech technologies, two main issues are under consideration. These are the technologies used to offer financial services, and the emergence of regulatory technologies. On the first issue, it is important to note that the overall technological platform used by digital lenders in Kenya and India are the same. In the Indian market, mobile banking is available through smartphone apps.<sup>8</sup> In addition, players in the fintech industry in the country rely on mobile apps to make mobile banking applications such as digital lending available to consumers.<sup>9</sup> In these two respects, mobile banking in India would offer the same level of convenience that has been associated with mobile banking in Kenya, since the technologies are the same.

The second element of the fintech industry of importance to this study is the emergence of regulatory technology (regtech) as part of the Indian business ecosystem. Regtech can be explained as the management of regulatory processes within the financial industry through technology. In India, regulatory technologies are coming into play riding on the capabilities of technology in today's financial markets to give regulators data that would traditionally take longer to gather.<sup>10</sup> These regulatory technologies assist regulators to monitor fast-moving events such as real-time transactions within the financial services sector. In the context of digital lending, technology can be deployed to monitor the activities of digital lenders in real time. With the addition of data query capabilities, a regulator may be able to tell when a company is involved in fraudulent or unethical lending activities simply based on the data collected by regulatory technologies in the same way that digital lenders use technology to generate risk profiles of their borrowers. This is an efficient way of monitoring and ensuring compliance with existing laws by the digital lenders.

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<sup>7</sup> KPMG, *Fintech in India powering mobile payments*, 2019,12.

<sup>8</sup> Khattar, K 'All you need to know about banking law and practice in India' -<<https://blog.ipleaders.in/banking-law-india/>>,2018, 1.

<sup>9</sup> D'Souza R, *Examining Mobile Banking as a tool for financial inclusion in India*. Observer Research Foundation, 2018, 1.

<sup>10</sup> Department of Economic Affairs, Ministry of Finance, Government of India, *Report of the steering committee on fintech related issues*, 2019, 68.

The third element in this review is the state of mobile lending in India, in terms of market dynamics. As at 2014 mobile retail loans constituted 7% of the Indian economy.<sup>11</sup> No recent reports could be located on the current volume of mobile retail loans in the country. It is however very reasonable to assume a large increase in this volume because of the continued growth of technology in the Indian financial services sector.

The second finding in regards to market dynamics was that fintech firms offer collateral-free loans in India and as such, make it possible for retail customers to access loans that they may not have been able to access from commercial Banks.<sup>12</sup> This means that on this point, India is not different from Kenya in as far as the motivations behind the growth of mobile loan services. Similarly, businesses that seek mobile loans are those that are not able to access formal commercial loans due to lack of collateral.

The third finding made in regards to market dynamics was that India's mobile lending ecosystem includes a robust peer-to-peer digital lending system, which is a model that is not prevalent in Kenya. Other lending platforms in India include cluster-centered funding, point-of-sale (POS)-based lending, peer-to-peer (P2P) lending and invoice-based lending. Peer-to-peer lending is when lenders jointly collaborate to give their money to borrowers mediated by a computerized digital lending system. What this means is the digital lending company does not have to lend from its balance sheet but rather, individuals with finances to invest provide that money to lenders based on the criteria set by the system.<sup>13</sup> This varies from the Kenyan case where the preferred model is lenders have their own designated funds and give these to borrowers. In light of this issue, Kenya may need a set of regulations that will govern peer-to-peer lending in the event that becomes mainstream. Some of the regulations, like in the Indian case, can include limiting the influence of any one lender in the system and limits on risk exposure to any one borrower by the system.<sup>14</sup> Such regulations will make it harder for an individual to influence lending practices, and at the same time will limit any damage that may be caused by any single large borrower.

A review of the specific regulations in the Indian fintech sector was carried out, and the main findings were as follows. The Peer to Peer (P2P) lending platforms in India are the most

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<sup>11</sup> Rao R S, 'Role of the Retail Banking in Indian Economy' 2(2) *International Journal of Engineering Research and General Science*, 2014,152.

<sup>12</sup> Khattar, K 'All you need to know about banking law and practice in India' 9.

<sup>13</sup> Department of Economic Affairs, Ministry of Finance, Government of India, *Report of the steering committee on fintech related issues*, 2019, 41.

<sup>14</sup> Department of Economic Affairs, Ministry of Finance, Government of India, *Report of the steering committee on fintech related issues*, 2019, 41.

common and are governed by a specific regulation issued by the Reserve banks of India. These regulation is titled “Master Directions - Non -Banking Financial Company – Peer to Peer Lending Platform (Reserve Bank) Directions, 2017”. The regulation has several specific regulations that are of interests to this study. First, Regulation 5 outlaws the operation of any peer to peer lending network without registration with the bank, and at the time of the implementation of the regulation, P2P firms in India already in operation were required to register with the Reserve Bank.<sup>15</sup>

Regulation 6 provides a detailed scope of activities of the P2P lenders, which include prohibition from holding deposits and or lending on their own.<sup>16</sup> The regulation clearly defines them as intermediaries, meaning that they cannot load their own funds except those raised in the P2P platform and requires them to facilitate the necessary due diligence in the interest of lenders on their platform. On disputes and customer protection, regulation 13 requires P2P Lending platforms to put in place a dispute resolution policy, and the mechanism for dispute resolution is restricted to one month following the filing of a complaint.<sup>17</sup> An aggrieved party can appeal or make a complaint with the regulator if a dispute filed with the company is not addressed within the period. The above regulations indicate that the Indian government adopted a regulatory framework that addressed some of the critical concerns that would arise from online lending, and it spans registration of the business, all the way to grievance resolution.

The fourth finding made in regards to market dynamics was that mobile lending apps in India use the same criteria as the mobile lending apps in Kenya to award loans. The criteria include review of call records, volume of transactions, and use of mobile money to pay utility bills, among others to determine whether to lend to a potential borrower.<sup>18</sup> This then means that India is dealing with the same data protection challenges that Kenya sought to address through the Data Protection Act. In the Indian case, section 43A of the Information Technology Act, 2000, makes any information technology company that handles personal data liable for any misuse of that data if it occurs due to negligence.<sup>19</sup> Section 72A of the same act makes data handling

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<sup>15</sup> Reserve Bank of India, *Master Directions - Non-Banking Financial Company – Peer to Peer Lending Platform (Reserve Bank) Directions, 2017*, 2019, 3.

<sup>16</sup> Reserve Bank of India, *Master Directions - Non-Banking Financial Company – Peer to Peer Lending Platform (Reserve Bank) Directions, 2017*, 4.

<sup>16</sup> Reserve Bank of India, *Master Directions - Non-Banking Financial Company – Peer to Peer Lending Platform (Reserve Bank) Directions, 2017*, 7.

<sup>17</sup> Reserve Bank of India, *Master Directions - Non-Banking Financial Company – Peer to Peer Lending Platform (Reserve Bank) Directions, 2017*, 7.

<sup>18</sup> D'Souza R, *Examining Mobile Banking as a tool for financial inclusion in India*. 9.

<sup>19</sup> Section 43A Information Technology Act, 2000 (India).

subject to the contractual terms between the two parties and as such, there is a loophole that one party may suffer at the hands of the other. This was however a better effort at consumer protection than what Kenya had before the Data Protection Act was enacted.

With respect to data protection and the right to privacy in India, the protection is accorded under Article 21 of the Constitution of India that provides for the fundamental freedom to life and liberty. **The Courts in K. S Puttaswamy (Retd.) & Anr. v. Union of India & Ors. [Writ Petition (Civil) No. 494 of 2012] (India)** ruled that the right to privacy is an intrinsic part of the right to life and personal liberty. The Indian courts have given paramount importance to the right of privacy which can only, in their opinion, be interfered with only due to compelling reasons, such as national security and in the interests of the public. India has also subscribed to the Universal Declaration of Human Rights, where protection of privacy is safeguarded under its Article 12. With the support by the Courts, this acts as a deterrent factor for the digital lenders and encourages them to safeguard the personal data of its customers. Further, any aggrieved customer may have a recourse to seek redress through the Courts.

In view of loan recovery, lenders are prohibited from harassing, badgering and coercing borrowers to repay their loans, and as such under regulation 12 (3) and are required to train their staff on these matters.<sup>20</sup> Further, The Limitation Act 1963 (India) provides that one may recover their debt but if the time between the days the debt was issued and debt recovery is more than three years then the debt is automatically written off by law.<sup>21</sup> This law is important for mobile lenders in India since they have to factor in this period to their business processes when handling issues of default. It is noted that in Kenya there is no regulation on writing-off of digital loans and the loans in default normally continue to accrue excessive rates of interest as discussed in Chapter 2.

The final set of findings made in the review of the Indian fintech and mobile lending sectors related to specific regulations currently in operations as the basis for identifying regulatory approaches that may be relevant to Kenya. The fintech regulatory environment in India is based on four main elements which were digital payment ecosystem, data localization interoperability between wallets and an increase in minimum net worth requirements. It also includes changes

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<sup>20</sup> Reserve Bank of India, *Master Directions - Non-Banking Financial Company – Peer to Peer Lending Platform (Reserve Bank) Directions, 2017,7.*

<sup>21</sup> Khattar, K, all you need to know about banking law and practice in India < <https://blog.ipleaders.in/banking-law-india> > 8 December 2018.

and standardization of know-your-customer rules. In addition it includes the inclusion of a regulatory sandbox.<sup>22</sup> These main elements are discussed in detail herein under.

A digital payment ecosystem refers to the collection of enabling technologies, laws and business practices that enable the existence of digital payment services. The inclusion of digital payment ecosystem in the regulatory framework for digital lending comes from the realization that digital payment loans rely on several sets of technologies that function on their own. The relevant technologies span from telecommunications, mobile app development, and the internet, among others. It is possible that all these elements fall under the jurisdiction of multiple regulators in India. This ecosystem must be taken into account when designing a fintech regulatory framework to ensure that the regulations are in harmony with existing systems.

On data localization, Indian regulations require that all critical data collected in the country is maintained within its borders. This requirement by the Reserve Bank of India, takes into account India's national security concerns.<sup>23</sup> It is comparable to recent efforts in Kenya that culminated in the enactment of the Data Protection Act 2019.<sup>24</sup> India's regulations also requires mobile wallet operators to have a minimum net worth of 50 million rupees, while in Kenya, there lacks any such requirements.<sup>25</sup> Kenyan mobile lenders can be required to maintain a minimum capital structure similar to the capital requirements for commercial banks to ensure that the companies have stability. India also has strict know-your-customer rules in regards to its technology products that are seen to slow down mobile lending. The difference with Kenya is that local laws allow for digital identification of customers, which decreases the period within which a fintech firm can process a loan. This may be argued to be an example of how regulations may at times slow down business and innovation.

The need to set up regulatory sandboxes in Kenya is underscored by their use in India. A regulatory sandbox is a setup that allows for regulators to test regulations using real-time data from players in the industry without imposing the actual regulations in a binding manner.<sup>26</sup> Regulatory sandboxes can be viewed as regulatory simulation designed to test the effect of regulatory activity in an industry before legalizing the regulatory initiatives. Kenya can benefit from the institution of regulatory sandboxes for mobile lending in order to test how the market will react to various regulatory initiatives. The sandbox allows for dynamic updates to the

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<sup>22</sup> KPMG, *Fintech in India Powering mobile payments*, 19.

<sup>23</sup> KPMG, *Fintech in India Powering mobile payments*, 18.

<sup>24</sup> Data Protection Act 2019.

<sup>25</sup> KPMG, *Fintech in India Powering mobile payments*, 15.

<sup>26</sup> KPMG, *Fintech in India Powering mobile payments*, 16.

regulations in ways that can also help the regulator understand the effect of its future actions in an experimental environment.

India has in place a mechanism for the protection of consumer rights in the form of principles based charter titled “Charter of Consumers Rights” developed by the Reserve bank of India. The charter sets forth principles of customer protection in ways that allow fintech firms to make their own customized procedures and processes. The charter addresses the problem of overregulation by only discussing the principles of consumer protection to the exclusion of detailed prescriptions on procedural issues. Some of the key elements in the charter are right to fair treatment, right to transparency, fair and honest dealings, right to privacy, and a right to have customer grievance resolved.<sup>27</sup> This use of principles based approach is said to take care of the potential of regulations to stifle innovation since it does not provide highly prescriptive direction to the sector.<sup>28</sup>

In summary, the key lessons Kenya can learn from India are as follows. First, India has a clear regulator when it comes to mobile loan services. Kenya needs to get such clarity. India’s foray into regtech is also an important lesson in the implementation of regulatory activity for mobile lending since it’s a data dependent operation, and is hence easier to regulate with the input of data services. Advances in Peer to Peer lending in India makes it an important case for Kenya where Peer to peer lending is not yet commonplace. The dispute resolution mechanism used by the Indian Mobile lending regulator would be a welcome element in Kenya’s context where such mechanisms are absent. The use of regulatory sandboxes is also an important lesson for Kenya from India’s experience.

### **3.3 Digital Lending Regulations in Nigeria**

Nigeria offers a unique viewpoint in as far as regulation of mobile lending services is concerned. A review of literature related to Nigeria reveals that the country has made efforts to regulate mobile lending and the Central Bank of Nigeria is a central player in the development of the existing regulatory framework. The country offers an opportunity for the consideration of the similarities and differences between the Nigerian mobile lending regulatory ecosystem and the Kenyan one.

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<sup>27</sup> Reserve Bank of India, *Charter of Customer Rights*, 2014, 1.

<sup>28</sup> Anichebe, Uche, How Regulations Can Define the Future of Fintech in Nigeria, <<https://ssrn.com/abstract>> 26 February 2019.

The key laws that anchor the regulatory framework in Nigeria include the Banks and other financial institutions Act (BOFIA) 1991 which has provided the legal basis for the Central Bank of Nigeria (CBN) to license and regulate the fintech sector, which include digital lenders.<sup>29</sup> for a digital lending entity that wishes to provide marketplace lending services may do so by registering as a bank or Other Financial Institution (“OFI”).<sup>30</sup>

In Nigeria, the CBN prescribes that it is only banks that have the legal mandate to handle financial transactions such as providing loans at interest.<sup>31</sup> The mobile network operators are only involved as infrastructure providers, and as such have no money in the mobile lending platforms. However, the CBN has licensed other non-bank institutions to offer mobile loan services, and these fall under its regulatory purview.<sup>32</sup> This is different from the Kenyan situation where mobile lenders, once licensed to operate, do not need to work in conjunction with a bank to lend money to the public and they operate autonomously.

In regulating the Nigerian mobile lending sector, The Central Bank of Nigeria has issued a set of guidelines specific to mobile money, which are updated periodically that cover the following ten areas.<sup>33</sup> These include; data management and privacy, product pricing disclosure, customer redress (dispute resolution mechanisms), consumer over-indebtedness, rates and pricing, systemic risk (relating to licensing and reporting), lending prohibition (for certain institutions), regulatory sandboxes, capital requirements and governance requirements. This is in contrast to the Kenyan context where mobile lenders have no unified regulator.

There is also an aspect of self-regulation in the Nigerian fintech industry, with the establishment of the Fintech Association of Nigeria, a self-regulatory, not-for-profit and non-political organization incorporated to regulate companies in the fintech business. The association serves as a platform for the development of the fintech industry in Nigeria and a forum for the exchange of ideas by and between various stakeholders in the industry.<sup>34</sup> The Central Bank of Nigeria (CBN) also initiated the Payment System Vision 2020 to fast track the development of fintech in the country, which has encouraged the use of electronic payment methods.

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<sup>29</sup> Banks and other financial institutions Act (BOFIA) 1991, Nigeria

<sup>30</sup> Chapter B3, Legal Finance Notice, 2004

<sup>31</sup> Ondiege P, ‘Regulatory Impact on Mobile Money and Financial Inclusion in African Countries - Kenya, Nigeria, Tanzania and Uganda’, Center for Global Development, 2015,10.

<sup>32</sup> Ondiege P, ‘Regulatory Impact on Mobile Money and Financial Inclusion in African Countries - Kenya, Nigeria, Tanzania and Uganda’, Center for Global Development, 2015,10.

<sup>33</sup> Ondiege P, ‘Regulatory Impact on Mobile Money and Financial Inclusion in African Countries - Kenya, Nigeria, Tanzania and Uganda’ 2.

<sup>34</sup> Central Bank of Nigeria, *Guidelines on Mobile Money Services in Nigeria*, 4.

In this regard, three central characteristics of the Nigerian mobile lending regulatory ecosystem are that only banks are allowed to lend and to manage financial transactions, the regulations in the country are made by the Central Bank of Nigeria, and the regulations are based on the need to ensure maintain the stability of the country's financial system.

With a view to curb cybercrime, the cybercrime (prohibition, prevention) Act 2015 was developed to step computer related crimes in the country and has found application in the digital lending sector.<sup>35</sup> Other noteworthy laws forming the legal framework for Nigerian fintech regulations are laws designed to deal with financial crime and include the Money laundering (prohibition) Act 2011<sup>36</sup> which addresses the risk of the use of financial technologies such as digital lending to perpetrate money laundering. The Terrorism (prevention) Act No. 10 of 2011 also deals with offences that may arise from the use of fintech services for terrorism financing and in effect has implications for the conduct of digital lending.<sup>37</sup> Based on the review, three key similarities were identified in literature between Kenyan and Nigerian mobile lending sectors.

First, the emergence of mobile lending in Nigeria was in part driven by the demand for credit by individuals and SMEs, which was not being met by commercial banks. Just like the case in Kenya, SMEs were largely ignored by banks because of the higher cost of availing credit to them, which in turn led to the growth of micro lending activities such as digital lending.<sup>38</sup>

The second similarity with Kenya is that Nigeria has a set of regulations and rules including specific guidelines developed by the Central Bank of Nigeria to govern the use of technology in financial services. However, Nigeria has a more structured and systematic regulatory regime governing the mobile lending sector. The guidelines issued by the Central Bank of Nigeria address elements such as mobile money services, electronic payments, USSD, international money transfer, remittance services, and direct debit schemes. The Central Bank Nigeria took a more structured approach towards digital lending regulation as compared to the Kenyan case.

Thirdly, it is quite clear that Nigeria is in the same position as Kenya whereby the rules for the mobile lending sector are created from existing laws and regulations to cover the operations of the fintech sector. In the Kenyan case, the regulatory framework for the mobile lending sector

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<sup>35</sup> Cybercrime (Prohibition, Prevention) Act 2015, Nigeria.

<sup>36</sup> Money laundering (Prohibition) Act 2011, Nigeria.

<sup>37</sup> Terrorism (Prevention) Act No. 10 of 2011, Nigeria.

<sup>38</sup> Regulatory Impact on Mobile Money and Financial Inclusion in African Countries - Kenya, Nigeria, Tanzania and Uganda.7.

is composed of disparate regulations governing specific elements of mobile lending along its value chain, but with no specific legislation or regulations developed specifically for the digital sector. Nigeria goes one step further in developing specific guidelines applying to the sector as opposed to the case of Kenya where the players in the industry are left to their own devices in cases where no existing laws or regulations apply.<sup>39</sup>

The CBN is also actively aiming to improve the current fintech landscape. The CBN has proposed a licensing structure in its published draft Circular on the Exposure Draft of New CBN Licensing Regime (License Tiering) for Payment System Providers, which proposes a new licensing regime for all fintech companies and, if implemented, will properly position traditional banks to address emerging fintech-related issues with respect to: cyber risks; risk management framework; capital adequacy; better focused regulation; and oversight operations.

The circular provides for the issuance of the following licensing structure that entails; a payment service provider (PSP) super license with a minimum capital requirement of N5 billion for a three-year period; a PSP standard license with a minimum capital base of N3 billion for a three-year period; and a PSP basic license with a minimum capital base of N100 million for a two-year period.<sup>40</sup> The proposed licensing regime has received mixed reactions from fintech stakeholders, principally because of the onerous capital requirements which could make it difficult for some fintech companies to operate.<sup>41</sup> In light of this feedback, the CBN is expected to issue new guidelines, which consider these concerns and find the right balance between protecting customers and creating non-stifling regulations.<sup>42</sup>

The implementation of tighter regulatory controls in the Nigerian mobile lending sector has led to the following impacts. First, the relatively stricter mobile money regulatory environment in Nigeria is associated with lower levels of access to credit facilities by the market. It has been observed that a country such as Kenya, which has had a more relaxed approach to regulation, has seen better access to credit for underserved segments because of mobile money activity.<sup>43</sup> Kenya seems to have achieved higher rates of access to credit as a result of its more open approach to the mobile money transfer business since it allows mobile network operators to manage financial transactions. It may well be the case that stricter regulations for mobile

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<sup>39</sup> Olayanju, P. An Overview of the regulatory framework for fintech in Nigeria, SPA Ajibade & Co. 2019, 2.

<sup>40</sup> Central Bank of Nigeria, Guidelines on Mobile Money Services in Nigeria.

<sup>41</sup> Central Bank of Nigeria, Guidelines on Mobile Money Services in Nigeria.

<sup>42</sup> Central Bank of Nigeria, Guidelines on Mobile Money Services in Nigeria.

<sup>43</sup> Ondiege P, Regulatory Impact on Mobile Money and Financial Inclusion in African Countries - Kenya, Nigeria, Tanzania and Uganda' 7.

network operators and digital lenders in Nigeria have limited their overall positive effect on access to credit for its citizens.<sup>44</sup> It has been observed that countries where mobile money services are directed by mobile network operators such as in East Africa, there is better access to credit facilities, as compared to the situation in Nigeria where such services are bank-led.<sup>45</sup>

In the Nigerian approach, mobile telecommunication companies serve as the interface between banks and lenders hence mobile network operators are only infrastructure providers and are not primarily in the business of offering the mobile loans. This complicates cost assignment and determination of margins by the players. In contrast, the Kenyan situation is such that mobile network operators have their own businesses but carry out money transfer services quite independently from banks. The second impact of this approach by Nigeria to regulation may be a much slower pace of innovation. This is brought about by limiting the options available to businesses that may have been interested in participating in the mobile money sector. In the overall, it is clear that there is a tradeoff to be made between encouraging innovation and maintaining sanity in the digital lending sector.<sup>46</sup>

The Nigerian Central Bank is considering changes to its rules to allow for telecoms to also offer services that were previously reserved for Banks. In this plan, Telecommunications companies will now be known as payment banking services (PBS) and will be allowed to offer most traditional banking services via their telecommunication systems.<sup>47</sup> This should lead to more innovation in the Nigerian mobile lending sector.

On a positive aspect, Nigerian courts have provided clarity around online transactions and they have recognized electronic signatures and the resultant electronic contracts as valid. In the case of **Misore & Anor v. Aregbesola & Others. (2015) 7 SCM 92 at 157**, the Court recognized online contracts executed through an e-signature as valid and enforceable. It was held that a valid electronic signature may be proved in any manner, including by showing that a procedure existed by which it is necessary for a person, in order to proceed further with a transaction, to have executed a symbol or security procedure for the purpose of verifying that an electronic record is that of the person. This position is supported by Section 93(3) of the Evidence Act of

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<sup>44</sup> Central Bank of Nigeria, Guidelines on Mobile Money Services in Nigeria, 40.

<sup>45</sup> Ondiege P, Regulatory Impact on Mobile Money and Financial Inclusion in African Countries, 10.

<sup>46</sup> Ondiege P, Regulatory Impact on Mobile Money and Financial Inclusion in African Countries, 11.

<sup>47</sup> Saigal, K. 'Regulators give mobile money in Nigeria a boost' Euromoney, 10 Jan 2019 -

<<https://www.euromoney.com/article/b1cmtgtzyr9/regulators-give-mobile-money-in-nigeria-a-boost>> on 19 Dec 2019.

Nigeria.<sup>48</sup> This interpretation therefore provides the clarity on whether mobile loans are legally enforceable contracts and it renders them valid.

In summary, the key lessons that Kenya can learn from Nigeria in the quest for setting up a fitting regulatory regime are as follow. First, Nigeria, just like India have a very clear regulator of the fintech sector which includes mobile lending, which is the Central Bank of Nigeria. This clarity is noteworthy. The use of guidelines in regulations can also be seen as a flexible approach to regulation since an Act of parliament would be more difficult to adjust with the changing times. Kenya will do well to avoid the bottlenecks introduced by failing to allow network operators to run mobile lending businesses since this has reduced innovation and the motivation of these firms to invest in mobile lending.

### **3.4 Conclusion**

In conclusion, some issues have been observed in the quest to compare Kenyan mobile lending regulatory framework to those of India and Nigeria. In India, it was observed that the country has a more stringent regulatory philosophy and government control over the financial sector is much stronger compared Kenya, with the Indian government having the power to issue instructions to the Indian Central Bank. Some of the key differences between India's and Kenya's mobile lending framework is that India has peer to peer lending approaches while in Kenya, the money lent to users comes from the lending company. Most of the technologies supporting digital lending are similar.

The Nigerian situation is such that the Central Bank is fully in charge of digital lending since only banks are allowed to lend. Banks use telecommunication infrastructure from mobile telephone firms to offer digital lending services. In this case, Nigeria's Central Bank has maintained control over the digital lending space since the laws in the country are interpreted to prohibit lending by anyone other than a bank. It was observed that Nigeria's mobile lending market is not as well developed and this is attributed to throttling by the regulatory framework.

Based on the findings in this Chapter, the key aspects that Kenya can borrow shall be presented in Chapter 4.

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<sup>48</sup> Section 93(3) Evidence Act 2011, (Nigeria)

## CHAPTER 4

### CONCLUSION AND RECOMMENDATIONS

#### 4.1 Introduction

This study sought to bring out the case for regulation in the digital lending sector in Kenya. This was based on the concern that the lack of a regulatory framework has led to detrimental effects to lenders and to the goal of financial inclusion in general. As such the study sought to look at the fintech sector and based on the findings, to provide a basis for instituting a regulatory framework for the digital lending sector. The first chapter addressed the conceptual issues relation to the study including consideration of background information, the adoption of a theoretical framework, and the adoption of a research methodology. The second chapter addressed itself to the regulatory framework governing digital lending in Kenya. This included a review of the laws with a regulatory dimension touching on digital lending, as well as the practices of digital lenders in Kenya. The third chapter compared the legal and regulatory framework for digital lending in Nigeria and India. This chapter presents a summary of the key findings of the study, the importance of these findings, the limitations of the study, the recommendations for legal and policy changes as well as recommendations for further studies.

#### 4.2 Findings of the Research

Three research questions were used in the effort to respond to the objective of the study. The first research question was, what is the current regulatory framework available to digital lending? In this regard, it was established that there are no specific laws enacted in Kenya for the purposes of governing the digital lending sector. It is also the case that no amendments have been made to the existing laws to effectively regulate digital lending. While it may be argued that it may not be necessary to have specific laws for each sector, the scale and scope of the services offered by digital lenders is such that the sector can have an adverse effect on the economy of the country due to the sheer volume of money disbursed by the sector.

The second research question was, how does lack of regulation contribute to exploitative lending practices by digital lenders in Kenya? It was established that the very absence of sector specific regulations makes it possible for digital lenders to find creative ways of circumventing financial sector best practices which in this case are not legally binding to them. This has resulted in some of them adopting exploitative lending practices as discussed in Chapter 1 and 2 of this study. Apart from laws that would provide specific direction on how players in the sector ought to

conduct themselves, there also lacks any statement of violations with specific sanctions applicable to the digital lending sector. While there are specific legal offences applicable to lenders which are stated in laws such as the Banking Act for institutions governed by the act, these violations are not applicable across the board. As a result, matters such as the in duplum rule do not apply to digital lenders and some of them have therefore charged exorbitant interests to vulnerable borrowers. The lack of express prohibitions with specific sanctions has therefore made it possible for digital lenders to act in ways considered illegal by other players in the financial services industry.

Further, the absence of express redress mechanisms supported by the law for the sector presents a difficulty for aggrieved consumers to find redress. Most borrowers are not sophisticated individuals who are financially capable of instituting legal proceedings against digital lenders when they feel that their rights have been violated. In the current context, any borrower who feels aggrieved must go to court and seek appropriate remedies, whilst in other sectors, there are regulators who can receive and process complaints from aggrieved parties and punish the offenders through penalties provided under the sector specific laws. In this case, lack of a legally instituted redress mechanism encourages the digital lending companies to take advantage and engage in exploitative lending practices.

The third research question was; what lessons from other jurisdictions on regulations be used to improve digital lending practices in Kenya. The main findings were as follows; first, both Nigeria and India have a specific fintech regulator, with a clear mandate over digital lending in their jurisdictions. The Indian Reserve Bank and the Central Bank of Nigeria has clearly spelt out mandates in the two countries. The presence of a specific regulator who monitors the operations of the various industry players has the effect of maintaining sanity in the sector.

Secondly, there are stronger customer protections regimes in India that ensure the rights of the consumers are upheld and they as a result minimize the legal hazards that customers in those countries face. For instance, India's charter of Customer rights directly addresses the principles that digital lenders are expected to implement in regards to digital lending. In the Nigerian case, digital lenders are in fact banks and hence customers enjoy the protections given to them through the Banks and other financial institutions Act (2004). It should be noted that in Kenya, the consumers enjoy some protections covered by other laws and regulations with crosscutting jurisdictions, but the challenge is such regulators only handle a specific element of business operations, such as the Competition Authority, and the Data Protection Authority. This leaves gaps in the protections specifically afforded to digital lending customers.

The third lessons Kenyan can learn from Nigeria and India is on proportionality of the regulatory framework with respect to innovation. While the two jurisdictions have elaborate regulatory frameworks for their fintech sectors, it is also the case that Nigeria's fintech sector is lagging behind and not as well developed as Kenya's. This has been attributed to the stifling effect of regulations on innovation as discussed earlier. In this case, the absence of restrictive regulations in Kenya has allowed more space for the digital lending sector to grow since players can innovate on their products to find business models that work. The lesson then is that regulations must be crafted carefully to avoid stifling innovation and the growth of the sector because of its importance in creating access to credit facilities.

The study also found two concepts that would be useful in the development of regulations for the digital lending sector in Kenya. These are setting up of regulatory sandboxes and secondly, the use of principles based approach to the development of regulations such as the Indian Charter of Customer Rights. A principles based approach to regulation in the case of the digital lending sector would mean relying on existing laws and practices in the development of sector specific regulations. This would mean that principles found in laws such as the Consumer Protection Act, The Data Protection Act, And The Banking Act, the to the extent that they are applicable to the sector, would be used as the general principles for the regulatory framework for the fintech sector. This approach takes care of the potential of regulations to stifle innovation since it does not provide highly prescriptive direction to the sector. The Indian Charter of Customer Rights illustrates this point effectively as it sets forth principles of customer protection in ways that allow fintech firms to make their own customized procedures and processes. The use of regulatory sandboxes in India is also idea that can help in the development of regulation where there is no pressure on the players to comply to proposed regulations, but provides both the players and regulators real world circumstances to help analyze the effect of a given regulation before it is instituted. This approach would be very useful in emerging sectors such as the Kenyan fintech sector.

### **4.3 Importance of the findings**

These findings have helped to identify some of the inadequacies in the existing regulatory framework of the digital lending space in Kenya. In particular, policy makers can utilize the findings of this study as a foundation for development of specific policies to support the regulation of digital lending in the country.

Some options will require changes to the law, or the enactment of new ones, while some are only administrative especially where existing regulations are applied to the digital lending sector.

#### **4.4 Recommendations**

Based on the findings made by this study, the following are the recommendations made;

##### **3.4.1. Establishment of a specific regulator**

A specific regulator for the digital lending sector needs to be appointed. This can either be done by the enactment of a fintech statute, or by assigning the role to one of the existing regulators in the financial services sector. In the first option, the creation of an office of a digital lender regulator would entail deployment of resources and build capacity to understand new technologies, the business models and their implications on the market and on regulation. This may not be ideal due to the cost implication on deployment of resources.

In the second option, the supervision of the lenders will rely on the framework and mandates already in place for the financial sector supervision. In this case the best placed regulators to oversee the sector are the Central Bank of Kenya (CBK) or the Microfinance Unit based in the ministry of finance.

The key challenge in regulating the digital lenders is the technological and innovative nature of their products and services that require the technical know-how. The appointed regulator should have a Digital Lenders' Supervision Department that will have adequate resources to undertake frequent research on the operations of the digital lending market in order to understand the associated risks and create regulation that addresses the risks. The regulator should also exercise oversight over the various digital lenders and keenly monitor their operations.

##### **3.4.2. Legislative amendments to incorporate digital lending services**

Some changes to existing laws are recommended to expand the mandate of the laws to increase the impact of regulations in the fintech sector. Once the chosen regulator is appointed, the CBK Act or the Microfinance Act as above, would have to be amended to define digital loans and digital lenders and to include them under the scope of the chosen act of parliament.

The proposals on other amendments are as follows; The Companies Act to be amended to require digital lenders to get authorization from an appointed regulator before registration. There should be stringent licensing requirements to ensure that the entities that get approved for

registration have met the minimum threshold which should include a minimum deposit to be held with the CBK.

The Microfinance Act should be amended to expand the definition of a microfinance company to include digital lenders. This will require the development of enabling regulations under the Act. The regulations should address the key issues arising on the reported digital lending practices. Of utmost importance is regulations that prescribe the interest rates to be charged on loans and penalties for their loans including the need to restrict the penalty interest chargeable to a certain amount, the same way as the *in duplum* rule that was discussed in Chapter 2. The regulations should also provide for compliance with consumer protection principles and there should be parameters set for acceptable debt collection practices.

Further, the functional approach to regulation that is applied in the financial services industry in Kenya can be maintained, where there will exist different regulators for each function undertaken. To achieve this, the acts of parliament with a regulatory interest in the fintech sector should be enhanced to expressly include digital lending services. The Acts include the Consumer Protection Act, the Data Protection Act and the Competition Act. The implication of the amendments would be to provide clarity and certainty on the applicability of the provisions in those acts to digital lenders.

There also should be a memorandum of understanding to promote collaborative efforts by the various enforcement agencies under the above acts to support digital lending. Some areas of cooperation which could enhance the efficiency of the sector would include joint inspections of digital lenders, sharing of risk assessment tests, joint financial literacy campaigns and public education, and collaboration in research to help identify and understand an appropriate and proportionate regulatory approach to fintech.

### **3.4.3. Self-regulation through the Digital Lenders Association of Kenya (DLAK)**

As discussed in Chapter 2, self-regulation may be preferred over state regulation especially in instances where regulation is on technical and highly specialized issues. As digital lending and its associated risks are technologically driven, the industry players can utilize their expertise in formulating regulation that is flexible and is rapidly able to adapt to technological changes.

It is recommended that the Digital Lenders Association of Kenya (DLAK) be recognised in law within the context of newly developed laws and regulations. With the creation of an underlying

legislation, the entity will obtain a stronger legal position along the same lines as the laws giving mandate to the LSK and ICPAK.

For self-regulation to be effective, DLAK should be mandated to exercise some direct oversight responsibility over the digital lenders. Further, DLAK should be subject to the oversight of the regulator in this case CBK or the Microfinance Unit in the Ministry of Finance, and it should observe standards of fairness and confidentiality when exercising its powers and delegated responsibilities.

The Self-Regulatory Organization (SRO) should facilitate sectoral stakeholder forums aimed at exchanging knowledge and enhancing the regulator's technical knowledge and understanding of the innovations and business models which in turn facilitates communication by the regulator on its expectations and concerns.

The key challenge with self-regulation is the potential for conflict of interest as a result of access by DLAK to valuable information about digital lenders. The appointed regulator should ensure that there is management of conflict of interest through regulations and a conflict of interest policy should be created to ensure frequent declarations by the SRO. To ensure compliance there should be provisions made for inspections and surveillance by the regulator to ensure compliance with the set standards. The regulator should set strict sanctions and have enforcement powers to ensure strict compliance by the SRO.

#### **3.4.4. Use of regulatory Sandboxes**

It is also recommended that the process of developing regulations include the use of regulatory sandboxes by the appointed regulator to ensure that regulations do not stifle innovation. This is through lessons learnt from the Indian context where the market players are exposed to any proposed regulation for purposes of interaction and giving feedback on the proposed law before it becomes binding. To that end, the proposed regulations for digital lenders should first be released in a non-binding manner to facilitate interaction and feedback by the players.

For the sandbox to be effective, there should be clear objectives and challenges that are being addressed by the sandbox. It is recommended that the appointed regulator, be it CBK or the Microfinance Unit, should formulate guidelines by on the minimum regulatory requirements for the participants in the sandbox testing, for instance in this case participants should be digital lenders who are legally incorporated as companies and have a minimum of 2 years in operations in order to utilise their expertise feedback. Further, there should be a clear procedure for

revocation or suspension of approvals to participate in the regulatory sandbox at any time before the end of the test period and the regulator should have the legal mandate to take enforcement action against a participant who breaches the set regulatory requirements.

The challenge in use of regulatory sandboxes may be regulatory arbitrariness where there may be the impression that the regulator is giving unfair advantage to selected lenders to the detriment of the others during the testing of the proposed regulation. To mitigate against this, there should be transparency and clear and documented criteria for any decisions reached.

#### **3.4.5. Use of principles based approach to regulation.**

Based on the lessons learnt from India, the use of principles based approach takes care of the potential of regulations to stifle innovation since it does not provide highly prescriptive direction to the sector. It will entail the reliance of existing laws and practices in the development of sector specific regulations. In the Kenyan Context, this would mean that principles found in laws such as the Consumer Protection Act, The Data Protection Act, Competition Act and The Banking Act, to the extent that they are applicable to the sector, would be used as the general principles for the regulatory framework for the fintech sector. The regulations to be formulated should expressly provide that the above principles are applicable and the lenders should therefore comply, failing which strict sanctions in the above acts will apply.

As earlier discussed, the rule based approach to regulation of innovation is not ideal due to its relative inflexibility and prescriptive nature. Due to the rapid and evolving nature of technology products, the rules may be rendered obsolete and they require constant review and amendments. It is therefore recommended that the approach to be used in digital lenders regulation should be the principle based approach.

To address the key challenge of uncertainty of what the regulator expects in terms of compliance in principle based regulation, the regulator should combine the outlined principles with elaboration in the form of guidance and minimal expectation as opposed to more detailed rules. In enforcement, the regulator should also apply consistency in its decisions so as to form certain precedents for the rest of the lenders in the industry.

When drafting regulations that have a cross border impact, policymakers and regulators, both at the national and international level, must work towards sound regulatory solutions that are in line with their public policy interests, and harmonized with its international partners in a way that boosts access to global markets and expands the benefits of digital trade. Policymakers

should ensure that their regulations are in line with the agreed international principles and standards, for ease of compliance for corporates like Safaricom that have an international presence.

Recommendations for further research are as follows; further research into the effectiveness of principle based regulations is needed to assess their effectiveness in light of the inter-sectorial nature of innovation driven by advances in technology. Secondly, based on the negative impact that regulation has had on the growth of the Nigerian digital lending sector, there is a need for further research into the impact of regulations on innovation.

#### **4.5 Final Conclusion**

In this study it has been demonstrated that there are existing inadequacies in regulatory framework of the digital lending sector in Kenya. While it is the case that digital lending as an activity is not clearly referenced in law, there are still many relevant laws that apply to the sector. The challenge is that the laws were not designed to handle the eventualities of digital lending which has become a significant source of debt for low income households and small businesses. The current situation therefore is that the existing laws are not optimized in ways that offer the best protections for consumers and in addition, there lacks a common body that ensures all the relevant laws are applied. The study has proposed measures to seal these gaps through a common regulator and an enabling system of laws, but has also pointed out that the regulations should be introduced with some care through the use of regulatory sandboxes to ensure that innovation in the sector is not stifled.

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## Appendices

### Appendix A – Ethical Clearance Report



17<sup>th</sup> March 2020

Ms Muli, Ann  
ann.muli@strathmore.edu

Dear Ms Muli,

**RE: Digital Lending in Kenya: The Case for Regulation**

This is to inform you that the SU-IERC has reviewed and **approved** your above research proposal. Your application approval number is **SU-IERC0663/20**. The approval period is **17<sup>th</sup> March, 2020 to 16<sup>th</sup> March, 2021**.

This approval is subject to compliance with the following requirements:

- i. Only approved documents including (informed consents, study instruments, MTA) will be used
- ii. All changes including (amendments, deviations, and violations) are submitted for review and approval by SU-IERC.
- iii. Death and life threatening problems and serious adverse events or unexpected adverse events whether related or unrelated to the study must be reported to SU-IERC within 72 hours of notification
- iv. Any changes, anticipated or otherwise that may increase the risks or affected safety or welfare of study participants and others or affect the integrity of the research must be reported to SU-IERC within 72 hours
- v. Clearance for export of biological specimens must be obtained from relevant institutions.
- vi. Submission of a request for renewal of approval at least 60 days prior to expiry of the approval period. Attach a comprehensive progress report to support the renewal.
- vii. Submission of an executive summary report within 90 days upon completion of the study to SU-IERC.

Prior to commencing your study, you will be expected to obtain a research license from National Commission for Science, Technology and Innovation (NACOSTI) <https://oris.nacosti.go.ke> and also obtain other clearances needed.

Yours sincerely,

  
Dr Virginia Gichuru,  
Secretary; SU-IERC

Cc: Prof Fred Were,  
Chairperson; SU-IERC



## Appendix B – Turn It In Report

Digital Lending; The case for regulation.docx

### ORIGINALITY REPORT

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## Appendix C: Turn It In Match Overview

The screenshot displays the Turn It In Match Overview interface. The main document content is visible in the center, showing the title "DIGITAL LENDING IN KENYA; THE CASE FOR REGULATION" and the author "Ann Kaswii Muli". The right-hand panel provides a detailed match overview, including a total match percentage of 16% and a list of six sources with their respective match percentages.

feedback studio | Ann Kaswii Muli | Digital Lending: The case for regulation.docx

**Match Overview**

**16%**

Rank	Source	Match Percentage
1	erepository.uonbi.ac.ke Internet Source	2%
2	Submitted to Stratford... Student Paper	1%
3	www.kesology.com Internet Source	1%
4	content.centerofvnan... Internet Source	<1%
5	Submitted to Mount Ka... Student Paper	<1%
6	Submitted to University... Student Paper	<1%

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## **Addendum**

At the point of submitting this dissertation for examination in February 2020, there was no specific bill or law seeking to specifically regulate the digital lenders. On 19<sup>th</sup> June 2020, the Central Bank of Kenya (Amendment) Bill, 2020, was published.

The principal object of the bill is to amend the Central Bank of Kenya Act in order to ensure that the Central Bank of Kenya obtains the legal mandate to regulate the conduct of providers of digital financial products and services as well as financial products and services.

The bill recognizes that there is currently no legal framework governing digital lenders and it proposes to amend Section 4 of the Central Bank Act to enhance the mandate of the CBK to include regulation of the digital lenders. The bill is still under discussion and there are currently no draft regulations. If the bill is passed into law, the CBK shall then proceed to formulate the regulations which are expected to address the gaps in the digital lending framework that have been discussed in detail in this paper.

There will also be need for further research to assess the adequacy of the legal framework governing digital lending services in Kenya, once the bill is passed into law.

