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Fintech Lending in Kenya: An Analysis of the Gaps in Consumer Protection Regulation

Daisy Karimi Ndwiga

Submitted in Partial Fulfillment of the Requirements of the Degree of Master of Laws at

Strathmore University



Strathmore University

Nairobi, Kenya

2021

Declaration

I declare that this work has not been previously submitted and approved for the award of a degree by this or any other university. To the best of my knowledge and belief, the thesis contains no material previously published or written by another person except where due reference is made in the thesis itself.

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Ndwiga, Daisy Karimi
.....

Approval

The thesis of Ndwiga, Daisy Karimi was reviewed and approved by the following;

Prof. Agasha Mugasha,

Senior lecturer, School of Humanities and Social Sciences,

Strathmore University.

Dr. Peter Kwenjera,

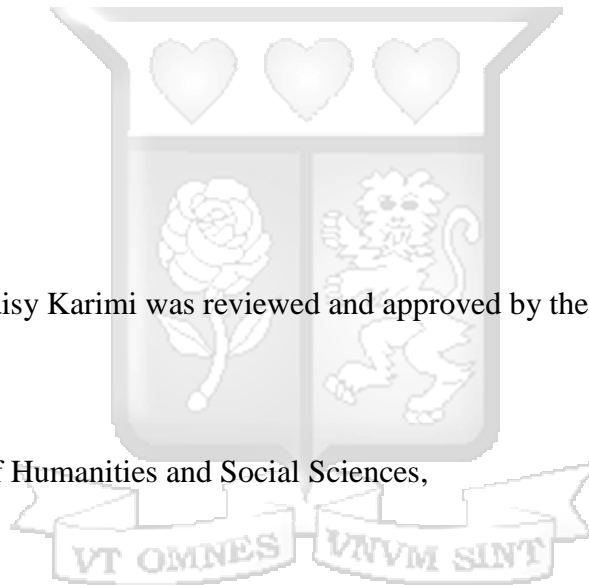
Dean, Law School,

Strathmore University.

Dr. Bernard Shibwabo,

Director of Graduate Studies,

Strathmore University.



Abstract

Traditional banks are sufficiently regulated compared to fintech. This is both an advantage to fintech as it allows for financial inclusion but it is also a disadvantage as consumers are exposed to risks. However, if fintech lending is overregulated, it will cease to have its current advantages such as financial inclusion over banks. The overarching issue, in this case, is how far the law and regulation should go in bridging the gap. To this end, this study explores whether consumer protection in fintech lending is predicated on incorporating efficient regulations to seal the potential and existing gaps. In assessing the viable and feasibility of regulations, this thesis relies on the lessons from other jurisdictions such as South Africa and the UK that have enriched strategies capable of being adopted in regulating fintech lending in Kenya.

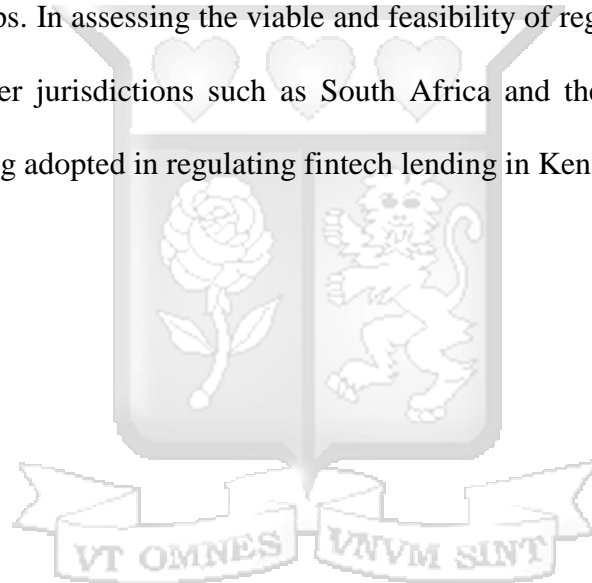


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List of Abbreviations

AI	Artificial Intelligence
BA	Banks Act
BoE	Bank of England
CBA	Commercial Bank of Africa
CBK	Central Bank of Kenya
CMA	Capital Markets Authority
COBS	Conduct of Business Sourcebook
CRA	Consumer Rights Act
CRB	Credit Reference Bureau
GDPR	General Data Protection Regulation
DISP	Dispute Resolution Sourcebook
DPME	Department of Planning, Monitoring and Evaluation
EU	European Union
FCA	Financial Conduct Authority
FIC	Financial Intelligence Centre
FICA	Financial Intelligence Centre Act
FOS	Financial Ombudsman Service
FSCA	Financial Sector Conduct Authority
FSCS	Financial Services Compensation Scheme
FSRA	Financial Sector Regulation Act
GFC	Global Financial Crisis
GFIN	Global Financial Innovation Network

ICO	Information Commissioner’s Office
ICT	Information and Communications Technology
IFWG	Inter-governmental Fintech Working Group
NCA	National Credit Act
NCR	National Credit Regulator
PA	Prudential Authority
POPIA	Protection of Personal Information Act
SARB	South African Reserve Bank
SARS	South African Revenue Services
SEIAS	Socio-Economic Impact Assessment System
SMEs	Small and Medium-sized Enterprises
TCF	Treating Customers Fairly
UK	United Kingdom



List of Cases

Civil Suit No. 400 of 2016, *Consumer Federation of Kenya (COFEK) v Commercial Bank of Africa, Central Bank of Kenya and Safaricom Limited*

Wirecard AG Case, 2020



List of Statutes

Kenya

Banking Act, Cap 488 Laws of Kenya

Central Bank of Kenya Act, Cap 491 Laws of Kenya

Constitution of Kenya 2010

Consumer Protection Act, No. 46 of 2010

Data Protection Act, No. 24 of 2019

Kenya Information and Communications Act, No. 25 of 2010

Microfinance Act, No. 19 of 2006

National Payment Systems Act, No. 39 of 2011

National Payment Systems Act, No. 39 of 2011

South Africa

Banks Act, No. 94 of 1990

Consumer Protection Act, No. 68 of 2005

Financial Sector Regulation Act, No. 9 of 2017

National Credit Act, No. 34 of 2005

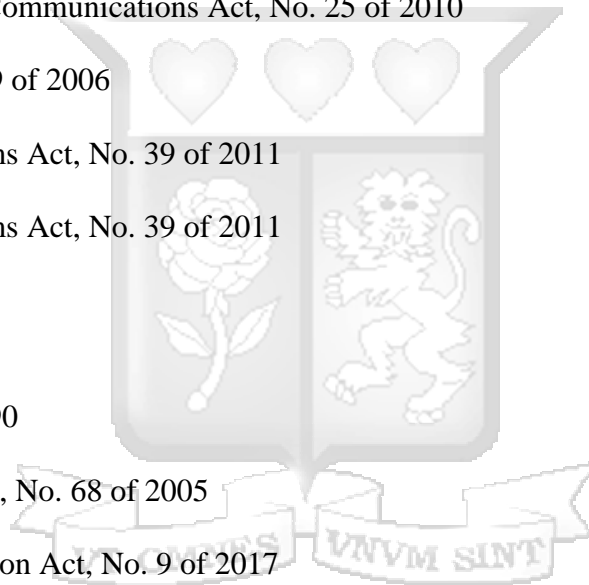
Protection of Personal Information Act, No. 4 of 2013

UK

Consumer Rights Act 2015

Data Protection Act 2018

Small Business Enterprise and Employment Act 2015



Acknowledgement

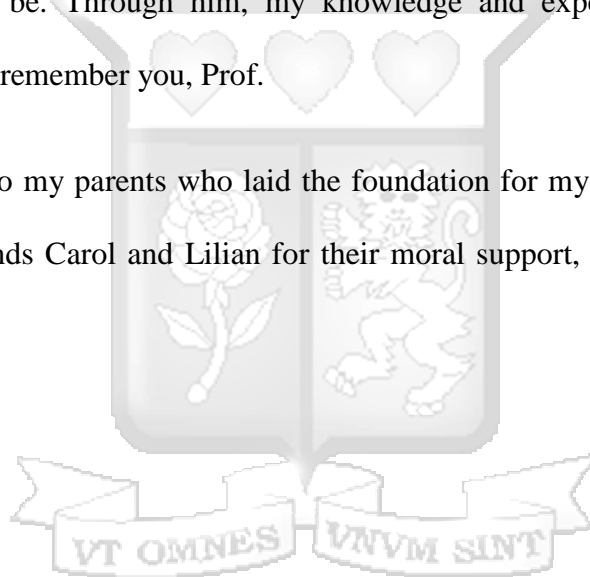
My deepest appreciation goes to God for his providence of anything I needed.

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CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

The development of finance and technology has been connected throughout history.¹ Financial technology (fintech) refers to a broad category of technologies² such as computer programs and other online automated processes to support banking among other financial services.³ The operation of fintech is enabled by a few factors such as mobile technology and the internet that are easily accessible and widespread, increased generation of data, increased use of cloud computing, and the development of algorithms used in decision making.⁴

Fintech lending, therefore, refers to technology-enabled credit intermediation, capital raising, and deposit-taking whereby formal collateral is not required and unsecured loans are provided⁵ compared to traditional banks. Over the past years, there has been significant growth of fintech lending in Kenya which provides a large proportion of credit to consumers. This is as a result of the widespread use of mobile phones and mobile money. Examples of fintech lending platforms in Kenya include M-Shwari and Tala among others.⁶

¹ Perkins DW, 'Fintech: Overview of innovative financial technology and selected policy issues.' Congressional Research Service, R46332, 2020, 1.

² Perkins DW, 'Fintech', 1.

³ Oxford Dictionary of English, 3rd ed.

⁴ Perkins DW, 'Fintech', 1.

⁵ Greenacre J, 'What regulatory problems arise when fintech lending expands into fledgling credit markets?' 61 *Washington University Journal of Law & Policy*, 2020, 229.

⁶ Greenacre J, 'What regulatory problems arise when fintech lending expands into fledgling credit markets?' 239, 242.

The reality for most Kenyans is that the process of accessing credit facilities from traditional financial institutions is complicated and sometimes they end up being disqualified from accessing the credit.⁷ The minimum requirements used by traditional financial institutions in evaluating the creditworthiness of borrowers exclude millions of borrowers from quickly accessing the credit. The institutions are often hesitant owing to lack of credit history, inadequate or absence of collateral, lack of or poor banking history and financial statements. These borrowers turn to friends for assistance, if possible, or use retained earnings. Fintech firms such as Tala and M-Shwari, have come in to help millions of people who were previously left out by traditional financial institutions.

M-Shwari was launched in the year 2012 by Safaricom and the Commercial Bank of Africa (CBA).⁸ The two services that M-Shwari provides include saving where funds are transferred from M-Pesa to M-Shwari and the bank deposit services are provided by the CBA. Thereafter, credit scores are developed by the CBA through monitoring how customers use M-Pesa. Credit scores help in building the credit history of borrowers which is later used in determining their credit limit that increases depending on loan repayment. The loan repayment should be done within 30 days with an interest rate of 7.5% but if borrowers default, an additional facilitation fee of 7.5% is charged.⁹ After sixty days of default, funds from M-Shwari accounts are deducted to settle the loans, and failure to repay after 120 days, the CBA reports borrowers to the Credit Reference Bureaus (CRBs).

⁷ Obiero O and Kiarie W, 'Is there room for optimism in the Kenyan digital credit sector?' MicroSave Consulting, 19 September 2019 - <<https://www.microsave.net/2019/09/19/is-there-room-for-optimism-in-the-kenyan-digital-credit-sector/>> on 16 May 2021.

⁸ Greenacre J, 'What regulatory problems arise when fintech lending expands into fledgling credit markets?' 239.

⁹ Greenacre J, 'What regulatory problems arise when fintech lending expands into fledgling credit markets?' 241.

Tala was launched in Kenya in 2014 and it provides instant lending facilities to customers.¹⁰ Anyone intending to access the lending facilities starts by downloading the app which has access to personal data on the phone such as call logs, text messages, contact lists, social media accounts, videos, and photos.¹¹ A form with personal questions is then filled out and a credit score developed using information related to the personal data. Regular repayments allow a customer to access larger loans. Behavioural and android device data are the two data categories used in providing loans.¹² On the one hand, behavioural data refers to the movement of the borrower through the app which includes the types of pages on the app that are visited. On the other hand, android data refers to the phone apps, operating system, and type of device. Machine learning algorithms are used in determining the weight that data point for each individual receives which in turn determines the extent of the initial loan.¹³

Banking has always been considered as something for the rich who can afford expensive and regular fees.¹⁴ As a result, banks have not been in a position to provide services to the unbanked because significant costs are required to establish branch networks. Kenya has focused on the policy goal of financial inclusion to enable communities without banks to access the services which include credit facilities.¹⁵ The use of mobile phones in making payments have enabled the unbanked and more than 18 million users of mobile phones into accessing flexible mobile payments.¹⁶ On the contrary, the policy goal of financial inclusion clashes with objectives for

¹⁰ Tala, 'Data ethics at Tala: Data ethics and consumer protection.' Tala, 9 October 2019 - <<https://perma.cc/4F8P-GUCX>> on 28 July 2021.

¹¹ Tala, 'Data ethics at Tala: Data ethics and consumer protection.'

¹² Greenacre J, 'What regulatory problems arise when fintech lending expands into fledgling credit markets?' 242.

¹³ Tala, 'Data ethics at Tala: Data ethics and consumer protection.'

¹⁴ Malala J, 'Consumer protection for mobile payments in Kenya: An examination of the fragmented legislation and the complexities it presents for mobile payments.' KBA Centre for Research on Financial Markets and Policy, Working Paper Series 02/14, 2013, 2.

¹⁵ Malala J, 'Consumer protection for mobile payments in Kenya', 3.

¹⁶ Malala J, 'Consumer protection for mobile payments in Kenya', 3.

consumer protection because consumers have no choice but to contract on the only terms presented by fintech lending firms.

The Central Bank of Kenya (CBK) has the authority of regulating consumer credit which covers fintech lenders.¹⁷ However, this is not an exclusive authority as other communication as well as insurance regulations also plays a role. As a result, there are overlapping jurisdictions which leads to diverse rights and a deviation from consumer protection. Coming up with a unified legal body has not been successful and the existing regulatory regimes do not adequately deal with issues raised by fintech lending.¹⁸

The risks experienced in fintech lending are similar to those in traditional banking as they both perform the same functions. On the contrary, they are neither subject to similar prudent regulations nor safety nets to minimise risks on consumers which threaten the stability of the whole financial system.¹⁹ Therefore, to protect consumers in the fintech lending system, the regulatory gaps must be addressed.²⁰

1.2. Statement of the Problem

Traditional banks are sufficiently regulated by the Constitution of Kenya 2010, the Central Bank of Kenya Act, Cap 491, the Banking Act, Cap 488, the Consumer Protection Act, No. 46 of 2012, the National Payment Systems Act, No. 39 of 2011, and the Data Protection Act No. 24 of 2019 among other provisions. They have clearly laid down terms and conditions on issues of

¹⁷ Greenacre J, 'What regulatory problems arise when fintech lending expands into fledgling credit markets?' 233.

¹⁸ Malala J, 'Consumer protection for mobile payments in Kenya', 9.

¹⁹ Section 4, *Central Bank of Kenya Act* (Cap 491) Laws of Kenya

²⁰ Mugasha A, 'Securing effective regulation of the shadow banking system.' 29 (4) *European Business Law Review*, 2018, 511.

billing, interest rates, confidentiality, protection of personal data, and credit reference bureau consent among others.

However, fintech is less regulated because the institutions are not considered as banks in respect of how a bank and banking business is defined.²¹ They do not set out interest rates, repayment fees, and additional fees on late repayment, bundled products, or other terms dictating the transactions.²² They fail to take into consideration the fact that they are required to disclose all mandatory information on lending conditions and key terms.

The current regulatory position of fintech is both an advantage as it allows for financial inclusion and a disadvantage as consumers are exposed to risks such as exploitation, infringement of data privacy, and a deviation from consumer protection because of overlapping regulatory jurisdictions among others. For example, a good percentage of consumers are heavily indebted and struggle to repay the loans majorly because of exploitation and lack of transparency on contracting terms.²³ A debt culture has developed as the byproduct where consumers live on loans and continue to accumulate bad debts. There are challenges posed by fintech lenders such as M-Shwari and Tala to youth, and other platforms below 18 years; other people stealing mobile lines and using them to borrow, or registering new lines after borrowing and defaulting within one of the many platforms. There is a need to strike a balance between enhancing financial regulation by encouraging fintech, and their regulation to ensure consumer protection. These are risks that require the government to step in to protect consumers. However, if fintech lending is

²¹ Ryder N, Griffiths M and Singh L, *Commercial law: Principles and policy*, Cambridge University Press, Cambridge, 2012, 497

²² Karaivanov A and Kessler A, '(Dis) advantages of informal loans—Theory and evidence.' 102 *European Economic Review*, 2018, 102.

²³ Mwangi IW and Sichei MM, 'Determinants of access to credit by individuals in Kenya: A comparative analysis of the Kenya National FinAccess Surveys of 2006 and 2009.' 3(3) *European Journal of Business and Management*, 2011, 207.

overregulated, it will cease to have its current advantages such as financial inclusion over traditional banks. This study will identify the problem by examining the different challenges stemming from fintech lending and link them to regulatory gaps. Notably, it will highlight the handling of sensitive consumer data by third parties, and this exposes it to incessant inappropriate abuse. Further, the absence of exclusive responsibility in fintech regulations can contribute to diverse abuse of rights primarily in the form of deviating from consumer protection. This study will explore variety of sources that have illuminated these problems and underpin how the lack of transparency affects ability of consumers to make decisions that are well informed. The end result is exploitation by different fintech firms where the consumers have little choice but to accept the unfair terms outlined in the contract they have to assent before accessing the fintech services. To address this problem, this study will evaluate the feasibility and applicability of the fintech laws in the UK and South Africa to the Kenyan context. It will proffer a series of recommendations that lawmakers can consider in their pursuit of safeguarding the rights of the Kenyan consumers.

1.3 Research Hypothesis

The existence of regulatory gaps causes potential risks in fintech lending in Kenya. For instance, consumer data is handled by third parties which puts it at the risk of being used inappropriately, lack of exclusive responsibility in regulating fintech can lead to diverse rights and a deviation from consumer protection, lack of transparency affects the consumer's ability to make informed decisions, and exploitation by fintech firms where consumers have no choice but to contract on the presented terms.²⁴

²⁴ Treleven P, 'Financial regulation of FinTech.' 3 (3) *Journal of Financial Perspectives*, 2015.

Therefore, this research hypothesises that

H1: Consumer protection in fintech lending is dependent on implementing efficient regulations to seal the existing and potential gaps.

However, the overarching issue is how far the law and regulation should go in bridging the gap between banks and fintech because if fintech is overregulated, they lose their advantages over traditional banks.

1.4 Justification of the Study

This research proves that there has been significant growth of fintech lending in Kenya as a result of easily accessible mobile technology and the internet in addition to increased data generation and cloud computing.²⁵ On the contrary, there are regulatory loopholes such as exploitation, lack of transparency, overlapping jurisdictions, and data privacy risks in fintech lending. Additionally, the rate of formulating policies and regulations to govern fintech lending is slower. This study offers recommendations that relevant authorities can use to seal the said gaps.²⁶

The research study has made a significant contribution to managerial practices in banking. It points out the need for banks to embrace fintech through the creation of internal teams that can come up with new fintech services or products. This can also be achieved through collaboration

²⁵ Perkins DW, 'Fintech', 1.

²⁶ Greenacre J, 'What regulatory problems arise when fintech lending expands into fledgling credit markets?' 251.

with other entities in the industry as well as the purchase of fintech services or products.²⁷ As a result, it changes the attitude of firms that take traditional approaches by conforming to the flow of recent technological developments in the industry.

The findings of the study generate succinct legal reasoning that contributes significantly to the existing knowledge on consumer protection in fintech lending. The study is a source of literature on tensions arising in fintech regulation, regulatory frameworks, and the challenges facing regulators. Researchers who are keen on analysing recent development in banking, finance, and technology²⁸ will benefit from this research study.

1.5 Research Objectives

The main objective of the study is:

1. To analyse the existing gaps in consumer protection regulation of fintech lending systems (such as M-Shwari and Tala) in Kenya and suggest remedies or solutions to fill the gaps.

Specific objectives of the study are:

1. To evaluate whether fintech lending is generally sufficiently regulated compared to traditional banking as far as consumer protection is concerned.
2. To assess how consumer protection in traditional banks and fintech lending in Kenya is regulated.
3. To discuss the potential risks and benefits of unregulated aspects in consumer protection from fintech lending systems vis-à-vis traditional banking in Kenya.

²⁷ Gulamhuseinwala I and Kotecha V, 'UK fintech on the cutting edge: An evaluation of the international fintech sector,' Ernst & Young LLP, 2016 - <https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/502995/UK_Fin_Tech_-_On_the_cutting_edge_-_Full_Report.pdf> on 6 August 2021, 70.

²⁸ Obiero O and Kiarie W, 'Is there room for optimism in the Kenyan digital credit sector?'

4. To determine whether fintech regulation should follow traditional banking regulation.

1.6 Research Questions

The research aims to answer the following questions:

1. Is fintech lending when compared to traditional banking generally sufficiently regulated as far as consumer protection is concerned?
2. How should consumer protection in financial lending and traditional banking be regulated?
3. What are the potential risks of unregulated aspects in consumer protection of the fintech lending system vis-à-vis traditional banking in Kenya?
4. To what extent should fintech regulation follow traditional banking regulation?

1.7 Theoretical framework

Regulation is defined by the Black's Law dictionary²⁹ as the act or process of controlling by restriction or rule. Regulation can also be said to be the use of law or instruments of law to implement social and economic policy.³⁰ However, in legal and economic literature, there is no fixed definition of the term 'regulation'. The term would be taken to mean the employment of legal instruments for the implementation of social-economic policy objectives where the legal instruments compel individuals or organisations to comply with the prescribed behavior or else suffer penalties/sanctions. Sanctions would include fines, imprisonment, injunctions, withdrawals, closing down a business.³¹

²⁹ Black's Law Dictionary, 9th ed.

³⁰ Jaivir S, ed. *Regulation, institutions and the law*, Social Science Press, New Delhi, 2007, 105.

³¹ Etienne J, 'Compliance theory: A goal framing approach.' 33 (3) *Law & Policy*, 2011, 324.

This research study relies on the theory of legal positivism which states that laws create legal obligations. It is a representation of how the law functions in a society where it is applied. The proponent of this legal theory is Herbert Lionel Adolphus Hart who points out that this theory consists of primary and secondary rules. The primary rules lay down behaviour standards and are obligation rules that create duties. The secondary rules are related to the former rules in different ways because they determine how the primary rules are varied, eliminated, introduced, or ascertained, and how to conclusively determine their violation. The secondary rules are not only remedial and procedural but include the rules that govern sanctions. They extend to judicial evidence and procedures as well as the introduction of new legislation. Therefore, according to Hart, a complete legal system consists of primary and secondary rules.³²

On the other hand, Lon Fuller on criticizing legal positivism holds the position that eight principles of internal morality govern the law. There should be an expression of rules in general terms, there should be public promulgation of the rules, the rules must have prospective effect, the terms of expressing the rules must be understandable, there should be consistency in the rules, the conduct required by the rules should not go beyond powers of the parties affected, the rules should not be frequently changed that they cannot be relied on by the subjects, and administration of the rules should be consistent with the wording.³³

Lon Fuller goes further to state that a system that does not satisfy the above legality principles cannot achieve the essential purpose of the law that aims at attaining social order by using rules which guide behaviour. Failure to satisfy requirements for public promulgation of the rules and expression of the rules understandably cannot be a guide to behaviour because it will be difficult

³² Freeman MDA, *Lloyd's Introduction to jurisprudence*, Sweet & Maxwell, London, 2014, 215.

³³ Freeman MDA, *Lloyd's Introduction to jurisprudence*, 108.

to determine what is required by the rules. Fuller concludes by pointing out that the principles are internal to law whereby they are built onto the existing conditions of the law. Failure to achieve any of the conditions does not result in a bad legal system that is not called a legal system at all.³⁴

Hart responds to Fuller's claim by pointing out that all actions have internal efficacy standards. However, where the standards contradict morality, just like poisoning, they are different from morality standards. Therefore, in Hart's concession to the eight principles by Fuller which are built into the legal conditions in existence, he concludes by stating that the same does not amount to a connection between morality and the law. Unfortunately, Hart fails to acknowledge the fact that the eight principles are moral ideas of fairness. For instance, public promulgation is a necessary efficacy condition but a moral ideal as well. It is morally wrong for rules to be enforced by a state without public promulgation. Similarly, it is wrong for retroactive rules to be enacted by the state, and rules which are inconsistent and impossible.³⁵

The adoption of legal positivism in this research will be used in achieving the purpose of the research because it reinforces the conventional nature of law in the sense that it is socially constructed. By proceeding on the presupposition that the existence and content of law is depended on social facts and not their merits, this study will advance arguments that the existence of law should be towards promoting social harmony and safeguarding consumer protection. With this background, it will be better directed in highlighting the need to improve the preexisting laws and enhancing them to levels that assure customers of their protection, away from the exploiting fintech lending firm capabilities.

³⁴ Freeman MDA, *Lloyd's Introduction to jurisprudence*, 109.

³⁵ Freeman MDA, *Lloyd's Introduction to jurisprudence*, 138.

Innovation in fintech lending has developed faster than regulations in place. Therefore, the adoption of innovation requires regulations to be put in place at an equal pace. The aim of advancing the government agenda of financial inclusion calls upon regulators to take action in regulating fintech lending to protect consumers during financial crises.³⁶ A balance should be struck across the board in respect to economic and regulatory development as well as regulatory capacity and objectives. Kenyan regulatory authorities should have what it takes to provide adequate and appropriate regulation of fintech lending to balance and justify state and regulatory intervention.³⁷ Additionally, this study discusses appropriate and adequate approaches by focusing on the integrity and stability of the financial system and the response of fintech lenders towards regulation. This study on fintech lending regulation in Kenya will focus on consumer protection.

1.8 Research Methodology

This research study analyses gaps in the regulation of fintech lending in Kenya through combining doctrinal and non-doctrinal research studies,³⁸ with qualitative research methods. It will be desk review research that is comparative by comparing the similar fintech situation in the UK and in South Africa. Furthermore, the study will discuss the popular M-Shwari and Tala fintech platforms to contextualize the need to improve Kenya's legal regulation on fintech lending. The doctrinal research study is used for knowledge building or theory testing in the legal field. It is a study of authoritative materials, existing laws, and related cases. It establishes the applicable law to consumer protection in fintech lending. It undertakes a discussion of legal

³⁶ Malala JN, 'Mobile payments systems in Kenya: A new era or false dawn?: An examination of the legal and regulatory issues arising 'post' financial inclusions.' published Ph.D. thesis, University of Warwick, Coventry, 2014, 202.

³⁷ Malala JN, 'Mobile payments systems in Kenya' 19.

³⁸ Jain SN, 'Doctrinal and non-doctrinal legal research.' 17 (4) *Journal of the Indian Law Institute*, 1975, 534.

rules, principles, concepts, and doctrines³⁹ on fintech lending in Kenya. The non-doctrinal research study is also called socio-legal research. It ensures that the law is analysed from the point of view of other disciplines for purpose of generating empirical data to answer the research questions. It deals with other aspects such as social, economic, and political issues that affect fintech lending. Qualitative research methods involve the collection and analysis of non-numerical data such as texts to understand concepts.⁴⁰ This research study will undertake an analysis of what has been done by other scholars on consumer protection in fintech lending. Nairobi is the study location with head offices for most fintech lending institutions. The target populations are individuals and institutions involved in regulating fintech lending in Kenya such as the Central Bank of Kenya, Communications Authority of Kenya, Capital Markets Authority, and the Competition Authority. The approach used by other jurisdictions in fintech lending has enriched strategies to be adopted in regulating fintech lending in Kenya.

1.9 Literature Review

The literature review for the regulation of fintech lending is relatively recent and most of it triggered by the investigation of the recent Global Financial Crisis (GFC) of 2008 whereby most literature has documented that lighter regulation of fintech lending was among one of the sources of systemic risk. The scholarly contributions used in the literature review were influenced by central themes of fintech regulation, digital financing disruption, fintech credit, fintech risk, and consumer protection.

Joy Malala commences her discussion on how banking in Africa has been revolutionized by mobile payment systems by pointing out how the entry of M-Pesa transformed financial services

³⁹ Jain SN, 'Doctrinal and non-doctrinal legal research.' 534.

⁴⁰ Jain SN, 'Doctrinal and non-doctrinal legal research.' 534.

and the banking industry as a whole.⁴¹ As a result, the unbanked have been able to access financial services. Malala goes further to address regulatory issues that have come up as a result of M-Pesa coming into place by looking at the regulatory capacity as a whole which includes processes used in arriving at government decisions, institutional arrangements, and the regulatory tools.⁴² This is done to understand Kenya's regulatory capacity in addressing vulnerabilities that come up as a result of technological innovation and the financial inclusion of consumers.

Malala further holds the position that the regulatory regime related to Kenya's mobile banking consists of significant gaps.⁴³ Certain market areas are yet to be regulated and that regulators need to have synchrony in their conduct to ensure that financial institutions conduct business within the law and the system's veracity is guarded. The wellbeing and safety of mobile payment and customers relying on it will be guaranteed when the law is developed by the financial watchdogs. This will be relevant to consumer protection in fintech lending. However, Malala's contributions were before implementing the data protection law, and this means that her contributions are limited in pursuit of this study's research study. This is a gap that this research will fill.

Stefan Zeranski and **Ibrahim E Sancak** analyse the case of Wirecard AG from the perspective of digital finance. The high speed of technological advancement and the low speed of financial supervision have led to an increase in technological gaps. This foggy atmosphere has become an

⁴¹ Malala J, *Law and regulation of mobile payment systems: Issues arising post-financial inclusion in Kenya*, Routledge, London, 2017, 53.

⁴² Malala J, *Law and regulation of mobile payment systems*, 63

⁴³ Malala J, *Law and regulation of mobile payment systems*, 73

atmosphere for fraudsters to abuse the advantages in Finance TECHs.⁴⁴ Stefan Zeranski and Ibrahim E Sancak state that fraudsters have formulated ways of abusing companies related to fintech because of money markets with unattractive yields, fierce competition in national economies, trade wars leading to national protectionism, and supervisory approaches that are inconsistent.⁴⁵ Stefan Zeranski and Ibrahim E Sancak conclude by pointing out that financial supervisor and governments should prepare for financial scandals and crises in fintech unless requirements for digital transformation and structural reforms are met.

In Stefan Zeranski and Ibrahim E Sancak's discussion of the Wirecard case, they have also looked at the Enron Scandal which was equally notorious. The Enron Scandal forced legislative organs and governments of several countries to come up with new organizations, committees, and rules as well as financial regulations. The Enron case became a destructive scandal globally. Later on, the GFC (2008) undermined the global financial markets.⁴⁶ The G-20 countries among other economies in the world had to develop stricter regulations and multiple reforms to counter the crisis. Under normal circumstances, corporate scandals in these countries are not expected. However, governments, financial markets, and economies are not perfect as they make mistakes and encounter crises. Fintech, a disruptive financial trend was developed after the GFC. However, new trends in the financial world come with unique risks of scandals and crises. Stefan Zeranski and Ibrahim E Sancak state that little is known about fintech crises and the Wirecard AG case sheds light on financial scandals related to fintech.⁴⁷ The case includes fraud allegations, motives, and analysis of what caused the fraud case. This research contends that

⁴⁴ Zeranski S and Sancak IE, 'Does the Wirecard AG case address FinTech crises?' Centre for Scientific Interdisciplinary Risk and Sustainability Management, Working Paper No. ZWP/20202, 2020, 7.

⁴⁵ Zeranski S and Sancak IE, 'Does the Wirecard AG case address FinTech crises?' 25.

⁴⁶ Zeranski S and Sancak IE, 'Does the Wirecard AG case address FinTech crises?' 6.

⁴⁷ Zeranski S and Sancak IE, 'Does the Wirecard AG case address FinTech crises?' 10.

proper measures should be put in place to protect consumers in fintech lending. The limitation in their work is that they focus on developed countries, and their works are not relevant to a developing country context. By focusing on fintech in Kenya, this study fills this particular gap.

John JA Burke discusses the financial services and systems which have a particular focus on the current systems and future developments. Burke has undertaken a brief history of the present-day financial markets, financial markets future, and the applicable law as well as regulatory components to the progressive system. Recent advances in finance such as Artificial Intelligence (AI), blockchain, and fintech applicable to markets and financial institutions have been incorporated. Burke further discusses trends that can reshape financial systems in the 21st Century⁴⁸ which includes emerging countries (BRICS) that are on the rise, economic power shift from the US to Asia, and the new financial order in the globe.

Burke states that institutions with the capability of steering the economy have no choice but to adapt to the current developments. Disregard demands by consumers for mobile financial services led to the creation of cheap systems of payment and fintech neo-banks. Also, development in AI and its use in financial markets, investment, and banking have been equally important. If large institutions and governments do not accommodate innovation, BRICS, AI, blockchain, and fintech will reform the financial system, introduce innovative payment systems and banking, reinvent monetary understanding, and reduce or eliminate the role of intermediaries.⁴⁹ Burke goes ahead to give examples of the Ant Group in Asia and M-Pesa in Africa which has transformed the banking architecture. This book offers insight into this research because it gives an in-depth understanding of the breadth of the financial systems with

⁴⁸ Burke JJA, *Financial services in the twenty-first century: The present system and future developments fintech and financial innovation*, Palgrave Macmillan, Cham, 2021, 190.

⁴⁹ Burke JJA, *Financial services in the twenty-first century*, 192

speculations of future developments⁵⁰ in the industry. This book falls short of contextualizing a situation where traditional banks can merge with other fintech firms, or even create their unique fintech capabilities that can be used to tap into the growing markets of fintech services seekers. With this regard, this thesis will fill this gap by illuminating these possibilities, the resulting challenges, and how to address these problems.

Iris H-Y Chiu and Gudula Deipenbrock examine the rapid change in financial technology which is shaping markets and financial services. The book analyses financial service development as well as markets and products that are reshaped by technology with a view to supervisory, regulatory, policy, and other legal effects. The role of the law in handling revolutionary developments in finance by offering legally enforceable values and principles in which the innovation can happen without threatening basic human rights, the general rule of law, and the law on financial markets has been illustrated in the book. Experts in international lending have made significant contributions to fintech and lending as well as financial inclusion among others. AI in the finance sector, financial regulation challenges, financial innovation regulations, fintech credit firms, consumer protection in fintech, international development in financial regulation, current and future concepts in the regulation of financial markets, and challenges in having orderly markets have been discussed in the book.⁵¹

On the one hand, the book defines fintech credit firms as online platforms for lending which is an innovative process that has changed the financial service sector. The market for fintech credit is innovative and it uses web-based platforms to offer lenders and borrowers cash opportunities as well as interest rates beyond the mainstream providers of financial services. Lending platforms

⁵⁰ Burke JJA, *Financial services in the twenty-first century*, 199.

⁵¹ Chiu IHY and Deipenbrock G, ed. *Routledge handbook of financial technology and law*, Routledge, Taylor & Francis Group, London, 2021.

have been reviewed and the implications of co-existence with traditional financial service providers.⁵² On the other hand, examines the datafication, disintermediation, and digitisation of markets for consumer credit which is also referred to as fintech credit. The impact of this aspect in the regulation and functioning of the credit markets with a focus on consumer protection challenges has also been discussed.⁵³ This research has been refined by the rich concepts in the book on fintech lending and consumer protection. This book provides insightful clarification of different terms concerning fintech lending, but it does not contextualize the application of these terms in real life contexts. In line with this gap, this thesis applies these terminologies in the Kenyan context, which assists in succinct understanding.

Suzanne Christi and Janos Barberis offer a primary guide to the revolution of financial technology, and opportunities, innovation, and disruptions. The book puts together different experts in the industry into one informative volume to offer investors, bankers, and entrepreneurs the needed answers to capitalise on the market.⁵⁴ A detailed explanation has been given on the major developments in the industry, including critical insights from lessons learned and first-hand information offered by practitioners. The book offers information on the risks, driving forces behind explosive growth, and the key players in fintech.

The book examines the global regulatory landscape which ranges from the US regimes where regulation of banks is at the state and federal levels to the complex but harmonized European Union (EU) regulations.⁵⁵ Companies wishing to give advice and investment management in the US must be specific on the applicable state laws. Serving an international clientele requires that

⁵² Chiu IHY and Deipenbrock G, ed. *Routledge handbook of financial technology and law*, 128.

⁵³ Chiu IHY and Deipenbrock G, ed. *Routledge handbook of financial technology and law*, 142.

⁵⁴ Christi S and Barberis J, ed. *The fintech book: The financial technology handbook for investors, entrepreneurs, and visionaries*, John Wiley & Sons, New Jersey, 2016, 13.

⁵⁵ Christi S and Barberis J, ed. *The fintech book*, 23.

issues of cross-border tax and international procedures for anti-money laundering should be handled properly. Startups must comprehend the rules of the game.

The technology on big data has also been analysed in the book. The technology makes it easier to implementation of compliance information and risk systems. The major web industry players have created technology on big data because traditional technologies could not adapt to increased processing capabilities need fast-growing data volumes and unpredictable users. Also, the web industry was seeking greater agility and flexibility so applications could rapidly evolve without interruption of the system. Compliance systems get data from internal systems such as trading, bad reputation, insurance, loans, and customer relationship management. The systems also get data from external sources such as government records, historical and real-time news, and financial data.⁵⁶

The book goes further to state that the technology on big data creates search engines that have rules and key indicators to pick out weak signals in huge information sets and transmit alerts to help in the early detection of fraud.⁵⁷ Big data helps in storing time stamps and results as well as related information within a single trial. This information is significant to this research as it helps in understanding the basis of consumer protection in fintech lending. The limitation in this book is its major focus on the developed countries and it fails to be critical on how the use of big data can be used in such countries. To this end, this research gap is addressed in this study.

⁵⁶ Christi S and Berberis J, ed. *The fintech book*, 101.

⁵⁷ Christi S and Berberis J, ed. *The fintech book*, 104.

Pranay Gupta and T Mandy Tham start by providing an outline of how fintech has disrupted financial services.⁵⁸ They have discussed the digital economy enablers and provided the current state of fintech which includes funding developments and trends, major players and investors, how traditional financial institutions are responding to the disruptive technology, and the future trends.⁵⁹ Gupta and Tham go further to discuss key digital economy enablers and underpinning technologies including machine learning, AI, open banking, digital payment, crypto assets, blockchain implementation, distributed ledger technology and blockchain, data bank and data science, and digital identity. This helps build trusted digital identities and data hubs with clear authentication and identification for customer consent in addition to security and privacy.

Gupta and Tham delve into investment management, capital markets, and the segment of asset services that have been affected by fintech disruptions and innovations. Further, crowdfunding and lending innovations have been examined including insurance and technology (InsurTech), regulatory technology (RegTech), and wealth and technology (WealthTech).⁶⁰ Gupta and Tham finish by examining technology effects in the sector of fast and moving consumer goods and undertake a discussion on the legal effects of fintech and the need to develop sets of talents and skills for the digital economy. Risk management and digital governance are currently the focus of several central banks as key digital economy enablers as are policies for data residency that govern the responsible, ethical and proper use of data.⁶¹ This research study establishes the relevance of embracing recent development in fintech. However, it fails to capture the realities that inform the rising uptake of these fintech services particularly in the developing countries

⁵⁸ Gupta P and Tham TM, *Fintech: The new DNA of financial services*, Walter de Gruyter GmbH & Co. KG, Berlin, 2018, 3.

⁵⁹ Gupta P and Tham TM, *Fintech*, 236.

⁶⁰ Gupta P and Tham TM, *Fintech*, 373.

⁶¹ Gupta P and Tham TM, *Fintech*, 120.

context. This research fills the gap by exploring and recommending the issues of unemployment, mental health challenges associated with the fintech services among the youths, and it proffers recommendations on how they can be issued.

Karen G Mills focuses on capital needs for small businesses and how technology has transformed the lending market for businesses.⁶² Small businesses support the US economy in a great way through innovation, job creation, promote social mobility, and support the middle class. However, small businesses are not included in models for economists and they influence policy-making circles in Washington in a very little way. Capital is the backbone of small businesses that require credit to start, grow and operate. Historically, they depended on banks for capital. However, after the financial crisis in 2008, credit markets froze and banks stopped giving out credit to businesses.⁶³ Small businesses were hit hard and recovery of the credit conditions has been slower. Securing credit for small businesses became harder which opened the door for new lenders and technology.

Mills discusses that when fintech entrepreneurs first entered the market, it appeared they had the opportunity of dramatically changing the lending landscape for small businesses. However, the process became more complicated. The new entrants majorly focused on customer experience which traditional banks could easily replicate. This takeoff phase that was aborted led to the market development phase and it included new players such as Square, American Express, and Amazon. AI and big data were used to help small businesses. The market is full of challenges as

⁶² Mills KG, *Fintech, small businesses and the American dream: How technology is transforming lending and shaping a new era of small business opportunity*, Springer, New York, 2018, 1.

⁶³ Mills KG, *Fintech, small businesses and the American dream*, 2.

it is difficult for lenders to determine creditworthiness for the business and most of the time borrowers do not know the kind of loan they need.⁶⁴

According to Mills, the current regulatory system in the US inhibits innovation and fails to protect borrowers in small businesses from bad lenders. Better regulatory structures and lending principles in the era of AI and big data are needed with lessons from China and the UK.⁶⁵ The regulatory framework should protect the businesses while encouraging innovation. Bold actions will be required to streamline contradictory and overlapping jurisdictional issues. The regulations should protect borrowers and create a transparent environment. Despite the revelations, this contribution is limited in the sense that it does not reveal the same situation in the context of a developing country. This gap is satisfied in this research, and additionally it will apply insights from the book to fintech lending in Kenya, challenges of consumer protections, and the formulation as well as the implementation of proper regulatory frameworks.

Alessandra Tanda and Christiana-Maria Schena analyse the evolution of business models and strategies used by financial institutions that use technology to provide financial services and products. Different sources with different strategic approaches used by BigTech, TechFin, and fintech companies have been highlighted. Tanda and Schena underline strengths, weaknesses, and distinctive patterns. The European market is the main focus for analysis under investigation in light of similarities and differences of different markets.⁶⁶ Re-bundling and unbundling of productive finance processes, information treatment, and innovation levels in customer relationships show intense changes that banking activities for service providers of financial

⁶⁴ Mills KG, *Fintech, small businesses and the American dream*, 5.

⁶⁵ Mills KG, *Fintech, small businesses and the American dream*, 7.

⁶⁶ Tanda A and Schena C, *Fintech, bigtech and banks: Digitalisation and its impact on banking business models*, Palgrave Macmillan, London, 2019, 38.

services are dealing with currently, particularly in the retail department. Despite implementation strategies by the main international banks, the level of fintech disruption is not understood fully.

Tanda and Schena highlight features of BigTech, FinTech and mandatory operators after which they present current views on the regulatory frameworks in Europe. They clarify differences between BigTech, FinTech, and TechFin with the exclusion of Tech companies that provide financial intermediaries technological solutions.⁶⁷ They analyse TechFin and FinTech financial activities with an emphasis on the business model peculiarities compared to traditional financial institutions such as banks. Differences in FinTech companies have been highlighted as well as their competitive strengths in comparison to incumbent companies. Subsequently, there is an analysis of the strategies that banks have been using to determine how they have incorporated digitisation and technological development into their businesses. The three bank categories that have been used to highlight the strategic approaches used include international banks, small banks, and native digital banks.

Tanda and Schena address a section of the regulatory issues while referring to the regulatory scope and boundaries of the activities. Initially, the 'wait-and-see' approach towards regulations was internationally determined with the perception that the intervention by hasty regulations would undermine the positive effects of innovation.⁶⁸ Currently, regulators are taking coordinated action to limit risks and close gaps for regulatory arbitrage. Failure to control and regulate activities of financial companies constitutes significant threats in the protection of investors and customers as well as resilience terms of the financial market and stability. Finally, Tanda and Schena conclude by pointing out considerations for future development in the

⁶⁷ Tanda A and Schena C, *Fintech, bigtech and banks*, 2.

⁶⁸Tanda A and Schena C, *Fintech, bigtech and banks*, 3.

financial system and banking.⁶⁹ This study is limited in terms of comparing the traditional banking format and fintech banking services. This gap is filled in undertaking this research, and it further applies the commitment of traditional financial institutions in digitising their financial services and collaboration with fintech to meet the preferences and demands of customers.

Anja Kovacs poignantly discusses how policies on cybersecurity in India are an uneven patchwork. She points out that technology users lose out in instances where intelligence agencies and law enforcement interests are not supportive. Kovacs uses India in her illustrations where she states that in 2000, it was one of the first countries to pass electronic commerce and cybercrime laws. Further, in 2019, consumer protection laws in the digital age were also approved. However, it still lacks laws on the protection of personal data.⁷⁰ As a result, loosely worded provisions allow agencies to access as well as retain personal data. Consumers are disadvantaged because the government has prioritised digital space control and surveillance over cybersecurity.⁷¹

Kovacs states that in 2017, the Supreme Court of India delivered a landmark judgment which was a confirmation that under the Indian Constitution, the people of India enjoy the right to privacy. This decision went against the position of the government that privacy was not a fundamental right. Two years later, India still did not have provisions on the protection of personal data. A draft Personal Data Protection Bill as well as a report called, 'A free and fair digital economy: Protecting privacy, empowering Indians' were released in July 2018. In 2019, intelligence agencies indicated their want of stronger protection under the bill. However, the bill

⁶⁹ Tanda A and Schena C, *Fintech, bigtech and banks*, 4.

⁷⁰ Kovacs A, *Cybersecurity and data protection regulation in India: An uneven patchwork*. In *CyberBRICS*, Springer, Cham, 2021, 1.

⁷¹ Kovacs A, *Cybersecurity and data protection regulation in India*, 146

emerged as a tool for regulation of how personal data was used by public and private actors but not as a tool aimed at protecting the rights of users.⁷²

Consumer protection has also been discussed by Kovacs where she states that Indian laws on consumer protection need to be updated. Legislation on consumer protection was first introduced in parliament in 2015. In August 2019, the Consumer Protection Act 2019 was passed. It repealed the Consumer Protection Act 1986. Further in November 2019, the Consumer Protection (e-commerce) Rules 2019 were open to public discussion. Contents of the provision ranged from the display of information by e-commerce, precautions for the protection of consumer rights, to redress procedures for grievances.⁷³ This research will use Kovacs' pointers to help in filling the gaps in the protection of personal data in fintech lending in Kenya.

Inna Romanova and **Marina Kudinska** discuss how the banking business has been changed globally by innovations and technologies.⁷⁴ Fintech has become an important aspect of banking as nonfinancial institutions that provide payment services are posing stiff competition to banks. The banking business landscape has been changed by fintech which has come up with innovative solutions. The fintech boom is seen by other actors in the financial services field as a threat to what is considered traditional banking.⁷⁵

Romanova and Kudinska have extensively analysed recent trends both in banking and fintech to establish development in the market, existing practices in the fintech field, and identify the risks. The analysis made by the authors will provide recommendations to be used by regulators to

⁷² Kovacs A, *Cybersecurity and data protection regulation in India*, 148.

⁷³ Kovacs A, *Cybersecurity and data protection regulation in India*, 151.

⁷⁴ Romanova I and KM, 'Banking and fintech. A challenge or opportunity? Contemporary issues in finance: Current challenges from across Europe' 98 *Contemporary Studies in Economic and Financial Analysis*, 2016, 28.

⁷⁵ Romanova I and KM, 'Banking and fintech. A challenge or opportunity? Contemporary issues in finance, 28.

ensure fintech risks are reduced. This will in turn address the main objective of the study of gaps in the regulation of fintech lending in Kenya.

Nicholas Ryder, Margaret Griffiths, and Lachmi Singh have provided a detailed overview of commercial law areas and policies behind the said areas. They have dealt with traditional commercial law areas such as the sale of goods and the law of agency.⁷⁶ However, other modern areas of law such as consumer credit law, finance law, and banking law have also been considered. According to the authors, radical legislation was introduced to protect businesses and consumers as well as encourage economic growth. Modern areas of commercial law discussed by the authors will be applicable in this research study as far as regulation of fintech lending in Kenya is concerned, because there is a gap in the research in terms of being contextualized in a developing country that has a rapidly spreading uptake of fintech services.

James Steven Rogers discusses the law on negotiable instruments by pointing out that there has been development in modes of payment that have become more complex.⁷⁷ This type of development in most law fields would be seen in the additions or changes to the structure of legal rules. Each of the new payment systems has led to the development of a different legal body. Efforts to come up with a unified legal body for systems of payment have been unsuccessful. Rogers goes further to state that laws on modern systems of payment are a mess.⁷⁸ There have been several publications in the application of traditional doctrines to modern transactions. He provides an account of how the law can be changed to suit new modes of

⁷⁶ Ryder N, Griffiths M and Singh L, *Commercial law: Principles and policy*, Cambridge University Press, Cambridge, 2012, 510.

⁷⁷ Rogers JS, *The end of negotiable instruments: Bringing payment systems law out of the past*. Oxford University Press, Oxford, 2012, 1.

⁷⁸ Rogers JS, *The end of negotiable instruments: Bringing payment systems law out of the past*. Oxford University Press, Oxford, 2012, 7.

payment. Rogers believes and this research also supports the need for changes in the law to suit development in fintech. However, there is a gap in the applicability of these changes because Rogers approach is quite broad. This gap is addressed in this research by narrowing the focus to a case study of Kenya and it underpins what is needed to implement the different changes in the fintech lending laws to promote consumer protection.

Jaivir Singh's work points out that the need of regulating particular aspects of the market economy is acknowledged widely. Legal and institutional mechanisms are used by several agencies in India to achieve this. Singh states that regulation might be related to law intimately but it surpasses it. He states that there has been organic growth of basic literature on regulation as a response to the Western Europe and United States markets.⁷⁹ Singh tries to understand the context within which regulation in India has unfolded under circumstances different from those in other jurisdictions. He also emphasizes how the regulatory issues go beyond national boundaries and affect the international sphere in this era of globalization.⁸⁰ Some papers in the book delve into the discussion of conceptual issues while others focus on how regulation has been affected by the political economy and pressure emanating from international organizations. Banking and finance which are relevant to this research have also been discussed. The limitation with this scholarly contribution is that there are myriad generalisations about fintech and its impact on an international platform, without a clear cut example of how this is the case. To fill this gap, this research will focus on the situation in Kenya, and how the data protection laws need to be improved in relation to what other international countries are doing for the sake of protecting the Kenyan consumers.

⁷⁹ Jaivir S, ed. *Regulation, institutions and the law*, Social Science Press, New Delhi, 2007, 9.

⁸⁰ Jaivir S, ed. *Regulation, institutions and the law*, 14.

1.10 Limitations of the Study

The Fintech lending industry in Kenya is growing rapidly and the business complexity poses new challenges to different companies.⁸¹ This also has an impact on its regulation as the legal wheel has to keep reinventing itself. Therefore, the findings of the study are not a complete representation of fintech lending in Kenya but a snapshot resulting from a qualitative study. Additionally, fintech is regarded as a new market trend.⁸² As a result, little research was previously conducted. This became a limitation in building up the literature review.

1.11 Chapter Breakdown

Chapter One has introduced this research study. Background of the study, statement of the problem, justification of the study, research objectives, research questions, theoretical framework, research methodology, literature review, limitations of the study, and research hypothesis have been discussed in this chapter. The general objectives of financial regulation include consumer protection, data protection, caps on interest rates, and provisions on competition. However, this thesis will focus on tackling consumer protection.

Chapter Two analyses the regulatory framework applicable to fintech lending systems in Kenya as well as the existing gaps and how the regulatory framework has been enforced in Kenya. The said regulatory framework includes the Constitution of Kenya 2010, Central Bank of Kenya Act, Cap 491, Banking Act, Cap 488, Consumer Protection Act, No. 46 of 2012, Microfinance Act, No. 19 of 2006, National Payment System Act, No. 39 of 2011, Kenya Information and

⁸¹ Romanova I and Marina K, 'Banking and fintech. A challenge or opportunity? Contemporary issues in finance, 28.

⁸² Goldstein I, Wei J and Karolyi GA, 'To FinTech and beyond.' 32 (5) *The Review of Financial Studies*, 2019, 1653.

Communication Regulations 2010, and Data Protection Act, No. 24 of 2019. Further, the practical problems of transparency and exploitation in consumer protection regulation operationalized by the Kenyan government are discussed. The insufficiency of consumer protection regulatory frameworks from the fintech lending systems in Kenya within the banking regulation is evaluated. The potential risks and benefits of unregulated aspects in consumer protection from fintech lending systems in Kenya are critically reviewed. More so, the challenges faced by fintech lending regulating institutions in Kenya are assessed.

Chapter Three entails a detailed discussion of the enforcement of laws and regulations. The chapter contains a detailed discussion of two fintech lenders in Kenya are M-Shwari and Tala. More so, it discusses the enforcement mechanisms. Further, the two foreign jurisdictions that this chapter will focus on are South Africa and the UK, their regulatory frameworks and enforcement of the same, and how the countries have succeeded and failed in equal measures.

Chapter Four addresses the conclusion, key findings, and recommendations. The conclusion is a summary of key points, key findings show what the study has revealed and recommendations suggest how gaps in fintech lending in Kenya can be filled. The recommendations will also undertake a discussion of the different methods and regulatory suggestions to be adopted for effective consumer protection regulation of fintech lending systems in Kenya.

CHAPTER TWO

REGULATORY FRAMEWORKS APPLICABLE TO FINTECH LENDING IN KENYA

2. Introduction

Regulatory frameworks, tensions arising from the regulations, and challenges facing regulators are dealt with in this section. The creation of unified laws and policies on fintech lending has not been successful in most developing countries including Kenya. This is because new technologies are in place but a lot of regulatory focus is still on traditional banking systems.⁸³ Compared to fintech, traditional banks are prudently regulated to minimise failure and extreme costs that might result from the failure.⁸⁴ Additionally, the formulation and enforcement of regulations and legal principles are slower compared to the pace at which fintech is developing. Eventually, this leads to a steadily widening gap between regulation and new technologies.⁸⁵ However, having a timely legislative intervention to support existing laws and fill the gaps will ensure the law is current and relevant. Therefore, it is helpful to acknowledge the fact that the growth of fintech has brought about some concerns which cannot be tackled adequately by regimes that are currently in place.⁸⁶

Consumer protection is one of the key objectives of financial regulation in Kenya. Focus on it is relevant because the flow of information from lenders is constrained while levels of education on consumer rights are lower. Therefore, strengthening consumer protection in fintech lending will go a long way in solving the issue. Regulators in fintech lending have the authority of improving

⁸³ Rogers JS, *The end of negotiable instruments: Bringing payment systems law out of the past*. Oxford University Press, Oxford, 2012, 19.

⁸⁴ Mugasha A, 'Securing effective regulation of the shadow banking system.' 29 (4) *European Business Law Review*, 2018, 4.

⁸⁵ Malala J, 'Consumer protection for mobile payments in Kenya' 9.

⁸⁶ Malala J, 'Consumer protection for mobile payments in Kenya' 19.

consumer protection through the amendment of legislation and putting more in place.⁸⁷ The CBK has been watchful and provided oversight but the same has not been extensive and exhaustive. This thesis focuses on a critical analysis of the underlying issues in fintech lending and consumer protection, regulatory frameworks in place on the same, regulatory institutions, and challenges facing the said institutions.

2.1 Tensions Arising from Fintech Regulations

2.1.1 Financial Inclusion v Consumer Protection

The goals of financial inclusion involve a widespread promotion of fintech lending throughout the country. However, financial inclusion goals seem to clash with traditional regulatory objectives such as consumer protection. There are two reasons why consumers need to be protected. First, there are few options available to consumers but to contract on terms presented by powerful fintech lending companies. Second, the companies have the capability of exploiting information in their favour.⁸⁸

On the contrary, the theory of exploitation has failed to prevail among economists who do not regard it as a justification for protecting consumers. This is because the theory fails to consider the competition that gives companies bargaining power. Also, it is because consumers do not know much about contracts and products compared to professionals. Sometimes it is argued that only a restricted role should be played in consumer protection because it is efficiently achieved through the operation of open and free markets. According to economists, the law is only required to intervene in markets where foul play thrives although the issue can be undertaken

⁸⁷ Srivastava SC, Chandra S and Theng YL, 'Evaluating the role of trust in consumer adoption of mobile payment systems: An empirical analysis.' 27 *Communications of the Association for Information Systems*, 2010, 561.

⁸⁸ Ruhl G, 'Consumer protection in choice of law.' 44 *Cornell International Law Journal*, 2011, 569.

cost-effectively. While accepting financial inclusion and consumer protection, it is important to acknowledge that certain approaches can be viewed from either perspective.⁸⁹

2.1.2 Transparency

Information in fintech can be presented differently particularly where different fees are charged by multiple entities involved.⁹⁰ This makes it challenging for consumers to determine the final costs. Simplified disclosure of the terms and conditions of fintech lending can help consumers in making informed decisions that would help in avoiding issues such as loan defaults. Putting in place regulations that assure the protection of consumers when anything goes wrong allows them to have a preference based on convenience, service, and price regardless of whether the provider is a new entrant or existing.⁹¹ Transparency is a pillar of modern regulation which aims at promoting market discipline, allow for timely intervention by regulators, and ensure there is competition.⁹² On the contrary, transparency could have little or no impact on financial choices and behavioral practices.⁹³ It is believed that some individuals with little to no education⁹⁴ have a high likelihood of making financial mistakes regardless of disclosure quality.⁹⁵ To this end, additional information should be avoided to consumers; the information should be broken down and translated to different local dialects that are easy to understand for such individuals. The information should be made readily available through brochures, incorporated in different radio

⁸⁹ Malala J, 'Consumer protection for mobile payments in Kenya' 31.

⁹⁰ Organisation for Economic Co-operation and Development, *Report on consumer protection in online and mobile payments*, OECD Publishing, 2012.

⁹¹ Organisation for Economic Co-operation and Development. *Report on consumer protection in online and mobile payments*.

⁹² Mugasha A, 'Securing effective regulation of the shadow banking system.' 24.

⁹³ Ben SO and Schneider CE, 'The failure of mandated disclosure', 159 *University of Pennsylvania Law Review*, 2011, 647.

⁹⁴ Lusardi A and Tufano P, 'Debt literacy, financial experiences, and overindebtedness.' *National Bureau of Economic Research, Working Paper No. 14808, 2009*

⁹⁵ Clark N, 'Education in Kenya.' *World Education News & Reviews*, 2 June 2015 - <<https://wenr.wes.org/2015/06/education-kenya>> on 5 June 2021

station advertisements and programs, community hall messages, and the setting up of different informative booths in strategic locations where people are encouraged to visit and seek guidance and clarification. To address the susceptibility of individuals with little to no education is to make knowledge and information about fintech lending as accessible as possible. The masses need to be sensitised about the benefits, processes and risks they are exposing themselves to by assenting to the services of the different fintech lending firms. It is also necessary to consider the economic interests that are pushing more people towards adopting fintech lending apps; in the same way these consumers are being informed about the obligations and content of the lending apps, they should be advised that the money they are using should not be used for recreational purposes, but rather they should be adopted for self-development aspect. The consumers should be advised not be overly reliant on these fintech apps as they risk getting trapped in a cycle of borrowing and repaying debts. The incessant repayment demands that are used by these fintech firms to get back their money which include calling people on the borrowers' contact list contributes to evasive measures by customers where they switch mobile networks, and for others the embarrassment that follows contributes to depression, stress and other mental health challenges.

2.1.3 Overlapping Jurisdiction

The Central Bank of Kenya (CBK) which is the main regulatory agency has the authority of regulating consumer credit from banks as well as other credit products. The said authority needs to cover fintech firms. However, this is not an exclusive oversight as other regulators in Kenya such as the communication and insurance share it. This is an indication that regulators do not

have the exclusive responsibility of regulating fintech products.⁹⁶ This allows several products to pass through the regulatory gaps. Having different regulatory regimes can lead to diverse rights and a deviation from consumer protection.⁹⁷ Consumers may not fully understand the regulations applicable to certain transactions because different regulatory bodies govern different fintech institutions. As a result, consumers are not sure of their redress rights or the regulatory institutions to turn to in case problems arise. To remedy against this it is advisable to similarly disseminate information about redress possibilities, processes and the options available to the consumers. The redress options should be condensed to simple to follow steps that guide the consumers to different departments/institutions where they can go to get assistance and be provided with avenues on how to seek redress.

2.1.4 Data Protection

Personal data of consumers are more often handled by third parties who put it at risk of being accessed and used inappropriately. The current legislation in Kenya does not define who is allowed to have access to data, when, how, and under what circumstances. This makes it difficult to protect consumer data while conflicting with the regulator's desire to prevent financial crimes. Law on data protection should integrate data on fintech to ensure that it is not put to undesirable use. It is not clear who is authorized to have access to an individual's data.⁹⁸

Data protection in developing countries shows a patchwork of regulations issued by different agencies that have overlapping jurisdiction as well as oversight;⁹⁹ however, this is not applicable

⁹⁶ Sejjal S and Rebelo D, 'Kenya: Fintech 2019.' International Comparative Legal Guides, 10 May 2019 - <<https://iclg.com/practice-areas/fintech-laws-and-regulations/Kenya>> on 8 June 2021

⁹⁷ Malala J, 'Consumer protection for mobile payments in Kenya' 15.

⁹⁸ Malala J, 'Consumer protection for mobile payments in Kenya' 34

⁹⁹ Kovacs A, "Cybersecurity and data protection regulation in India: An uneven patchwork." In *CyberBRICS*, Springer, Cham, 2021, 146

to the Kenyan situation because there is specific data protection legislation that is implemented by specific authorities. Designing and enforcing data protection rules would require coordination between regulatory and supervisory authorities as fintech affects different sectors such as telecommunication and banking. Regulations to be put in place should be robust and consistent to hold fintech lenders responsible for the protection of data and should be held responsible for any misuse or breaches. On the other hand, the regulations should be neutral because imposing specific protocols and standards on an industry that is rapidly evolving can hinder innovation.¹⁰⁰

2.2 Regulatory Frameworks

2.2.1 Constitution of Kenya 2010

The Constitution is the supreme law of the land and the basis for other legal provisions on fintech lending and consumer protection. The Constitution provides for consumer protection under Article 46 (1) which states that consumers have the right to “goods and services of reasonable quality, to the information necessary for them to gain full benefit from goods and services, to the protection of their health, safety, and economic interests, and compensation for loss or injury arising from defects in goods or services.” Data protection for a consumer is further provided for under Article 31 (c) and (d) which state that “every person has the right to privacy which includes the right not to have information relating to their family or private affairs unnecessarily required, or the privacy of their communications infringed.”

¹⁰⁰ Malala J, ‘Consumer protection for mobile payments in Kenya’ 35.

2.2.2 Central Bank of Kenya Act, Cap 491

The CBK is the main regulatory body responsible for the formulation and implementation of monetary policy.¹⁰¹ Section 4 (1) of the Central Bank of Kenya Act 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.” Under section 34 (2) additional services considered to be desirable may be provided by the CBK to institutions in Kenya. Section 34 (3) of the Central Bank of Kenya Act goes further to list the institutions which include a specific bank, financial institution, microfinance bank, and any person or body of persons which the CBK may recommend then prescribed by the Minister. This is an indication that the body of a person or persons may include fintech lenders. Be as it may, the CBK has been receptive to fintech where it allowed implementation of transfer services for mobile money when there was no legislation in place to govern the innovation. This critical decision led to financial services development and a basis for fintech innovations growth.¹⁰²

On the contrary, fintech lending practices in Kenya were intensely scrutinised and caused outrage from regulators and the public. One of the reasons for this was that principles of consumer protection could not be met. Terms and conditions offered contravened consumer protection laws with vague solutions being offered.¹⁰³ This is evident in Civil Suit No. 400 of 2016, *Consumer Federation of Kenya (COFEK) v Commercial Bank of Africa, Central Bank of Kenya and Safaricom Limited* where the Petitioner moved the court in seeking that additional

¹⁰¹ Blythin J and Van CJ, ‘The development of fintech in Nairobi: Contributions to financial inclusion and barriers to growth.’ Published Masters in Management Thesis, Lund University School of Economics and Management, Scania, 2017, 34.

¹⁰² Sejjal S and Rebelo D, ‘Kenya: Fintech 2019,’ International Comparative Legal Guides,

¹⁰³ Syekei John, Indokhomi D and Issaias A, ‘Fintech 2021 Kenya: Trends and developments.’ Chambers & Partners, 18 March 2021 - <<https://practiceguides.chambers.com/practice-guides/fintech-2021/kenya/trends-and-developments>> on 8 June 2021

sums that the 1st Respondent charged was unconstitutional and illegal, contrary to the Banking Act. The Petitioner prayed that the CBA be compelled to ensure full compliance with the Banking Act. Although the Petition was dismissed, the court pointed out that the CBK exercised its mandate of approving the M-Shwari product on the condition that the facilitation fee of 10% of the disbursed amount is reduced to 7.5%. In December 2020, concerns were raised by the CBK on fintech lending practices considered to be predatory.¹⁰⁴ The CBK governor pointed out to parliament the need to protect consumers from lending practices that are unfair and plans to put in place laws that scrutinise fintech lenders.

There is a proposed Central Bank of Kenya (Amendment) Bill, 2020 (National Assembly Bill No. 21) whose aim is to bring the digital financial sector under the jurisdiction of the CBK.¹⁰⁵ The bill was first to read on 28th July 2020 then it was handed over to the relevant committee for further action. The second bill, the Central Bank of Kenya (Amendment) Bill, 2020 (National Assembly Bill No. 47) intends to introduce licensing of fintech lending platforms. The first reading of this bill was done on 25th February 2021 then handed over to the relevant committee. The Central Bank of Kenya (Amendment) Bill, 2021 which is the third was gazetted on 16th April 2021. The evolution of the current legislation will help meet the changing public interest and consumer protection while promoting innovation. On the contrary, the regulator is given wide discretionary powers by the laws which should be exercised judiciously to avoid stifling innovation.

¹⁰⁴ Syekei J, Indokhomi D & Issaias A. 'Fintech 2021 Kenya', 14 June 2021 - <<https://iclg.com/practice-areas/fintech-laws-and-regulations/kenya>> on 28 July 2021

¹⁰⁵ Indokhomi D and Issaias A, 'Opportunities and pitfalls in fintech regulatory push.' Business Daily, 26 April 2021 - <<https://www.businessdailyafrica.com/bd/opinion-analysis/columnists/opportunities-pitfalls-in-fintech-regulatory-push-3376510>> on 8 June 2021

2.2.3 Banking Act, Cap 488

This provision is the anchor for banking operations in Kenya and a legal basis for the operation of fintech lending. The Banking Act identifies lending as a characteristic that constitutes a bank.¹⁰⁶ Fintech lenders are not considered as banks per-se in respect to how a bank and banking business is defined. Under section 2 (1) of the Banking Act, a bank is defined as “a company which carries on, or proposes to carry, banking business in Kenya but does not include the Central Bank.” Further, the banking business does not define the mode of lending in fintech lending where money is lent on no deposits held by the financial institutions. Digital lenders do not take deposits. Therefore, they are not defined as banks and cannot be regulated by the CBK.

On the contrary, fintech lenders are partly in banking because of the lending business through financial institutions in lending such as SACCOs and microfinance institutions that have not been regulated by the CBK would also be affected by this argument. These institutions have specific regulators. SACCOs have SACCO Societies Regulatory Authority while microfinance institutions have the Microfinance Unit in the Ministry of Finance.¹⁰⁷

2.2.4 Consumer Protection Act, No. 46 of 2012

Section 4 provides for purposes of the Act which are “to promote and advance the social and economic welfare of consumers in Kenya by establishing a legal framework for the achievement and maintenance of a consumer market that is fair, accessible, efficient, sustainable and responsible for the benefit of consumers generally, reducing and ameliorating any disadvantages experienced in accessing any supply of goods or services by consumers, promoting ethical and

¹⁰⁶ Section 2 (1) (d), *Banking Act* (Act No. 10 of 2010)

¹⁰⁷ Abd EESA, ‘The regulatory and supervision framework of microfinance in Kenya.’ 3 *International Journal of Social Science Studies*, 2015, 123.

fair business practices, protecting consumers from all forms and means of unconscionable, unfair, unreasonable, unjust or otherwise improper trade practices, including deceptive, misleading, unfair or fraudulent conduct, improving consumer awareness and information and encouraging responsible and informed consumer choice and behavior, promoting consumer confidence, empowerment and the development of a culture of consumer responsibility through individual and group education, vigilance, advocacy and activism, providing a consistent, accessible and efficient system of consensual resolution of disputes arising from consumer transactions, and providing for accessible, consistent, harmonized, effective and efficient system of redress for consumers.” There are no express provisions in the Act on fintech lending. However, based on how the provision is interpreted, fintech lending is regulated under the Act.

2.2.5 Microfinance Act, No. 19 of 2006

Microfinance institutions are directly regulated by the CBK but limits are placed on the activities to engage in. Activities that microfinance institutions are not allowed to engage in include enterprise capital investment, undertaking trade-in wholesale or retail, securities underwriting, and purchase.¹⁰⁸ Also, the money lent by microfinance institutions that do not take deposits should be their own money. This brings in the similarity with fintech lenders who gain interest for lending their money. A distinction is brought in under section 11 (1) where microfinance institutions are expected to have minimum capital requirements before they are allowed to operate.¹⁰⁹ This is a requirement that does not exist in fintech lending. This then establishes the position that an organization cannot be classified as a bank just because it is in the finance sector and does not have to be regulated by the CBK.

¹⁰⁸ Abd EESA, ‘The regulatory and supervision framework of microfinance in Kenya.’

¹⁰⁹ *Microfinance Act* (Act No. 19 of 2006)

The Microfinance Act touches on fintech lending in the definition of what microfinance business is. It states that microfinance business provides loans as well as other facilities to households with low income and small enterprises.¹¹⁰ Additionally, there is a similarity between microfinance institutions and fintech lending in what constitutes them and the law. For instance, M-Shwari allows for saving and withdrawal at will which questions whether it is a microfinance institution. It has therefore been established that fintech lenders are involved in microfinance although they are not as conventional as microfinance institutions. They take part in advertisements, accept applications for loans, determine the eligibility of borrowers, issue loans, and deal with defaulting customers. The only difference between fintech lenders and microfinance institutions is that the latter uses traditional business processes and marketing methods while the former has deployed technology.¹¹¹

2.2.6 National Payment System Act, No. 39 of 2011

This legislation was developed for purposes of addressing gaps in online and mobile payments as well as prevent money laundering among other reasons. The Act is relevant in the regulation of fintech lending because it was put in place with the sole purpose of regulating how transfer services of mobile money are conducted. On the contrary, this development came into existence before fintech lending became a common phenomenon. Therefore, fintech lending activities were not anticipated as they were a non-issue at the time. However, the existence of this legislation is a signal of how changes in financial services were considered.¹¹²

¹¹⁰ Section 2, *Microfinance Act* (Act No. 19 of 2006)

¹¹¹ Muli AK, 'Digital lending in Kenya: The case for regulation.' Published Master of Laws Thesis, Strathmore University, Strathmore Law School, Nairobi, 2020, 24.

¹¹² Muli AK, 'Digital lending in Kenya' 26.

2.2.7 Kenya Information and Communications Regulations

The Kenya Information and Communications Act equates electronic copies of documents with critical information such as contracts, to hard copies of documents. It then gives them legal standing.¹¹³ This legal provision was put in place to create a conducive environment for the growth of fintech and to put into consideration changes in technology that would lead to efficient service delivery. The Kenya Information and Communication (Consumer Protection) Regulations 2010 and the Kenya Information and Communication (Dispute Resolution) Regulations 2010 under the Kenya Information and Communications Act have set out consumer rights that apply to fintech lending. The rights and responsibilities of consumers have been outlined in the regulations with specific provisions defining service providers' obligations related to the handling of complaints, disclosure of information, data privacy, and billing information. Service providers are also required to submit a commercial code of practice that defines their compliance procedures and policies for approval.¹¹⁴

In 2016, an order was issued by the Competition Authority of Kenya that required lenders to make a declaration to their clients of fees charged before advancing loans.¹¹⁵ This came as a result of complaints from consumers that fees of financial products were being hidden by lenders. The Communication Authority requires licensees to lodge complaints as well as make inquiries about the services. This is an indication that the Communications Authority applies the same criteria used on physical goods and services to technological products and services.

¹¹³ Section 83, *Kenya Information and Communication Act* (Act No. 25 of 2015)

¹¹⁴ *Kenya Information and Communications Act* (Act No. 2 of 1998)

¹¹⁵ AFI CEMC, 'Digitally delivered credit: Consumer protection issues and policy responses to new models of digital lending', 2017, 8.

2.2.8 Data Protection Act, No. 24 of 2019

This provision aims at giving effect to the right to privacy provided for by the Constitution of Kenya under Article 31. In doing so, express provisions under the act provide for how data from consumers should be handled and protected.¹¹⁶ The Data Protection Act is important to fintech lending that largely deals with data from consumers. Some fintech lending apps request permission from users to access their data such as personal contacts, CRB records, and their account balances. However, all these apps read location data, contacts and have access to network connectivity data.¹¹⁷ The purpose of this could be because of geo-locating the loans to Kenya. In spite of this, these apps have unfettered and continuous access to location data, which infers that they easily track the movements of the borrowers. For example, Okash demands the user to provide it permission for extra location, which means that it will get access extra location provider commands. These apps run from the start-up of the phone, which prevent it from sleeping raising concerns from the perspective of data protection; such as data minimisation and transparency. It is questionable whether these loan apps have to examine the movements of the borrowers at such a close and constant level.¹¹⁸ Other concerns that illuminate concerns for data protection are for instance Branch's requirement to access the microphone of the borrower's phone for the sake of recording audio. Similarly, OKash requires access to the calendar of the user; and it insists permission to modify or add the different calendar events, as well as email different guests without the knowledge of the borrower. Most of these fintech lending apps read

¹¹⁶ Section 3, *Data Protection Act* (Act No 24 of 2019)

¹¹⁷ CIPT. 'Privacy and Data protection practices of digital lending apps in Kenya.' 4 November 2020. <<https://privacyinternational.org/sites/default/files/2021-09/CIPIT-Privacy-and-Data-Protection%20Practices-of-Digital-Lending-Apps-in-Kenya.pdf>>

¹¹⁸ CIPT. 'Privacy and Data protection practices of digital lending apps in Kenya.' 2020, p. 18

the status of the phone, their identity and text messages on the phone. This permission is not one-off, instead it is constantly required.¹¹⁹

Whereas, this Act addresses loopholes that exist in fintech lending related to violation of privacy on consumer data, there are several weaknesses that not only warrant the undertaking of this study, but also underpin the focus of the need to improve the existing legislation on consumer protection from fintech firms. For example, the Act¹²⁰ guarantees the right to privacy, but from the foregoing examples, the right to privacy seems to only encompass the privacy of communications; the model of the non-deposit taking apps is dependent on examining personal data on their phones and then proceeding to make inferences such as the creditworthiness of the borrower. This is an infringement of privacy. More so, the Act provides for lawful, fair and transparent processing,¹²¹ the fintech lending apps provide useful information such as the overall cost of loans in the apps, at times even before the downloading commences. Nevertheless, the information on aspects of data was not as explicit; for instance, even when the app explains that it relies on the data from the phone of the borrower to ascertain the different limits on credit; the parameters adopted in ascertaining this creditworthiness are unknown to borrowers. This was apparent during the COVID-19 pandemic following the government's declaration that consumers should not be added to credit reference bureau (CRB), and since these fintech apps directly linked their creditworthiness algorithm with the CRB reference, almost instantly most of these apps suspended the loan limit systems even for the customers who had developed a positive borrowing rate of borrowing and repaying on time. Concerning purpose limitation in the

¹¹⁹ CIPT. 'Privacy and Data protection practices of digital lending apps in Kenya.' 2020, p. 19

¹²⁰ Section 25 (a), *Data Protection Act* (Act No 24 of 2019)

¹²¹ Section 25 (b), *Data Protection Act* (Act No 24 of 2019)

Act,¹²² fintech apps are renowned for being directly connected to data analytic systems, and this raises issues of whether the data collected is employed for additional purposes other than the creditworthiness of the borrower. There are traditional banks that send prospecting messages to potential customers; indicating the loan amounts that they qualify for, but they do not disclose how they arrived at these loan limits. This underpins that banks rely on the information analysed or collected from different sources. Therefore, such information is obtained from other purposes, and is likely not linked to other purposes of prospecting to new customers.

Another weakness of the Act is encapsulated in the Data protection by design and default clause,¹²³ whereby the digital lending apps failed to promote and protect data protection through design. For instance, these fintech apps do not incorporate meaningful consent, they have insufficient information on the different types of data they are collection. Consumers do not know how long the data collected is stored, and with whom it is shared with. More so, there is inadequate communication to consumers on the different processing that impacts their interests. Another limitation of the Act concerns data portability,¹²⁴ in the sense that the fintech apps do not provide information on how they can port their data to different service providers. These fintech firms are required to incorporate interoperability as part of their system design. It is also prudent for the regulator to intervene so that borrowers are not locked to a particular lender. Moreover the Act discusses protection from automated decision making,¹²⁵ whereas the apps inform the borrowers that the data they collect is for determining their creditworthiness, it nevertheless remains a decision making process that is automated. These apps fail to provide redress mechanisms for the many borrowers who are aggrieved by the decision making from the

¹²² Section 25 (c), *Data Protection Act* (Act No 24 of 2019)

¹²³ Section 41, *Data Protection Act* (Act No 24 of 2019)

¹²⁴ Section 38, *Data Protection Act* (Act No 24 of 2019)

¹²⁵ Section 35, *Data Protection Act* (Act No 24 of 2019)

automated processes. The foregoing limitations reveal that additional improvements need to be incorporated into the Act, with a unified regulatory regime being one of the solutions needed in fintech lending.

2.3 Challenges Facing Regulators

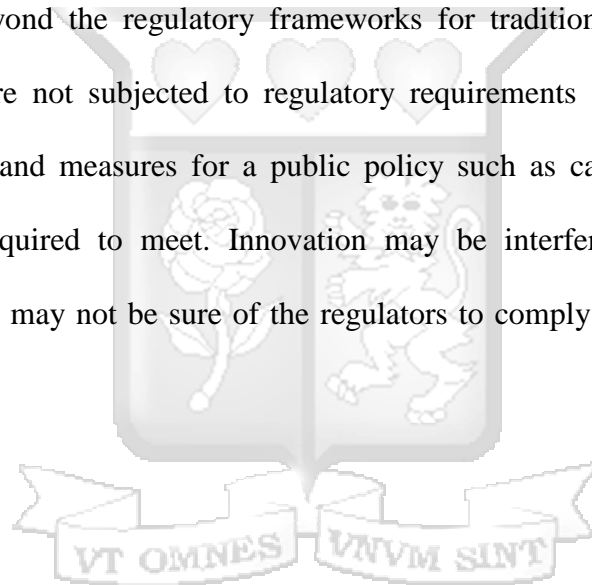
The regulators in fintech lending include the Central Bank of Kenya, the Communications Authority of Kenya, the Capital Markets Authority, the Competition Authority, and the Insurance Regulatory Authority. The regulators face numerous challenges in the formulation and implementation of rules and policies. For instance, they face the challenge of being unable to forecast what will happen in the future because of the rapidly changing technology. The inability to predict technological evolution forces the regulators to only put in place rules for current problems. However, there are possibilities that problems will arise concerning the rules once new technologies come into existence. This has been brought forth by fintech lending which leapfrogged traditional systems. With continuous innovation, the regulators must find frameworks to cope with uncertainty.¹²⁶

When multiple regulators are in place, companies tend to select those in their favour. For instance, they select lenient regulators or capitalise on beneficial rules. This is a problem where regulations have not been put in place to cater for different services that could be supervised by at least one supervisor. With the presence of various alternatives, they can settle for an option that may not be the best for the industry or society. An argument that it is desirable to have several regulators in place because institutional learning can be fostered through the expansion of desirable legal models and elimination of obsolete ones may practically not be possible. This is

¹²⁶ Malala J, 'Consumer protection for mobile payments in Kenya', 21.

because government interests are not aligned with those of companies. Companies aim at maximizing profits while the government focuses on maximizing societal welfare. Companies wish to apply rules that may not be beneficial to society.¹²⁷

Regulatory frameworks that have been proposed by the government need further scrutiny. For instance, there should be more express provisions that guarantee customer protection in the contract between the fintech lending firms and the borrowers. For instance, the warning from the CBK pointed out that establishing the Authority meant digital fintech products could be developed by banks beyond the regulatory frameworks for traditional banks. This could be because fintech firms are not subjected to regulatory requirements for capital, disclosure of mandatory information, and measures for a public policy such as caps on interest rates than traditional banks are required to meet. Innovation may be interfered with by overlapping jurisdictions as the firms may not be sure of the regulators to comply with when new products are being launched.¹²⁸



2.4 Conclusion

It is almost impossible to look at fintech lending without focusing on consumer protection which is considered an important legal issue. For instance, the goal of financial inclusion by fintech lenders may clash with traditional regulatory objectives such as consumer protection. This is because companies have the capability of exploiting information in their favour while consumers

¹²⁷ Malala J, 'Consumer protection for mobile payments in Kenya', 20.

¹²⁸ Kalunda T and Hu I, 'Groundbreaking new policy and regulatory initiatives may spur more fintech innovation in Kenya.' FSD Kenya Blog, 5 July 2018 - <<https://fsdkenya.org/blog/groundbreaking-new-policy-and-regulatory-initiatives-may-spur-more-fintech-innovation-in-Kenya/>> on 8 June 2021

have no option but to contract on terms presented by powerful fintech lending companies. Other issues such as transparency, overlapping jurisdiction, and data protection are crucial in fintech lending and consumer protection. However, the issue of consumer protection does not go well with economists who argued that only a restricted role should be played in consumer protection because it is efficiently achieved through the operation of open and free markets. Regulators are facing challenges in the formulation of rules and policies but it has been established that legislation that is currently in place should evolve at a faster rate to fill the existing legislative loopholes and provide a fair playing field for both lenders and consumers.

The current legal provisions apply to consumer protection both expressly and by implication. Consumer protection has been provided for under the Constitution of Kenya 2010. The Central Bank of Kenya Act provides for fintech lending by implication. However, consumer protection principles have not been met. As a result, the Central Bank of Kenya (Amendment) Bills aim to bring the digital financial sector under the CBK jurisdiction, introduce licensing for fintech lending platforms, and meet public interest and consumer protection needs while promoting innovation. The Banking Act identifies lending as a characteristic that constitutes a bank. However, fintech lenders are not considered as banks per-se in respect of how a bank and banking business is defined.

Under the Consumer Protection Act, fintech lending has not been expressly provided for. In respect to the Microfinance Act, it has been established that fintech lenders are involved in microfinance though they are not as conventional as microfinance institutions. The National Payment System Act is relevant in the regulation of fintech lending where it provides for how transfer services of mobile money are conducted. Under the Kenya Information and Communications Regulations, consumer protection has been provided with an outline of

responsibilities for both consumers and service providers. The Data Protection Act addresses loopholes that exist in fintech lending related to the violation of privacy on consumer data.



CHAPTER THREE

ENFORCEMENT OF FINTECH LENDING IN KENYA AND LESSONS FROM OTHER JURISDICTIONS

3. Introduction

This chapter focuses on M-Shwari and Tala in detail in addition to the enforcement mechanisms used for the applicable regulations. The chapter further undertakes an analysis of how fintech regulations in South Africa and the UK have been dealt with. A lot has changed in Kenya in the past fifteen years leading to the entry of fintech into the economy. The first factor that led to this is the increase in mobile phone use which provided further information for fintech lenders and banks.¹²⁹ This led to the provision of a wide range of information about consumers which is later used by fintech firms and banks.¹³⁰ Changes in regulatory arrangements in Kenya are the second factor to facilitate fintech lending entry. The emergence of several fintech lending services as permitted by the CBK in Kenya without the imposition of strict regulatory frameworks.¹³¹ The establishment of the Credit reference bureau was the third factor to change the landscape of consumer credit in Kenya. In 2010, the CBK launched Credit Reference Bureau, Metropole, and Creditinfo which helped financial institutions share information on consumer creditworthiness

¹²⁹ Yermack D, 'FinTech in Sub-Saharan Africa: What has worked well, and what hasn't.' National Bureau of Economic Research, Working Paper No. 25007, 2018, 5.

¹³⁰ Obulutsa G, 'M-Pesa has completely changed Kenyans' access to financial services, this is how....' CNBC Africa, 3 April 2019 - <<https://www.cnbc.com/news/east-africa/2019/04/03/m-pesa-has-completely-changed-kenyans-access-to-financial-services-this-is-how/>> on 14 July 2021

¹³¹ Herbling D and Faux Z. 'Kenya's mobile lenders could be supervised by Central Bank.' Bloomberg, 24 October 2019 - <<https://www.bloomberg.com/news/articles/2019-10-24/kenya-draft-law-proposes-central-bank-supervises-mobile-lenders>> on 14 July 2021

and loan defaulters.¹³² Other institutions use the information in determining whether individuals should be given digital credit.¹³³

3.1 Enforcement of Fintech Lending in Kenya

This section discusses M-Shwari and Tala, which are arguably two of the most popular and widely used fintech lending platforms. They are relatable and known to many borrowers, and their parameters of operation reveal how customers are exploited through the loopholes existing in the regulation.

3.1.1 M-Shwari

M-Shwari is a digital bank operating through M-Pesa and it was launched in the year 2012 through the partnership between CBA and Safaricom.¹³⁴ M-Shwari was remarkably taken up whereby 4.5 million individuals were actively using it with 10 million accounts having been opened. M-Shwari customers can access short-term loans payable within 30 days with a monthly interest rate of 7.5% despite not having a credit or banking history.¹³⁵ Issuing of M-Shwari loans is based on a strict credit score cutoff assigned to consumers upon opening M-Shwari accounts, a score which the consumer knows nothing about.¹³⁶ What is known to consumers is whether they are eligible for loans and their credit limit or how much can be approved.

¹³² Gaitho NW, 'Role of credit reference bureaus on credit access in Kenya: A survey of commercial banks in Kenya.' 9 (13) *European Scientific Journal*, 2013, 303.

¹³³ Getenga J, 'Parliamentary petition to disband the CRB mechanism is retrogressive, FSD Kenya Blog, 23 May 2021 - <<https://fsdkenya.org/blog/parliamentary-petition-to-disband-the-crb-mechanism-is-retrogressive/>> on 14 July 2021

¹³⁴ Ntwiga DB, 'Credit risk analysis for low-income earners.' Kenya Bankers Association, working paper series No. 02/18, 2018, 3.

¹³⁵ Totolo E, 'The digital credit revolution in Kenya: An assessment of market demand, 5 years on.' *Financial Sector Deepening Kenya*, 2018, 2.

¹³⁶ Ntwiga DB, 'Social network analysis for credit risk modeling.' unpublished Ph.D. Thesis, School of Mathematics, University of Nairobi, Nairobi, 2016, 8.

CBA has gained a competitive advantage within the banking industry because of M-Shwari. Its market share has grown dramatically and provided an important revenue source. The Kenyan banking industry has been transformed by M-Shwari with similar products being provided by competitors. M-Shwari disburses uncollateralized loans which start with small amounts of as low as Kshs. 100 to as high as Kshs. 10,000.¹³⁷ The credit limit of an individual grows over time if they save and repay. Behind the process of approving loans, there are rules on credit scoring and approval based on the M-Pesa data of the user. The process of credit scoring provides individuals with loan limits that increase with the timely repayment of the loans.¹³⁸ Failure to pay the loan on time, there is an extension of the repayment time for 30 more days with an additional facilitation fee of 7.5% charged on the unpaid balance.¹³⁹ Borrowers are reported to CRB if they fail to pay the outstanding amount after 120 days. There is no locking of savings during the loan duration as M-Shwari savings are reclaimed to clear the loan.¹⁴⁰

M-Shwari consumers are assigned credit scores immediately upon signing up for accounts whether they want to borrow or not. A credit limit is assigned based on the credit score.¹⁴¹ For instance, consumers are assigned zero limits in instances where their scores are below cutoff levels. The said zero limits can be upgraded with time through saving in M-Shwari.

¹³⁷ Prashant B, William J and Tavneet S, 'Fintech and household resilience to shocks: Evidence from digital loans in Kenya.' National Bureau of Economic Research, Working Paper No. 25604, 2019, 8.

¹³⁸ Ntwiga DB, 'Can fintech shape the dynamics of consumer credit usage among the un (der) banked.' Kenya Bankers Association, working paper series No. 04/19, 2019, 4.

¹³⁹ Owiti J, 'Challenges faced in the strategic alliance between Safaricom and Commercial Bank of Africa in the provision of M-Shwari services.' published Ph.D. thesis, University of Nairobi, Nairobi, 2016, 17.

¹⁴⁰ Greenacre J, 'What regulatory problems arise when fintech lending expands into fledgling credit markets?' 229.

¹⁴¹ Cook T and McKay C, 'How M-Shwari works: The story so far.' Consultative Group to Assist the Poor) and Financial Sector Deepening, 2015, 5.

3.1.2 Tala

Tala is an international fintech establishment formerly called InVenture whose founder is Shivani Siroya. Her focus was the alleviation of micro-finance needs in developing countries where there was a lack of credit scores for business owners who often turned to loan sharks to get funding. The software was developed by the company which borrowers downloaded into their phones. Tala got numerous indicators of people's routines as well as responsibility levels from the app for purposes of estimating default risk associated with loan requests.¹⁴² The operation of Tala was in economies that were traditionally ignored such as the Philippines and Western Africa. No fee was charged with an 11% average interest rate.¹⁴³ 50% of the applicants were accepted by the company and over 6,000 loans were given out in the first year. Most of the said loans were small and ranged between 20 to 100 dollars. There was an 85% repayment rate with over 75% returned applicants for other loans. By 2016, approximately 20 million dollars had been loaned to more than 150,000 customers with over 90% as the average rate of repayment.¹⁴⁴

Tala is a fintech company seeking to provide consumers with digital credit through the use of technology. The two categories of data that are used by Tala in providing loans are behavioral and android device data. The consumer grants permission before data from their android phone is directly accessed. On the one hand, applications, operating system, and device type are the android data accessed by Tala. On the other hand, behavioural data entails how the consumer uses the Tala app and the types of pages that they visit on the app. Algorithms generated by

¹⁴² Adams S, 'How Tala mobile is using phone data to revolutionize microfinance.' Forbes, 29 August 2016 - <<https://www.forbes.com/sites/forbestreptalks/2016/08/29/how-tala-mobile-is-using-phone-data-to-revolutionize-microfinance/?sh=45fda1b2a9f2>> on 18 July 2021.

¹⁴³ Lindsay D, 'Inventure: For introducing trust to an unsteady economy.' Fast Company, 2015 <<https://www.fastcompany.com/3039583/inventure>> on 18 July 2021.

¹⁴⁴ Lindsay D, 'Inventure'

machines determine the weight that data point for each individual gets. Thereafter, the algorithms are used in evaluating data points that are picked up from phones of potential borrowers to determine the extent of initial loans.¹⁴⁵

Contrary to M-Shwari, Tala provides unsecured credit and cannot access the savings balance of the consumer. Additionally, Tala's capital is lent to consumers posing risks of the balance sheet to the firm.¹⁴⁶ There has been a rapid growth of Tala since it was launched in 2014 where there have been over a million downloads of the app from the Google store.¹⁴⁷

3.1.3 Enforcement Mechanisms

Particular fintech services, products, and players exist without any form of regulation. In cases where regulators are concerned about certain fintech services and products, the public has been issued with cautionary notices or warnings regarding interacting with products or providers of financial services that do not meet regulatory requirements.¹⁴⁸ In cases where principles of consumer protection have not been met, for instance, where vague solutions are offered with terms and conditions contravening laws on consumer protection, warnings have been issued to consumers against taking the products up. The CBK has been keen on ensuring that Kenyans are protected from unfair practices. The Central Bank of Kenya (Amendment) Bill, 2020 gives the

¹⁴⁵ Tala, 'Data ethics at Tala: Data ethics and consumer protection.' Tala, 9 October 2019 - <<https://perma.cc/4F8P-GUCX>> on 19 July 2021.

¹⁴⁶ DM, 'Tala: Using machine learning to provide access to credit for the world's unbanked.' Harvard Business School, Digital Innovation & Transformation, 9 April 2018 - <<https://digital.hbs.edu/platform-digit/submission/tala-using-machine-learning-to-provide-access-to-credit-for-the-worlds-unbanked/>> on 17 July 2021

¹⁴⁷ Macharia K, 'Mobile lending app Tala closes Sh. 6.5b investment, to expand to India and Mexico.' Capital Business, 18 April 2018 - <<https://www.capitalfm.co.ke/business/2018/04/mobile-lending-app-tala-closes-sh6-5b-investment-to-expand-to-india-and-mexico/>> on 17 July 2021

¹⁴⁸ Malala J, 'Consumer protection for mobile payments in Kenya', 5.

CBK powers to supervise and regulate providers of financial services and products which include digital lending.¹⁴⁹

In March 2019, a regulatory sandbox was established by the Capital Markets Authority (CMA) for purposes of accelerating their understanding of the technologies coming up within the capital markets space.¹⁵⁰ A regulatory sandbox refers to a framework that permits fintech standups to undertake live experiments in controlled environments under the supervision of the regulator. The different issues identified in this thesis as requiring regulation can be approached and resolved by a regulatory sandbox because the fintech firms will be put to the task regarding their different decision making processes, and what this means to the borrower, and whether this is within the existing laws. Innovative solutions, products, and services capable of deepening or broadening the capital markets are tested by the sandbox. Seven fintech firms were admitted for purposes of testing fintech solutions. In 2021, more admissions and successful exits from the sandbox are expected.¹⁵¹ New regulations, notices, or guidelines may also be adopted by the CMA as a result of an increase in activities in the sandbox and gained insights from the sandbox tests where broader regulatory or legal reforms are needed. New regulations aimed at governing specific innovations or business models that are not adequately addressed by the current regulations may be adopted or designed.

Attempts have been made to increase collaborations between regulators across the border. This is a strategy aimed at supporting innovative solutions within the capital markets industry. The

CMA will join 23 regulators globally to test innovative regulatory technology, business models,

¹⁴⁹ Alonso N, Luis S, Fernandez MAE, Bas DS, and Kaczmarek J. 'Reasons fostering or discouraging the implementation of central bank-backed digital currency: A review.' 8 (2) *Economies*, 2020, 41.

¹⁵⁰ Eija Holttinen, Taylor CR, Morozova A, and Wilson C, 'Institutional Arrangements for Fintech Regulation and Supervision' International Monetary Fund, NOTE/19/02, 2019, 4.

¹⁵¹ Eija Holttinen, Taylor CR, Morozova A, and Wilson C, 'Institutional Arrangements for Fintech Regulation and Supervision, 8.

and financial services and products on a cross-border basis.¹⁵² The tests will be undertaken through the Global Financial Innovation Network (GFIN), a network of international regulators of financial services and related organizations with a common goal of supporting financial innovation. Some of the regulators that take part include the Monetary Authority of Singapore, the UK's Financial Conduct Authority, and the Dubai Financial Services Authority.¹⁵³

Collaboration among players within the Kenyan fintech industry has been the key driver of growth. There has been the development of integration and partnerships between traditional institutions and players offering money services. An example is a collaboration between the CBA and Safaricom for M-Shwari to provide its fintech lending services.¹⁵⁴ Fintech lending is one of the most common financial services offered by partnerships. Additionally, the collaboration has allowed the operation of certain fintech players without direct regulation.

Fintech lending entails the processing of personal data for the services to be offered. The Data Protection Act regulates individuals who process the data which applies to both resident and non-resident processors and controllers of data. Personal data processing is provided for under the Act which not only provides for the rights of data subjects but obligations of data processors and controllers. The first Data Commissioner in Kenya was recently appointed and set up the Office of the Data Commissioner with the mandate of implementing the Act. A Taskforce for the Development of Data Protection (General) Regulations was established by the Information and Communications Technology (ICT) cabinet secretary on 15th January 2021. The task force is

¹⁵² Eija Holttinen, Taylor CR, Morozova A, and Wilson C, 'Institutional Arrangements for Fintech Regulation and Supervision, 6.

¹⁵³ Eija Holttinen, Taylor CR, Morozova A, and Wilson C, 'Institutional Arrangements for Fintech Regulation and Supervision, 7.

¹⁵⁴ Obiero O and Kiarie W, 'Is there room for optimism in the Kenyan digital credit sector?'

required to come up with regulations for clarity of Data Protection provisions. Further obligations may be placed on fintech lenders who are data processors or controllers.¹⁵⁵

3.2 Lessons from other Jurisdictions

In this section, the different lessons from the UK and South Africa jurisdictions are critically discussed. Notably, it highlights how in South Africa fintech development has affected the traditional financial institutions that have made them appreciate the significance of remaining aware and involved in the development of novel and progressive business models. It illuminates how fintech has pushed the conventional banking models on the impact and possibilities for mergers or collaborations with fintech companies. Resultantly, some conventional financial entities have set up in-house teams that focus on development through, fintech collaborative programs, and incubators. Additionally, legal mandates on acquisitions, financing, financial service regulation, intellectual property, and data privacy have become popularized. In the UK, the fintech sector has enjoyed myriad successes and a few limitations. Nevertheless, it shows how several SMEs approach traditional banks but the best deals are never offered but by alternative financing platforms. Some of the factors that attract individuals to the sector include increased access and preferable rates, interaction with interested parties, transparency, and the speed of achieving things. These jurisdictions reveal the proper approaches and strategies that the Kenyan context can apply to ensure that the fintech revolution does not exploit customers, but it provides the necessary development and assistance within the proper framework of the law. The intention of comparing these jurisdictions is to draw lessons for Kenya.

¹⁵⁵ Mkiwa H, 'Consumer protection framework in the Kenyan financial services sector: Current state, deficiencies, lessons from the world and possible solutions.' 3 (4) *Journal of Financial Compliance*, 2020, 370.

3.2.1 South Africa

The key regulatory authorities for fintech lending in South Africa are the South African Revenue Bank (SARB), Prudential Authority (PA), Financial Sector Conduct Authority (FSCA), National Credit Regulator (NCR), and the Financial Intelligence Centre (FIC).¹⁵⁶ The SARB has the primary responsibility of maintaining the stability of prices for purposes of balance as well as sustainable economic growth. Payment and banking services are regulated by SARB. Recently, there has been an extension of its mandate to include prudential requirements regulation for all institutions offering financial services through its function of prudential authority.

The PA is a juristic person that operates under the SARB administration with departments that include the Policy, Statistics and Industry Support Department, Risk Support Department, Banking, Insurance, and FMI Supervision Department, and the Financial Conglomerate Supervision Department. The PA has the responsibility of regulating financial conglomerates, cooperative financial institutions, insurers, banks, and particular market infrastructures. The Financial Sector Regulation Act 2017 (FSRA) created the PA and gave SARB the explicit mandate of maintaining and enhancing financial stability. It also established the FSCA which operates outside SARB.¹⁵⁷

The FSCA is the conduct regulator in the market with the responsibility of overseeing collective investment schemes, central securities depository participants, central securities depositories, stockbrokers, stock exchanges, retirement funds, asset management, and/or investment advisory entities, funds and fund managers, insurers, and financial services providers.

¹⁵⁶ Geral D, Tibane B, and Kern K, 'Fintech in South Africa: Overview,' Thomas Reuters Practical Law, 1 February 2021 - <[https://uk.practicallaw.thomsonreuters.com/w-014-7399?transitionType=Default&contextData=\(sc.Default\)&firstPage=true](https://uk.practicallaw.thomsonreuters.com/w-014-7399?transitionType=Default&contextData=(sc.Default)&firstPage=true)> on 30 July 2021

¹⁵⁷ Geral D, Tibane B, and Kern K, 'Fintech in South Africa'.

The NCR has the responsibility of regulating particular aspects where the credit value has exceeded the prescribed thresholds, and where consumers being natural entities or persons falling below particular thresholds for annual turnover or value for net assets. The NCR regulates debt collectors, credit bureaus, and credit providers. The National Credit Act 2005 (NCA) is applicable to credit arrangements that affect South Africa regardless of where the credit provider is domiciled.¹⁵⁸

The FIC is the main regulator of money laundering. The Financial Intelligence Centre Act 2001 (FICA) points out those accountable institutions should comply with client verification and anti-money laundering reports.

Traditional financial services entities actively take part in the development of fintech as well as teaming up with other startup companies for purposes of developing fintech services and products. The development of fintech has affected traditional financial institutions which have made them realise the importance of staying aware and involved in the development for full assessment and management of their effect on business models, and have an understanding of the level of that impact and possibilities for mergers or collaborations with fintech companies.¹⁵⁹ As a result, some traditional financial entities have established in-house teams to focus on development, fintech collaborative programs, and incubators. Also, legal mandates on acquisitions, financing, financial service regulation, intellectual property, and data privacy have become increasingly common. They are demonstrating that they can use their positions in the market to understand, make contributions, and influence where fintech regulation and development is leading.

¹⁵⁸ Geral D, Tibane B and Kern K, 'Fintech in South Africa'.

¹⁵⁹ Geral D, Tibane B and Kern K, 'Fintech in South Africa'.

In 2015, the government of South Africa introduced a Socio-Economic Impact Assessment System (SEIAS). According to published guidelines, cabinet memoranda that seek for draft regulations, bills and policies to be approved need to include signed-off impact assessment by SEIAS special unit. The Department of Planning, Monitoring, and Evaluation (DPME) has the mandate of establishing the SEIAS unit for capacity support, quality control, and implementation of SEIAS.¹⁶⁰ The economic and social impact assessment is useful in determining future regulation of fintech which entails a detailed analysis of possible effects of new technologies and measures that have been proposed for purposes of regulating them to enhance the quality of regulatory response and to allow the focus of regulators to be directed to areas with a high intervention need. All in all, the challenge should aim at ensuring that the practice does not become a formal exercise of ticking boxes.

The Intergovernmental Fintech Working Group (IFWG) was established in 2016 and it comprises of SARB members, the South African Revenue Services (SARS), the FIC, the FSCA, and the National Treasury whose purpose is to come up with a common goal among policymakers and regulators in the development of financial technology, and regulatory and policy implications for the economy and financial sector.¹⁶¹ The IFWG Innovation Hub was launched in April 2020 and it is made up of the innovation accelerator, the regulatory sandbox unit, and a regulatory guidance unit. The innovation accelerator has the responsibility of providing a collaborative and exploratory environment for regulators in the financial sector to work together and learn about the industry's emerging innovations. The regulatory sandbox unit presents an opportunity to market innovators for testing new services and products that challenge

¹⁶⁰ DPME, 'Socio-Economic Impact Assessment System (SEIAS) Guidelines.' *Department: Planning, Monitoring, and Evaluation; Republic of South Africa*, 2015, 3.

¹⁶¹ Geral D, Tibane B and Kern K, 'Fintech in South Africa'.

the application and formulation of current regulation under the relevant regulators' supervision.¹⁶² The regulatory guidance unit is helpful to market innovators in resolving specific questions that regard regulatory requirements and policy landscape as well as providing a central entry point for innovators in the market to submit questions related to innovation-oriented regulations and policies on fintech.

All lending/credit activities in South Africa are regulated by the NCR according to the NCA.¹⁶³ The regulation of lending/credit activities is done regardless of where the credit came from. The NCA has the capacity of regulating any lending forms regardless of the used platform. However, there are certain exemptions provided by the NCA. The first exemption is where it will not apply to a credit agreement where the credit receiver is a legal or juristic person with an annual turnover or combined value of net assets, in addition to the annual turnover or combined value of net assets of every person who is related to the juristic person receiving the credit, is a minimum of ZAR 1 million after the agreement.

Another NCA exemption is where there are agreements on large credits where the principal debt in the transaction is at least ZAR 250,000 and a consumer is a juristic person within the NCA definition having an annual turnover or value of net assets below ZAR 1 million.¹⁶⁴ The final NCA exemption is where a local applicant for the credit can make a formal application to the Ministry of Trade and Industry in South Africa for an agreement that the receiver of credit is interested in entering with a foreign provider of credit to be exempted formally from the NCA application.

¹⁶² Didenko A, 'Regulatory challenges underlying FinTech in Kenya and South Africa.' *Bingham Centre for the Rule of Law*, 2017, 4.

¹⁶³ Geral D, Tibane B and Kern K, 'Fintech in South Africa'.

¹⁶⁴ Geral D, Tibane B and Kern K, 'Fintech in South Africa'.

The main issues for fintech regulatory compliance in South Africa include anti-money laundering and financial crime, cybersecurity, data protection, and consumer protection. Currently, there are no regulations that specifically apply to fintech, and fintech providers are required to mould their businesses to comply with the regulatory regimes in place.¹⁶⁵ The Consumer Protection Act 2008 applies to the transactions between consumers and suppliers unless there are specific exemptions.¹⁶⁶ Products that are exempted include financial services where the responsible regulator is the FSCA that oversees the conduct of the providers and fair treatment of the consumers.

The Protection of Personal Information Act 2013 (POPIA) provides that fintech companies processing personal data both domestically and across the border should comply with the provisions. This is the first comprehensive legislation in South Africa on data protection. POPIA is a codification of the current protections under the South African Constitution and common law. On 22nd June 2020, it was announced that the commencement date for POPIA provisions will be 1st July 2020. However, a year's transition period was provided by POPIA. This means public bodies, organizations, and private businesses that take part in the processing of personal information were required to comply with POPIA by 1st July 2021.¹⁶⁷

Arrangements between traditional financial services firms and fintech are common. However, certain traditional financial services firms such as banks require regulatory approval before getting into the arrangements. According to the Banks Act, SARB (PA) should grant approval

¹⁶⁵ Financial Services Board, 'FSB bulletin', Financial Services Board Newsletter, First Quarter 2016, Strengthening South Africa's Financial Institutions, 2016, 15.

¹⁶⁶ Geral D, Tibane B and Kern K, 'Fintech in South Africa'.

¹⁶⁷ Geral D, Tibane B and Kern K, 'Fintech in South Africa'.

where contractual arrangements exist between the entities and where economic activities are undertaken by the parties, the same is subjected to joint control.

Foreign fintech firms that invest in South Africa are required to comply with exchange control regulations. The investment requires SARB's approval or approval from any Authorised Dealer in Foreign Currency which has to be a South African bank. Additionally, the foreign entities will be required to adhere to immigration law compliance where employees are to be sent to South Africa. Also, compliance with the Companies Act is required in the registration of the eternal company or branch in South Africa.

In June 2016 there was the discontinuation of M-Pesa.¹⁶⁸ Shortly thereafter, mobile money services provided by MTN were scraped off because operating costs that ran the platform had become prohibitive. However, the FSCA has developed a special interest in foreign providers of financial services where it requires applicant entities to show whether they will register eternal companies if the licenses are granted. However, this only applies to fintech entities interested in licenses for the provision of financial products or services. Other regulations such as NCR and SARB always require persons intending to operate regulated businesses to have their local presence established through registration of an eternal company or subsidiary.

3.2.2 UK

Fintech in the UK currently stands as the largest alternative finance industry¹⁶⁹ where it has experienced successes as well as challenges in the earliest stages of its development. It is

¹⁶⁸ Ross PB and Malady L, "Building consumer demand for digital financial services: The new regulatory frontier." 3 (3) *Journal of Financial Perspectives*, 2015, 20.

¹⁶⁹ Walport M, 'Fintech futures: The UK as a world leader in financial technologies', Government Office for Science, March 2015 -

common for fintech platforms to offer over 10% returns to savers who look for improved returns compared to what traditional banks are offering.¹⁷⁰ Consumers in need of loans now have avenues with affordable rates. With innovative technology as its driver, fintech lending in the UK has the highest growth rate in the world.

Firms in traditional financial services have approached fintech in four ways.¹⁷¹ First, they have embraced fintech. This has been through the creation of internal teams that come up with new fintech services or products. Also, firms have come up with launch pads or accelerators for startups to get investment opportunities, workspace, and expert advice. There has been the creation of consortia through collaboration in the industry to come up with new fintech products that are beneficial to the whole industry as to gather resources for the upcoming fintech projects.¹⁷² To add on, fintech start-ups' acquisition by firms in traditional financial services has led to attitude change in firms as the cultural difference has allowed firms to take approaches that are less traditional in managing employees.

The second approach has been through the purchase of fintech services or products and it is most evident in small or medium-sized firms. This is because these firms have smaller infrastructures. Therefore, it is cost-effective and easier for their whole operating model to change and for new services or products to be offered faster. Mid-size and smaller firms have also been targeted by fintech firms as potential clients. Resources have been pooled by many fintech services or

<https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/413095/gf-15-3-fintech-futures.pdf> on 8 August 2021.

¹⁷⁰ Robinson S, Altkemper S and Kang D, 'Fintech in the UK: Overview', Tomson Reuters Practical Law, 1st September 2019 - <[https://uk.practicallaw.thomsonreuters.com/w-019-3924?transitionType=Default&contextData=\(sc.Default\)&firstPage=true](https://uk.practicallaw.thomsonreuters.com/w-019-3924?transitionType=Default&contextData=(sc.Default)&firstPage=true)> on 6 August 2021.

¹⁷¹ Robinson S, Altkemper S and Kang D, 'Fintech in the UK'

¹⁷² Gulamhuseinwala I and Kotecha V, 'UK fintech on the cutting edge', 70.

products, or more efficient methods have been created to provide commonly available resources to bigger institutions.¹⁷³

The third approach has been an engagement with fintech which involves attending workshops and conferences to interact with disruptors considering new business models and products, and the automation of different business operations. Engagements run side-by-side with other approaches. Financial institutions engage at certain levels with fintech which most of the time end up in the purchase of fintech services or products or future investment. The fourth approach that has been taken by financial institutions is the ‘wait and see’ in engaging with fintech. This approach is based on strategies to avoid investment in services or products that have not been established in the market or become mature.¹⁷⁴

So far, fintech has had a significant influence on retail banking among other financial services such as payment services, insurance, alternative finance, and fundraising. In retail banking, the launching of new banks in the UK is on the rise. While they have mixed success, product innovation and new operating models have been created based on fintech solutions. Also, automated underwriting of loans is a form of fintech that has been adopted by large banks. Customers can now get loan approval that involves less interaction with humans,¹⁷⁵ and interestingly, there has been a focus on using AI to improve the processes.¹⁷⁶

Fintech lending continues to support approximately 5.4 million Small and Medium-sized Enterprises (SMEs) although there is limited awareness of the newly available options.¹⁷⁷ A good

¹⁷³ Burke JJA, *Financial services in the twenty-first century*, 192.

¹⁷⁴ Mills KG, *Fintech, small businesses and the American dream*.

¹⁷⁵Walport M, ‘Fintech futures’, 58.

¹⁷⁶Robinson S, Altkemper S and Kang D, ‘Fintech in the UK’

¹⁷⁷ Department for Business Innovation & Skills, ‘Statistical release: Business population estimates for the UK and regions 2015’ -

number of the small businesses approach the big four traditional banks such as the RBS Group, Lloyds Banking Group, Barclays, and HSBC but they are never offered the best deals.¹⁷⁸ Consumers try negotiating through hidden fees with no success. Alternative financing platforms for businesses that are denied by traditional bank financing in the UK are contained in the Small Business, Enterprise, and Employment Act 2015.

The central stage in the UK has been taken by fintech lending as a global leader in financial innovation by providing better value and customer experience. Increased access and preferable rates, as well as ease of interaction with interested parties, transparency, and the speed of achieving things, is the consideration that attracts institutions and individuals to the sector.¹⁷⁹ The core services have been selected carefully and developed by fintech lending institutions leading to significant changes in investing, borrowing and lending. The UK's Financial Conduct Authority (FCA) undertook an extensive examination of the retail banking business models; the review focused at the primary differences between traditional and emerging retail banking business models. It evaluates how these differences are being propelled by technological innovation and changes and how they impact the products of firms and their competition. This review is interested in understanding the impact that the increasing usage and popularity of fintech lending channels and the declining use of branches is having on business models and the outcomes for customers.

As fintech lending adapts to the rapidly changing environment of finance, there is the development of a broader fintech ecosystem around them. Despite the reliance on traditional

<https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/467443/bpe_2015_statistical_release.pdf> on 18 July 2021

¹⁷⁸ Walport M, 'Fintech futures', 57.

¹⁷⁹ Christi S and Berberis J, *The fintech book*.

calculations for credit scoring, fintech lending institutions are getting abundant information through the use of software meant for big data as well as the ability to come up with better algorithms. The newly developed models for credit scoring have kept RateSetter and Zopa at the lowest default rates unlike savings accounts in traditional banks with non-existent Financial Services Compensation Scheme (FSCS) coverage that insures savings accounts in the UK to upwards of £85,000.¹⁸⁰ Besides RateSetter and Zopa, other top four fintech lending platforms in the UK include the funding Circle, Crowdcube, Seedrs, and SyndicateRoom.

In the UK, consumer protection is governed by the Consumer Rights Act 2015 (CRA) which establishes statutory rights.¹⁸¹ On the contrary, Financial Ombudsman Service (FOS) and the Financial Conduct Authority (FCA) have the mandate of determining whether there has been fair treatment of consumers and can look into complaints. The CRA provides several consumer rights that have an impact on fintech firms. For instance, it states that services should be conducted with reasonable care and skill within a reasonable time and at reasonable prices. It also states that consumers have the right of canceling digital content or services within fourteen days after agreeing with the contract. Additionally, it states that firms should provide consumers with clear service contract cancellation mechanisms.

Fintech firms that involve consumers often encounter issues in creating compliant procedures and policies relating to the handling of internal complaints. This may be for several reasons such as pressure emanating from rapid expansion, difficulties in hiring qualified support, and lack of resources.¹⁸² Handling of financial services complaints is availed in the FCA Dispute Resolution

¹⁸⁰ Financial Services Compensation Scheme, 'Compensation limits: Banks and building societies 2021.'
<<http://www.fscs.org.uk/what-we-cover/products/banks-building-societies/>> on 19 July 2021

¹⁸¹ Robinson S, Altkemper S and Kang D, 'Fintech in the UK'

¹⁸² Walport M, 'Fintech futures', 26.

Sourcebook (DISP) as well as the Conduct of Business Sourcebook (COBS) contained in the FCA Handbook, and the FCA Principles such as Treating Customers Fairly (TCF). The FCA internal policies requirements, complaints reporting and handling process have been set out. Also, regulated firms may be subjected to the FOS jurisdiction which directly deals with consumers in providing redress. Firms can be required by FOS to make compensation of as high as GBP350, 000.¹⁸³ The available maximum award level depends on the complaint date and the omission or act date that led to the complaint.

Protection of consumer data is provided for by the General Data Protection Regulation (GDPR) as well as the Data Protection Act 2018.¹⁸⁴ Thereafter, the Information Commissioner's Office (ICO) oversees compliance. Fintech firms that take part in data control are required to put a few things into consideration. For example, processing of personal data should only be done for specific reasons, data controllers should create and maintain a policy document consisting of requirements for data control and compliance, safeguards are needed in making significant decisions where there is automated data processing, there should be restrictions and prohibitions where personal data is transferred to third countries, consumer's right of getting data copy that relates to them or deletion of the data, and responding to consumers where data has been breached. Also, failing to comply with GDPR implementation could attract a fine of as high as EUR 20 million or 4% of the total global annual turnover in the undertaking, whichever will be considered higher.

Regulatory requirements in the UK apply to UK-based firms as well as that outside but wish to take part in regulated cross-border business. Foreign firms outside the UK are allowed to operate

¹⁸³Robinson S, Altkemper S and Kang D, 'Fintech in the UK'

¹⁸⁴ Robinson S, Altkemper S and Kang D, 'Fintech in the UK'

in the UK with the required permissions and reliance on exclusions, for example, the exclusion for overseas persons. Domestic fintech firms encounter barriers similar to foreign firms. Also, the FCA is encouraging firms to collaborate with foreign firms in fintech innovation. Agreements with a few countries such as the US, Australia, and Hong Kong are already in place.¹⁸⁵

The key regulatory authorities in the UK are the FCA and the Prudential Regulatory Authority (PRA). The FCA is the major regulatory authority for financial services in the UK. Its responsibility is to authorise firms outside the PRA remit and to regulate conduct for the financial services industry in the UK. In a nutshell, it supervises the conduct of all financial markets and financial services firms as well as the prudential agreements for firms that the PRA does not supervise. The FCA takes the form of a company limited by guarantee and it is independent of the UK government. The PRA supervises and regulates the largest firms that provide financial services which have the capability of harming the UK's overall financial stability. This includes large investment firms, insurance firms, credit unions, building societies, and banks. Additionally, it is a section of the Bank of England (BoE).¹⁸⁶

The promotion of fintech in the UK is undertaken by several initiatives from the BoE and the FCA. In 2014, 'Project Innovate' was launched by the FCA for purposes of supporting new financial regulation technology.¹⁸⁷ It includes the Advice Unit, Direct Support, and Regulatory Sandbox. Additionally, the BoE is working on the Fintech Accelerator Project. The Advice Unit came up with the strategy of supporting firms that launch models for automated advice. Eligible firms from the advice unit are allowed to access regulatory feedback related to their automated

¹⁸⁵ Gulamhuseinwala I and Kotecha V, 'UK fintech on the cutting edge', 58.

¹⁸⁶ Robinson S, Altkemper S and Kang D, 'Fintech in the UK'

¹⁸⁷ Robinson S, Altkemper S and Kang D, 'Fintech in the UK'

model. This entails a dedicated contact point in the unit and results in regulatory implications concerning automated models. Signposts have also been established by the Advice Unit to guidance and existing rules for purposes of assisting firms that intend to provide automated advice.

Direct support teams have dedicated contacts that support authorisation applications and permission variations. Fintech firms that want to be under the FCA regulations and fall within particular criteria for eligibility can make applications to the Direct Support Unit. To add on, the Unit provides regulatory returns support and handles general regulatory inquiries for up to one year.¹⁸⁸

The regulatory sandbox allows the testing of business models, services, and products in a laid-back regulatory environment without the regulatory enforcement risk and full authorisation by regulators. Additional assistance and guidance will be provided by the regulator through the development of consumer safeguards. The regulatory sandbox in the UK has at least 375 applicants of which 131 only were accepted. It is important to note that while the UK regulations are relaxed in their application in the regulatory sandbox, the EU directives and regulations still apply. A global sandbox has also been launched by the EU. Green fintech challenge was launched by the FCA in 2018. It provides support similar to authorisation support and regulatory sandbox for fintech companies to come up with green solutions.¹⁸⁹

The BoE has developed a fintech interest by creating a Fintech Hub.¹⁹⁰ The Fintech Accelerator project is part of the hub, where it is partnering with innovative firms for purposes of allowing

¹⁸⁸ Gupta P and Tham TM, *Fintech*, 237

¹⁸⁹ Robinson S, Altkemper S and Kang D, 'Fintech in the UK'

¹⁹⁰ Gulamhuseinwala I and Kotecha V, 'UK fintech on the cutting edge', 51.

the BoE to consider new technology. Concept proofs are undertaken for improved incidence monitoring and to understand financial market development.

3.3 Conclusion

Fintech lending continues to rapidly grow since its entry into the global market. Increased use of mobile phones and the internet led to the penetration of mobile money in Kenya. Other factors that facilitated the entry of fintech lending in Kenya include changes in the regulatory arrangement and the establishment of the Credit Reference Bureau.

The two fintech lenders in Kenya that have been analysed include M-Shwari and Tala, others like OKash and Branch have been examined briefly. On the one hand, M-Shwari is a local digital bank operating through M-Pesa having resulted from the partnership between CBA and Safaricom. Issuing of loans through this platform has strictly been on credit scores assigned to consumers upon opening of accounts. Uncollateralised loans disbursed by M-Shwari start with small amounts and the credit limit grow with time as individuals save and repay. On the other hand, Tala is an international fintech lender that uses behavioral and android device data to determine how loans are advanced to individuals. It provides unsecured credit and cannot access the savings balance of the consumer. The two categories of data that are used by Tala in providing loans are behavioral and android device data. The consumer grants permission before data from their android phone is directly accessed.

Enforcement mechanisms have been laid down for fintech lending in Kenya. In cases where principles of consumer protection have not been met, for instance, where vague solutions are offered with terms and conditions contravening laws on consumer protection, warnings have been issued to consumers against taking the products up. Also, innovative solutions, products,

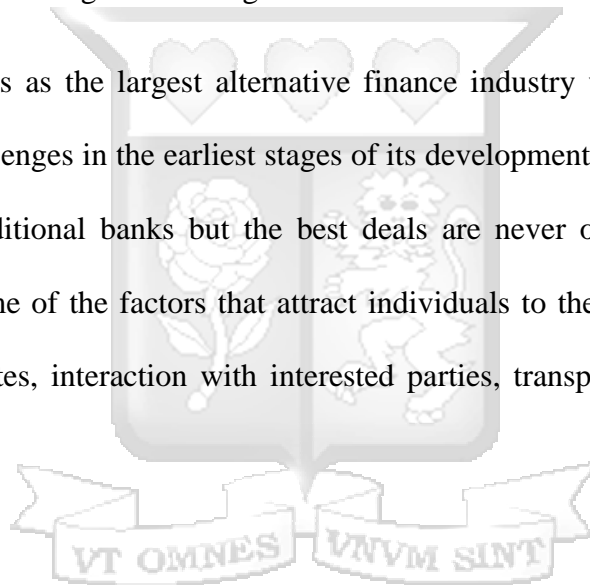
and services capable of deepening or broadening the capital markets are tested by the regulatory sandbox established by the CMA for purposes of accelerating an understanding of the technologies coming up within the capital markets space.

Additionally, collaboration among players within the Kenyan fintech industry has been the key driver of growth. There has been the development of integration and partnerships between traditional institutions and players offering money services. An example is collaboration between the CBA and Safaricom for M-Shwari to provide its fintech lending services. Attempts have also been made to increase collaborations between regulators across the border. This is a strategy aimed at supporting innovative solutions within the capital markets industry. The first Data Commissioner in Kenya was recently appointed and set up the Office of the Data Commissioner with the mandate of implementing the Act. A Taskforce for the Development of Data Protection (General) Regulations was established by the Information and ICT cabinet secretary on 15th January 2021. The task force is required to come up with regulations for clarity of Data Protection provisions.

In South Africa, the development of fintech has affected traditional financial institutions which have made them realise the importance of staying aware and involved in the development for full assessment and management of their effect on business models, and have an understanding of the level of that impact and possibilities for mergers or collaborations with fintech companies. As a result, some traditional financial entities have established in-house teams to focus on development, fintech collaborative programs, and incubators. Also, legal mandates on acquisitions, financing, financial service regulation, intellectual property, and data privacy have become increasingly common.

The main issues for fintech regulatory compliance in South Africa include anti-money laundering and financial crime, cybersecurity, data protection, and consumer protection. Currently, there are no regulations that specifically apply to fintech, and fintech providers are required to mould their businesses to comply with the regulatory regimes in place. Arrangements between traditional financial services firms and fintech in South Africa are common. However, certain traditional financial services firms such as banks require regulatory approval before getting into the arrangements. To add on, foreign fintech firms that invest in South Africa are required to comply with exchange control regulations.

Fintech in the UK stands as the largest alternative finance industry where it has experienced successes as well as challenges in the earliest stages of its development. A good number of small businesses approach traditional banks but the best deals are never offered but by alternative financing platforms. Some of the factors that attract individuals to the sector include increased access and preferable rates, interaction with interested parties, transparency, and the speed of achieving things.



CHAPTER FOUR

CONCLUSION, FINDINGS AND RECOMMENDATIONS

4.1 Conclusion

The reality for most Kenyans is that the process of accessing credit facilities from traditional financial institutions is complicated. The minimum requirements used by traditional financial institutions in evaluating the creditworthiness of borrowers exclude millions of borrowers from quickly accessing the credit. The institutions are often hesitant owing to lack of credit history, inadequate or absence of collateral, lack of or poor banking history and financial statements. Fintech firms such as Tala and M-Shwari, have come in to help millions of these individuals who were previously left out by traditional financial institutions.

Traditional banks are sufficiently regulated. They have laid down terms and conditions on issues of confidentiality, protection of personal data and credit reference bureau consent among others. However, fintech is less regulated as the institutions are not considered as banks in respect of how a bank and banking business is defined. They do not set out interest rates, repayment fees, additional fees on late repayment, bundled products, or other terms dictating the transactions. They fail to take into consideration the fact that they are required to disclose all lending conditions and key terms. The current regulatory position of fintech is both an advantage as it allows for financial inclusion and a disadvantage as consumers are exposed to risks such as exploitation and infringement of data privacy among others. These are the risks that require the government to step in to protect consumers. However, if fintech lending is overregulated, it will cease to have its current advantages such as financial inclusion over traditional banks.

The current legal provisions apply to consumer protection both expressly and by implication. Consumer protection has been provided for under the Constitution of Kenya 2010. The Central Bank of Kenya Act provides for fintech lending by implication. However, consumer protection principles have not been met. As a result, the Central Bank of Kenya (Amendment) Bills aim to bring the digital financial sector under the CBK jurisdiction, introduce licensing for fintech lending platforms, and meet public interest and consumer protection needs while promoting innovation. The Banking Act identifies lending as a characteristic that constitutes a bank. However, fintech lenders are not considered as banks per-se in respect of how a bank and banking business is defined.

Under the Consumer Protection Act, fintech lending has not been expressly provided for. In respect to the Microfinance Act, it has been established that fintech lenders are involved in microfinance though they are not as conventional as microfinance institutions. The National Payment System Act is relevant in the regulation of fintech lending where it provides for how transfer services of mobile money are conducted. Under the Kenya Information and Communications Regulations, consumer protection has been provided with an outline of responsibilities for both consumers and service providers. The Data Protection Act addresses loopholes that exist in fintech lending related to the violation of privacy on consumer data.

Enforcement mechanisms have been laid down for fintech lending in Kenya. In cases where principles of consumer protection have not been met, for instance, where vague solutions are offered with terms and conditions contravening laws on consumer protection, warnings have been issued to consumers against taking the products up. Also, innovative solutions, products, and services capable of deepening or broadening the capital markets are tested by the regulatory

sandbox established by the CMA for purposes of accelerating an understanding of the technologies coming up within the capital markets space.

Additionally, collaboration among players within the Kenyan fintech industry has been the key driver of growth. There has been the development of integration and partnerships between traditional institutions and players offering money services. An example is a collaboration between the CBA and Safaricom for M-Shwari to provide its fintech lending services. Attempts have also been made to increase collaborations between regulators across the border. This is a strategy aimed at supporting innovative solutions within the capital markets industry. The first Data Commissioner in Kenya was recently appointed and set up the Office of the Data Commissioner with the mandate of implementing the Act. A Taskforce for the Development of Data Protection (General) Regulations was established by the Information and ICT cabinet secretary on 15th January 2021. The task force is required to come up with regulations for clarity of Data Protection provisions.

In South Africa, the development of fintech has affected traditional financial institutions which have made them realise the importance of staying aware and involved in the development for full assessment and management of their effect on business models, and have an understanding of the level of that impact and possibilities for mergers or collaborations with fintech companies. As a result, some traditional financial entities have established in-house teams to focus on development, fintech collaborative programs, and incubators. Also, legal mandates on acquisitions, financing, financial service regulation, intellectual property, and data privacy have become increasingly common.

The main issues for fintech regulatory compliance in South Africa include anti-money laundering and financial crime, cybersecurity, data protection, and consumer protection.

Currently, there are no regulations that specifically apply to fintech, and fintech providers are required to mould their businesses to comply with the regulatory regimes in place. Arrangements between traditional financial services firms and fintech in South Africa are common. However, certain traditional financial services firms such as banks require regulatory approval before getting into the arrangements. To add on, foreign fintech firms that invest in South Africa are required to comply with exchange control regulations.

Fintech in the UK stands as the largest alternative finance industry where it has experienced successes as well as challenges in the earliest stages of its development. A good number of small businesses approach traditional banks but the best deals are never offered but by alternative financing platforms. Some of the factors that attract individuals to the sector include increased access and preferable rates, interaction with interested parties, transparency, and the speed of achieving things. In the UK, firms in traditional financial services have approached fintech in four ways. They have embraced it, purchased its products or services, engaged with it through workshops and conferences to interact with disruptors, and taken the 'wait-and-see' approach in engaging with fintech. The new banks that are being launched in the UK have been created based on fintech solutions. In the UK, institutions and individuals are attracted to fintech because of increased access and preferable rates, ease of interaction with interested parties, transparency, and the speed of achieving things. The CRA governs consumer protection while the FOS and the FCA have the mandate of determining whether consumer protection has been complied with. The GDPR and the Data Protection Act 2018 are the provisions that protect consumer data. Additionally, the key regulatory authorities in the UK are the FCA and the PRA.

4.2 Findings and Recommendations

The findings of research question one are that fintech lending practices in Kenya were intensely scrutinised and caused outrage from regulators and the public. One of the reasons for this was that principles of consumer protection could not be met. Terms and conditions offered contravened consumer protection laws with vague solutions being offered. In December 2020, concerns were raised by the CBK on fintech lending practices considered to be predatory. The CBK governor pointed out to parliament the need to protect consumers from lending practices that are unfair and plans to put in place laws that scrutinise fintech lenders.

Particular fintech services, products, and players exist without any form of regulation. In cases where regulators are concerned about certain fintech services and products, the public has been issued with cautionary notices or warnings regarding interacting with products or providers of financial services that do not meet regulatory requirements. In cases where principles of consumer protection have not been met, for instance, where vague solutions are offered with terms and conditions contravening laws on consumer protection, warnings have been issued to consumers against taking the products up. The CBK has been keen on ensuring that Kenyans are protected from unfair practices.

The proposed Central Bank of Kenya (Amendment) Bill, 2020 (National Assembly Bill No. 21) whose aim is to bring the digital financial sector under the jurisdiction of the CBK gives the CBK powers to supervise and regulate providers of financial services and products which includes digital lending. The bill was first to read on 28th July 2020 then it was handed over to the relevant committee for further action. The second bill, the Central Bank of Kenya (Amendment) Bill, 2020 (National Assembly Bill No. 47) intends to introduce licensing of fintech lending

platforms. The first reading of this bill was done on 25th February 2021 then handed over to the relevant committee. The Central Bank of Kenya (Amendment) Bill, 2021 which is the third was gazetted on 16th April 2021. The evolution of the current legislation will help meet the changing public interest and consumer protection while promoting innovation. On the contrary, the regulator is given wide discretionary powers by the laws which should be exercised judiciously to avoid stifling innovation.

In March 2019, a regulatory sandbox was established by the CMA for purposes of accelerating their understanding of the technologies coming up within the capital markets space. Innovative solutions, products, and services capable of deepening or broadening the capital markets are tested by the sandbox. Seven fintech firms were admitted for purposes of testing fintech solutions. In 2021, more admissions and successful exits from the sandbox are expected. New regulations, notices, or guidelines may also be adopted by the CMA as a result of an increase in activities in the sandbox and gained insights from the sandbox tests where broader regulatory or legal reforms are needed. New regulations aimed at governing specific innovations or business models that are not adequately addressed by the current regulations may be adopted or designed.

Attempts have been made to increase collaborations between regulators across the border. This is a strategy aimed at supporting innovative solutions within the capital markets industry. The CMA will join 23 regulators globally to test innovative regulatory technology, business models, and financial services and products on a cross-border basis. The tests will be undertaken through the GFIN, a network of international regulators of financial services and related organizations with a common goal of supporting financial innovation. Some of the regulators that take part include the Monetary Authority of Singapore, the UK's Financial Conduct Authority, and the Dubai Financial Services Authority.

Collaboration among players within the Kenyan fintech industry has been the key driver of growth. There has been the development of integration and partnerships between traditional institutions and players offering money services. An example is collaboration between the CBA and Safaricom for M-Shwari to provide its fintech lending services. Fintech lending is one of the most common financial services offered by partnerships. Additionally, the collaboration has allowed the operation of certain fintech players without direct regulation.

Fintech lending entails the processing of personal data for the services to be offered. The Data Protection Act regulates individuals who process the data which applies to both resident and non-resident processors and controllers of data. Personal data processing is provided for under the Act which not only provides for the rights of data subjects but obligations of data processors and controllers. The first Data Commissioner in Kenya was recently appointed and set up the Office of the Data Commissioner with the mandate of implementing the Act. A Taskforce for the Development of Data Protection (General) Regulations was established by the Information and ICT cabinet secretary on 15th January 2021. The task force is required to come up with regulations for clarity of Data Protection provisions. Further obligations may be placed on fintech lenders who are data processors or controllers.

Policymakers are exploring possible reforms to address regulatory gaps. The exploration started in 2018 when Patrick Njoroge, the CBK governor called for an extensive regulation. Also, a new regulation called the Financial Markets Conduct Authority Bill was introduced by the Kenyan government in the same year. This aimed at putting in place an independent regulator called Financial Markets Conduct Authority for the finance and digital credit sector tasked with supervising and regulating how financial services and products are provided including credit to financial customers in retail. To add on, the bill gave the Authority power to give out licenses for

launching digital financial products in addition to punishing any individual or platform for going contrary to the bill.

Capping of interest rates by fintech platforms was not provided for by the bill but there was clarification that lenders should not charge interest rates higher than what has been specified in the contract for the loan. Financial Sector Ombudsman has also been established with the mandate to determine complaints presented to it by financial customers in retail against providers of financial services.

The findings of research question two are that the Central Bank of Kenya (CBK) which is the main regulatory agency has the authority of regulating consumer credit from banks as well as other credit products. The said authority needs to cover fintech firms. However, this is not an exclusive oversight as other regulators in Kenya such as the communication and insurance share it. This is an indication that regulators do not have the exclusive responsibility of regulating fintech products. This allows several products to pass through the regulatory gaps. Having different regulatory regimes can lead to diverse rights and a deviation from consumer protection. Consumers may not fully understand the regulations applicable to certain transactions because different regulatory bodies govern different fintech institutions. As a result, consumers are not sure of their redress rights or the regulatory institutions to turn to in case problems arise.

The CBK is the main regulatory body responsible for the formulation and implementation of monetary policy. Section 4 (1) of the Central Bank of Kenya Act 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.” Under section 34 (2) additional services considered to be desirable may be provided by the CBK to institutions in Kenya. Section 34 (3) of the Central Bank of Kenya Act goes further to list the institutions which include a specific

bank, financial institution, microfinance bank, and any person or body of persons which the CBK may recommend then prescribed by the Minister. This is an indication that the body of a person or persons may include fintech lenders. Be as it may, the CBK has been receptive to fintech where it allowed implementation of transfer services for mobile money when there was no legislation in place to govern the innovation. This critical decision led to financial services development and a basis for fintech innovations growth.

On the contrary, fintech lending practices in Kenya were intensely scrutinised and caused outrage from regulators and the public. One of the reasons for this was that principles of consumer protection could not be met. Terms and conditions offered contravened consumer protection laws with vague solutions being offered. In December 2020, concerns were raised by the CBK on fintech lending practices considered to be predatory. The CBK governor pointed out to parliament the need to protect consumers from lending practices that are unfair and plans to put in place laws that scrutinise fintech lenders.

There is a proposed Central Bank of Kenya (Amendment) Bill, 2020 (National Assembly Bill No. 21) whose aim is to bring the digital financial sector under the jurisdiction of the CBK. The bill was first to read on 28th July 2020 then it was handed over to the relevant committee for further action. The second bill, the Central Bank of Kenya (Amendment) Bill, 2020 (National Assembly Bill No. 47) intends to introduce licensing of fintech lending platforms. The first reading of this bill was done on 25th February 2021 then handed over to the relevant committee. The Central Bank of Kenya (Amendment) Bill, 2021 which is the third was gazetted on 16th April 2021. The evolution of the current legislation will help meet the changing public interest and consumer protection while promoting innovation. On the contrary, the regulator is given

wide discretionary powers by the laws which should be exercised judiciously to avoid stifling innovation.

The findings of research question three are that there are two reasons why consumers need to be protected. First, there are few options available to consumers but to contract on terms presented by powerful fintech lending companies. Second, the companies have the capability of exploiting information in their favour. Fintech is less regulated as they are not defined as financial institutions by the regulations in place and they lack sufficient supervisory safeguards to ensure consumer protection. This is both an advantage as it allows for financial inclusion and it is also a disadvantage as consumers are exposed to risks such as exploitation and infringement of data privacy among others. It is on this basis that fintech lenders go to the extent of charging exorbitant interest rates of as high as 43% on their credit products. As a result, a good percentage of consumers are heavily indebted and struggle to repay the loans. A debt culture has developed as the byproduct where consumers live on loans and continue to accumulate bad debts.

Also, fintech lenders do not set out interest rates, repayment fees, additional fees on late repayment, bundled products, or other terms dictating the transactions. They fail to take into consideration the fact that they are required to disclose all lending conditions and key terms. Consumers end up taking loans without a full understanding of the terms and conditions. This introduces new risks that require the government to step in to protect consumers. However, if fintech lending is overregulated, it will cease to have its current advantages such as financial inclusion over traditional banks.

On the contrary, the theory of exploitation has failed to prevail among economists who do not regard it as a justification for protecting consumers. This is because the theory fails to consider the competition that gives companies bargaining power. Also, it is because consumers do not

know much about contracts and products compared to professionals. Sometimes it is argued that only a restricted role should be played in consumer protection because it is efficiently achieved through the operation of open and free markets. According to economists, the law is only required to intervene in markets where foul play thrives although the issue can be undertaken cost-effectively. While accepting financial inclusion and consumer protection, it is important to acknowledge that certain approaches can be viewed from either perspective.

Information in fintech can be presented differently particularly where different fees are charged by multiple entities involved. This makes it challenging for consumers to determine the final costs. Simplified disclosure of the terms and conditions of fintech lending can help consumers in making informed decisions that would help in avoiding issues such as loan defaults. Putting in place regulations that assure the protection of consumers when anything goes wrong allows them to have a preference based on convenience, service, and price regardless of whether the provider is a new entrant or existing. Transparency is a pillar of modern regulation which aims at promoting market discipline, allow for timely intervention by regulators, and ensure there is competition. On the contrary, transparency could have little or no impact on financial choices and behavioral practices. It is believed that some individuals with little to no education have a high likelihood of making financial mistakes regardless of disclosure quality.

Personal data of consumers are more often handled by third parties who put it at risk of being accessed and used inappropriately. The current legislation in Kenya does not define who is allowed to have access to data, when, how, and under what circumstances. This makes it difficult to protect consumer data while conflicting with the regulator's desire to prevent financial crimes. Law on data protection should integrate data on fintech to ensure that it is not put to undesirable use. It is not clear who is authorized to have access to an individual's data.

Data protection in developing countries shows a patchwork of regulations issued by different agencies that have overlapping jurisdiction as well as oversight. Designing and enforcing data protection rules would require coordination between regulatory and supervisory authorities as fintech affects different sectors such as telecommunication and banking.

The findings of research question four are that for most Kenyans, the process of accessing credit facilities from traditional financial institutions is complicated and sometimes ends up being disqualified from accessing the credit. The minimum requirements used by traditional financial institutions in evaluating the creditworthiness of borrowers exclude millions of borrowers from quickly accessing the credit. The institutions are often hesitant owing to lack of credit history, inadequate or absence of collateral, lack of or poor banking history and financial statements. These borrowers end up turning to friends for assistance if possible or use retained earnings. Fintech firms such as Tala and M-Shwari, have come in to help millions of these individuals who were previously left out by traditional financial institutions. If fintech regulation is to follow banking regulation, consumers will lose out on these advantages. Also, fintech firms will not benefit from the advantages of tapping into the market.

Additionally, the risks experienced in fintech lending are similar to those in traditional banking as they both perform the same functions. On the contrary, they are neither subject to similar prudent regulations nor safety nets to minimise risks on consumers which threaten the stability of the whole financial system. Therefore, to protect consumers in the fintech lending system, the regulatory gaps must be addressed.

Based on the above findings, the following recommendations are advanced by this study.

First, concerning engendering a balance between consumer protection in using fintech and guarding against overregulation of fintech lending, the study recommends that the designing of these regulations should strike a balance between consumer protection and overregulation. There needs to be regulation that places consumer protection at the helm, and any sort deviation or infringement by the fintech firms attracts extremely punitive fines that would discourage other firms from exploiting customers. Such a regulation should directly address the issue of overlapping jurisdiction on different institutions touching on the traditional banks, competition authorities, data protection and consumer regulation, should have standard clauses that promote coordination amongst the different agencies in protecting fintech. Regulations to be put in place should be robust and consistent to hold fintech lenders responsible for the protection of data and should be held responsible for any misuse or breaches. On the other hand, the regulations should be neutral because imposing specific protocols and standards on an industry that is rapidly evolving can hinder innovation.

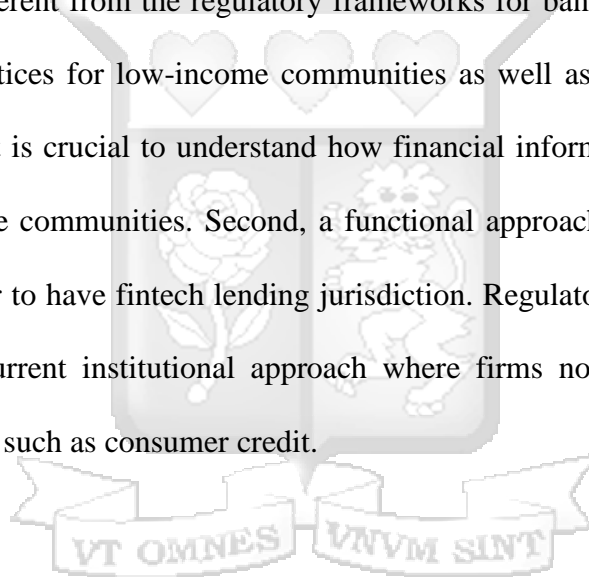
Second, regarding ensuring coordination among the various institutions dealing with fintech and consumer protection to avoid conflicts and overlaps, the lessons drawn from the findings underpin that the authorities should ensure that the same services and activities share the same risks against the consumer; therefore, the same laws should apply, irrespective of the types of legal entity that supervises them. In implementing such regulations, the authorities should devise strategies to source adequate information from the existing fintech ecosystem to allow them to monitor and evaluate technological developments, the different market segments being served, and the ongoing evaluation of the potential risks and benefits concerning investor and customer protection, as well as financial inclusion. This knowledge can be built for instance through

having a centralized public electronic record that contains the list and details of all fintech companies and their respective subsidiaries. This record should be managed by a special body apart from the CBK, because this would avert generating expectations in consumer and preventing the inappropriate abuse of the term ‘record’ as a manner of providing an apparent situation of financial supervision. In ensuring a uniform provision of the information to avert overregulation, the different authorities should coordinate on the usage of a standardised format for obtaining information and permitting consumers to quickly understand the information that is in the centralized electronic record. By implementing this recommendation, the issue of overlapping and overregulation will be addressed because it will be quicker to identify any roles and regulations being repeated. More so, the challenge of youth stealing phones and borrowing from these platforms, or registering new lines to borrow following default of payment from other platforms will be addressed by having such an electronic record.

Third, on the lessons drawn from South Africa and UK that can inform regulation in Kenya and ensuring consumer protection, from the comparative analysis, the lessons directly drawn from the UK and South Africa legal frameworks are that it is beneficial to incorporate all the different authorities involved in digital innovation, financial prudence, and lending practices. It is beneficial to have central guidelines that promote the protection of customer rights, providing them with adequate information, and safeguarding them from the risks associated with fintech lending, exploiting the borrowers, and abusing their private data. It is useful to incorporate harsh penalties for any fintech lender that infringes on these provisions. More importantly, the issue of vulnerable groups and youths relying on these platforms to access funding should be addressed at the communal level, the government should intervene and offer avenues for educating them that they are dangers associated with these practices such as mental health challenges. Conversely,

the fintech apps should be reined from adopting their harsh, prohibitive, and abusive means of reclaiming their unpaid loans. More importantly, regulations should be unified such that it becomes apparent what the information and data the fintech lending apps obtained is used for beyond ascertaining the creditworthiness of the borrowers. Measures promoting transparency and consumer protection should be insisted from all legal provisions.

Fourth, on how to protect vulnerable groups, such as the youth, who resort to such platforms due to rising unemployment. Fresh thinking is required on fintech lending regulatory proposals. The thinking needs to be different from the regulatory frameworks for banks. It should focus on the study of behavioral practices for low-income communities as well as determine the regulators with jurisdiction. First, it is crucial to understand how financial information relating to loans is processed by low-income communities. Second, a functional approach should be developed in determining the regulator to have fintech lending jurisdiction. Regulatory confusion is emerging partly because of the current institutional approach where firms not classified as banks are providing bank functions such as consumer credit.



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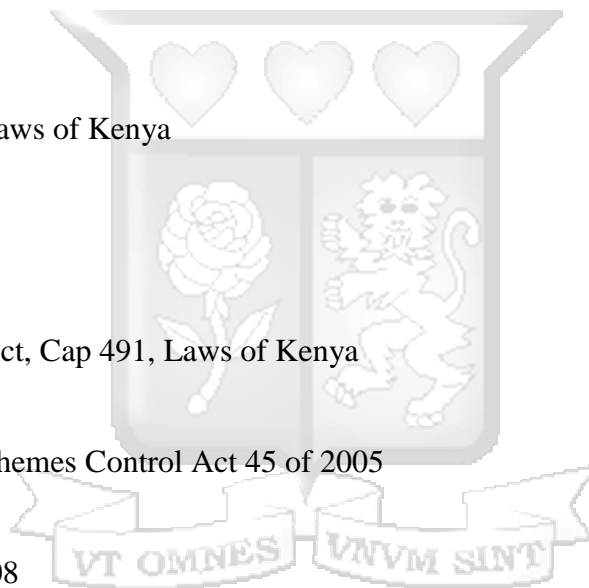
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Appendices

Appendix 1 – Ethical Certificate



25th October 2021

Ms Ndwiga Daisy,
daisy.ndwiga@strathmore.edu

Dear Ms Ndigwa,

RE: Fintech Lending in Kenya: An Analysis of the Gaps in Consumer Protection Regulation

This is to inform you that SU-IERC has reviewed and **approved** your above **SU- master's** research proposal. Your application reference number is **SU-IERC1165/21**. The approval period is **25th October 2021 to 24th October 2022**.

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 48 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 48 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://research-portal.nacosti.go.ke/> and also obtain other clearances needed

Yours sincerely,

for: Prof Fred Were,
Chairperson;



Appendix 2 - Originality Report

Document Information

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