

## EFFECTS OF THE CENTRAL BANK OF KENYA (AMENDMENT) ACT, 2021 ON DIGITAL CREDIT/LENDERS BUSINESSES

### 1 Background

The interest rate cap, which was introduced in 2016 had the impact of slowing down the private sector credit growth as banks did not have flexibility with regards to pricing the risk of lending. As a result, commercial banks rejected unsecured loan applications, locking out low-income customers as well as small and medium-sized businesses as they were deemed too risky to lend to. This subsequently triggered an appetite for easily accessible unsecured loans. Within the same period, there was increased innovation around digital payment and credit services being leveraged by regulated and unregulated entities. Consequently, with an increased demand in loans there was ultimately major investment and activity in the digital lending industry.

The uptake of digital loans in Kenya has been on a steady rise over the years as borrowers have been able to access credit at the touch of a button through user friendly mobile applications. This has led to calls for putting in place controls and regulations within the said sector hence the enactment of the Central Bank of Kenya (Amendment) Act, 2021.

To unpack the effects of the recently enacted [Central Bank of Kenya \(Amendment\) Act, 2021](#) on digital lenders, one needs to be familiar with the following background facts;

1. Central Bank of Kenya supervises and regulates all financial, payments and settlement institutions in Kenya;
2. Over the years, the Kenyan government, through the Communications Authority of Kenya and Ministry of ICT has facilitated supportive policies that formed the foundation of investment in telecommunications, ICT and mobile networks infrastructure, leading to rapid mobile market expansion (which Groupe Speciale Mobile Association “GSMA” placed at 52% in 2019 and estimates to reach 58% by 2025);
3. Rapid mobile penetration rates acted as a catalyst to internet usage, giving rise to many innovative digital products accessible via mobile phones in the Kenyan market. This included financial services products relating to digital money (Airtel money and M-pesa) which were launched by the main Telecom players Airtel and Safaricom and supported by a large agency network.
4. Soon enough, innovations around mobile wallets with digital credit functionalities were launched in the market and borrowers could access digital credit and cash out at the nearest agent station. The attractive features of this innovation were that the

borrower was not taken through the traditional barriers represented by traditional banking including physical presentation, long term account history, collateral and turn around times.

5. This innovation had tapped into an existing gap in the financial services market, which traditional banks had not been able to fill, leading to financial inclusion of a substantial amount of the unbanked demographic in Kenya;
6. The fact that digital credit business was largely unregulated, fast-tracked penetration of these digital credit products in the market since they had a lot of wiggle room to innovate and design the products without experiencing major regulatory hurdles;
7. Big telecom players in the market, like Airtel and Safaricom, initially partnered with banks to offer digital credit. Banks played the role of managing the financial aspects, while Mobile Network Operators (MNO's) had the telecommunication infrastructure and the customer base;
8. Medium size players like Tala and Branch soon emerged. They did not hold any customer deposits and disbursed funds through the borrower's mobile number. As of September 2021, there were a total of 49 digital credit providers in Kenya;<sup>1</sup>
9. As of December 2021, the total registered mobile money accounts in Kenya were 68.03 million.<sup>2</sup> (Kenya's population as per the 2019 census was 47.5million.<sup>3</sup> It is now estimated at 53.77 million). Communications Authority places the figure of Mobile Money subscriptions at 34.5 million;<sup>4</sup>
10. Communications Authority reported that active mobile subscribers (active sim cards) as of 30<sup>th</sup> September 2021 were 64.9 million.<sup>5</sup>
11. Mobile data subscriptions as of September 2021 was 44.8 million users;<sup>6</sup>

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<sup>1</sup> <https://kepsa.or.ke/the-state-of-digital-lending-report-2021-launch/>

<sup>2</sup> <https://www.centralbank.go.ke/national-payments-system/mobile-payments/>

<sup>3</sup> <https://www.knbs.or.ke/2019-kenya-population-and-housing-census-results/>

<sup>4</sup> <https://www.ca.go.ke/document/sector-statistics-report-q1-2021-2022-2/>

<sup>5</sup> <https://www.ca.go.ke/document/sector-statistics-report-q1-2021-2022-2/>

<sup>6</sup> <https://www.ca.go.ke/document/sector-statistics-report-q1-2021-2022-2/>

## 2 Difference between digital lenders and traditional banks

Lending under the traditional banking set up in Kenya encounters heavy regulation. 'Banking business' as defined under the Banking Act, requires one to apply for a licence. The test for meeting the threshold of being regarded as a bank under the Act includes 'collecting customer deposits'. Digital credit providers navigated this hurdle by ensuring they didn't hold customer funds. The National Payments Systems Act enacted in 2014 regulates most aspects of mobile money services. This meant that once enacted, it affected MNO's and not digital lenders with applications that did not have mobile wallet features built in. In this case, no digital money would be collected or held on behalf of the customer. The borrowed funds would be disbursed using mobile money infrastructure set up by a mobile money operator. Repayments would be made by the borrower to the lender using the same channels. Collaboration within the payment ecosystem specifically with PSP's, MNO's, Banks and other players facilitated a smooth execution of business models of these digital credit players while avoiding regulation.

## 3 Digital credit providers regulated under other laws

Micro finance institutions and SACCOS have also been huge players in the digital credit market for a long time. They operate under what can be regarded as soft touch regulations specifically Micro finance Act and Sacco Societies Act respectively.

## 4 Case made for regulation

Following the rapid growth of the digital credit market, various calls were made to CBK and Parliament to regulate the practices emerging from digital lending sphere.

Some of the reasons given were;

1. **Predatory practices;** The CBK Governor made remarks alluding to predatory lending practices <https://www.standardmedia.co.ke/business/news/article/2001369734/you-are-like-a-flea-in-the-economy-cbk-governor-to-digital-lenders>
2. **Money laundering concerns(AML);** <https://www.businessdailyafrica.com/bd/markets/capital-markets/digital-lenders-disclose-source-of-funds-cbk-dirty-cash-fight-3661954>

3. **Misuse of credit reference bureau**; The CBK earlier delinked unregulated digital lenders from CRB listing which facilitated credit information sharing between lenders. <https://www.businessdailyafrica.com/bd/news/cbk-bars-digital-mobile-lenders-from-crb-listing-2286988>
4. **Unconscionable interest rates**; Public outcry made a case for regulation <https://cotu-kenya.org/cbk-and-parliament-must-crackdown-on-digital-microfinance-mobile-lenders/>.
5. **Public interest due to high indebtedness of borrowers**, aggressive debt collection, personal data abuse, and uneven playing field regulatory arbitrage <https://www.the-star.co.ke/business/kenya/2020-12-01-cbk-governor-says-digital-lending-needs-regulation/>

## 6. Case made against regulation

The Digital lenders lobbied collectively through their association, Digital Lenders Association, advocating for no regulation or at the worst soft touch regulation with wiggle room for self-regulation <https://www.dlak.co.ke/>. The case made against regulation by CBK included;

- a. That it is a '**willing buyer willing seller**' situation in the digital lending marketplace and the market forces should reign
- b. That the digital lenders were catering to a demographic that was previously unbanked and did not have access to credit hence contributing towards **financial deepening within the Kenyan economy**
- c. That the high interest rates were necessitated as **compensation for the high risk taken by the Lenders**. They demonstrated that their non-performing loan ratios were higher than an average traditional bank lender.

In the end, Parliament sought to curb the so-called predatory practices while still enabling digital lending in a fair and regulated space. On 7<sup>th</sup> December 2021, parliament enacted The Central Bank of Kenya (Amendment) Act of 2021 and the same was gazetted on 5<sup>th</sup> January 2022. The Act ushers in new changes in the digital lending market in Kenya.

## 7. How the Amendments affect digital credit businesses

	Key Term used in the Act	Meaning as provided in the Act	Our comment
i.	<b>"digital channel"</b>	the internet, mobile devices, computer devices, applications and any other digital systems as may be prescribed by CBK;	While the most common channel in Kenya is mobile devices (mobile money and mobile apps), it is important to assess what makes a lender 'digital'. Other models include, website online lender, P2P lender, tech-enabled lender, supply chain lender, e-commerce and social platforms as well as market-place platforms
ii.	<b>"digital credit"</b>	a credit facility or arrangement where money is lent or borrowed through a digital channel;	Following Central Bank's release of the Discussion Paper on Central Bank Digital Currency in February 2022 which examines the applicability of a potential Central Bank Digital Currency (CBDC) in Kenya, there seems to be potential for the expansion of the definition of digital credit to include CBDC
iii.	<b>"digital credit business"</b>	providing credit facilities or loan services through a digital channel;	It is important to know the difference between digital readiness and digital lending/credit business. Digital readiness is where one deploys digital tools to help streamline operations, processes, activities and systems that will

			<p>ultimately support digital initiatives in the lending process.</p> <p>a. Digital credit business goes beyond the textual definition in the Act, it is when a digital product offers access to credit from a customer’s perspective. A customer-centric digital product offers fast and convenient access to credit, little to no physical documentation, convenient channels for disbursement and repayment, and a more personalized and customized interaction with the service provider.</p> <p>b. Digital credit business is therefore an end-to end process of developing and delivering a financial credit product that is applied for, disbursed, and managed through digital channels</p>
iv.	<b>"digital credit provider"</b>	a person licensed by CBK to carry on digital credit business;	the Act uses “digital lenders” and “digital credit providers” interchangeably.
v.	<b>“specified digital credit provider”</b>	a person licensed as a digital credit provider;	<p>a. Specified digital credit providers are required to provide CBK with any information and data it may reasonably require for the proper discharge of its functions.</p> <p>b. CBK may publish all or part of the information provided to it with the exclusion of information</p>

			<p>pertaining to financial affairs of any person unless written consent is obtained.</p> <p>c. This puts digital lenders directly under CBK’s ambit in terms of the compliance and reporting requirements and therefore it would be important to ensure that they are compliant with the current and continuing obligations/requirements under the Act and Regulations to avoid any sanctions for non-compliance.</p> <p>d. Specified digital credit providers may be required to prepare and submit periodic reports to the CBK on the status of compliance of the organization.</p>
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**8. Compliance requirements for digital credit providers:**

Scope of Provision under the Act		Our comments
1.	Regulator	
Licensing of digital credit providers	<p>i. A licensing application to CBK shall be accompanied by:</p> <p><i>a) a copy of the certificate of incorporation under the Companies Act;</i></p> <p><i>b) a certified copy of the Applicant’s memorandum and articles of association;</i></p>	<p>a. Directors of these companies should ensure compliance with the Act since non-compliance exposes them to imprisonment for a term not exceeding 3 years or a fine not exceeding Kenya shillings five million or both, upon being held liable for an offence under the Act.</p>

		<p>c) <i>a notification of the Company's registered address;</i></p> <p>d) <i>a certificate issued pursuant to section 19 of the Data Protection Act;</i></p> <p>e) <i>a statement as to compliance with the provisions of Part VII of the Consumer Protection Act; and</i></p> <p>f) <i>such other documents as may be prescribed by CBK.</i></p> <p>ii) In addition, the Applicant is required to submit the terms and conditions applicable to the digital credit and which must be accepted by the borrower before activation of a mobile loan account.</p> <p>iii) CBK may grant or reject an application for licensing by written notice to the Applicant within <b>Sixty (60) days</b> from the date of receipt of an application. CBK shall publish in the Gazette and in its website before the <b>thirtieth (30<sup>th</sup>)</b> day of March in each year, the names and addresses of all licenced digital lenders.</p> <p>iv) The licence shall be valid unless suspended or revoked CBK.</p>	<p>b. Since digital credit providers face the risk of suspension or revocation of their license, there is need to ensure continuous compliance with the Act. This includes ensuring compliance with consumer protection and data protection requirements.</p> <p>c. Given the nature of personal data processed by digital lenders, they are to be licensed as a Data Controller and/or Data Processor by the Office of the Data Protections Commissioner (ODPC). The digital credit provider should therefore evaluate personal data processed by the organization, purpose for processing such data, categories of data subject whose data is being processed, risks and safeguards in place to ensure protection of the data.</p> <p>d. These safeguards should also be well documented in form of data protection policies and procedures as these may be required at the point of licensing under the draft Regulations.</p> <p>e. The Act empowers CBK to enact further regulations to give full effect to the Act with regards to data protection and therefore we</p>
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iv) CBK may suspend a digital credit provider's license by written notice if:

a) *the licensee does not meet the conditions prescribed by CBK*

b) *the licensee is in breach of subsection (3) or the conditions of the Data Protection Act or the Consumer Protection Act;*

c) *the licensee is found to have given false information during the application;*

d) *the licensee goes into liquidation or an order for winding up is issued;*

e) *the Licensee carries out activities outside the scope of the licensed activities;*

f) *the licensee is in breach of any of the provisions of the Act and regulations*

v) CBK shall publish in the Gazette and on its website within **thirty (30) days** of suspension or revocation of a license, the name and address of the digital lenders whose licences have been suspended or revoked.

anticipate further guidance on the safeguards the CBK would require with regards to customers data. Digital lenders should subsequently have in mind the duration granted under the various licenses, issued by the CBK and the ODPC to ensure timely renewal of the same.

f. Digital credit providers should formulate sound terms and conditions, policies and organization procedures applicable to the digital credit business.

g. The consumer protection safeguards should also be embedded in the organisation's systems to ensure compliance with the Act.

h. The digital credit provider also needs to ensure that any third parties whom they share their customer's data with, are bound to the same data protection obligations.

2.	Consultation with other regulators	<p>i) The CBK under the Act can consult with other regulators, including but not limited to, the ODPC and the Communications Authority.</p> <p>ii) Pursuant to the draft Regulations the CBK may disclose information received in the performance of its duties to any financial regulatory authority or tax agency or fraud investigation agency.</p>	<p>a. The digital credit market is moving from an area of minimal regulation to encountering a barrage of regulators. The import of this is that there may be several compliance requirements under various legislations.</p> <p>b. This requires the digital credit provider to develop a robust internal regulatory compliance mechanism which can be done by developing an elaborate compliance checklist to ensure full compliance with all the regulators they are subject to as well as ensuring they get sound legal advise on the compliance and reporting requirements as and when the need arises.</p> <p>c. We also recommend pro-active engagement with the regulator to ensure compliance.</p> <p>d. Additionally, considering the CBK under the draft Regulations is allowed to share information with other agencies, one of them being the Kenya Revenue Authority, it would be prudent to ensure accuracy in the digital credit providers reports to the CBK.</p>
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			e. The digital credit provider should generally ensure that they have in place technical and organizational measures to ensure compliance.
3.	Disclosure of credit information	The Act allows the digital lenders to disclose any positive or negative information of its customers to the licensed Credit Reference Bureaus where such information is reasonably required for the discharge of the functions of the digital lenders and the licensed Credit Reference Bureaus.	While exercising this right, the digital credit provider must ensure that the information shared with the licensed Credit Reference Bureau is complete and accurate and that the information is shared in good faith and pursuant to the Act and/or the Regulations to avoid legal proceedings on any consumer or data protection related breaches.
4.	Licensing	<p>i) The Act empowers CBK to enact further regulations to give full effect to the Act. This may include but is not limited to:</p> <ul style="list-style-type: none"> <li>i. Licensing requirements for digital credit businesses;</li> <li>ii. Consumer protection;</li> <li>iii. Reporting requirements</li> <li>iv. Offences and penalties</li> </ul>	<p>a. It is important to note that the draft Regulations require licensing applications to be made within six months of their gazettelement. Considering the Act was passed in December, the Regulations are likely to be published soon as a three -month window provided for their release. Therefore, organizations should be ensuring they have in place the required policies and procedures to allow for a smooth transition.</p> <p>b. Further, under the draft regulations, significant shareholders, directors and chief executive officers will be required to meet the fit and proper criteria as set out under the</p>

Some of the penalties that can be imposed by the CBK are:

- i. Monetary penalties not exceeding five hundred thousand shillings for each violation or non-compliance;
- ii. Additional penalties not exceeding ten thousand shillings for each day or part thereof for which the violation or non-compliance continues;
- iii. Suspension of office of defaulting director, officer or employee;
- iv. Disqualification from holding any position or office in any licensed financial institution in Kenya;
- v. Frequent inspections on the digital credit provider
- vi. As order to submit to the CBK a plan within forty-five days a plan to resolve deficiencies;
- vii. Suspension or revocation of the licence and
- viii. Any other action the Bank may consider appropriate.

Regulations and submit declarations to this effect to CBK. CBK will also have the discretion to request for additional information in determining their moral suitability. This should be taken into consideration once the Regulations are gazetted and digital credit providers are applying for their licenses, as failure to meet the fit and proper requirements may lead to a shareholder having to forfeit their shares in the digital credit provider.

- c. Under the draft regulations, digital credit providers are required to have a well-established complaints redress mechanism as well as system integrity which ensures customer information confidentiality and security. Further, digital credit providers are cautioned against false advertising, this, includes deceptive representations. On this front we would advise that digital credit providers use exclusion terms/disclaimers and fine print in their advertising or terms of conditions in accordance with the Consumer Protections Act and Guidelines and in a way

that would not be seen as misleading to a reasonable observer.

- d. Further, the draft Regulations have put in place a limit on interest recoverable from non-performing loans. It would therefore be important for a digital credit provider to satisfy themselves of the customers' ability to pay prior to on boarding them.
- e. The draft regulations require digital credit providers to make their books and records readily available to CBK for inspection and supervisory purposes as well as preparing of periodic reports and returns. We would therefore recommend that digital credit providers keep up to date and accurate records.
- f. Seeing as the penalties that may be imposed are quite hefty it would be imperative to ensure that as a digital lender, your organization has adequate compliance checks in place, both technical and organizational.

5.	Approval of digital channels	The Act empowers CBK to approve digital channels through which digital credit business may be conducted	Subject to the draft regulations, there are aspects of the digital lenders product of the that may also require approval from CBK upon lodging of the licensing application. Some of these are the consumer and data protection mechanisms deployed, Know Your Customer requirements in line with the Anti-Money Laundering and Combating the Financing of Terrorism policies and procedures, delivery channels or platforms to be used and the information and communication technology systems to be used.
6.	Pricing of digital credit	The Act mandates the CBK to determine the parameters for pricing of digital credit providers	<p>The likely approach to be taken by CBK is similar to that imposed on banks which would constitute justification of their margins to the CBK. The regulator in 2017, asked banks to submit their loan pricing formula which forms the basis of setting interest rates on credit.</p> <p>(CBK Circular- <a href="https://www.centralbank.go.ke/uploads/banking_circulars/136870827_Banking%20Circular%20No.%2003%20of%202017%20-%20Cost%20of%20Credit%20Website%20Portal.pdf">https://www.centralbank.go.ke/uploads/banking_circulars/136870827_Banking%20Circular%20No.%2003%20of%202017%20-%20Cost%20of%20Credit%20Website%20Portal.pdf</a>)</p> <p>Article by business daily- <a href="https://www.businessdailyafrica.com/bd/economy/relief-mobile-lenders-as-cbk-stay-clear-interest-caps-3636882">https://www.businessdailyafrica.com/bd/economy/relief-mobile-lenders-as-cbk-stay-clear-interest-caps-3636882</a> )</p>

			This would therefore mean digital lenders will need to justify the pricing of their loans through their pricing formula which CBK will subsequently approve.
7.	Supervision of digital credit providers	The Act mandates the CBK to supervise digital credit providers	CBK already has the adequate capacity in terms of technical skills, resources, technical tools and systems to monitor, oversee and supervise the licensees so a lag is not expected.
8.	Changes as required by the CBK	The Act mandates CBK to direct or require such changes as CBK may consider necessary	Some of the changes that may be required by the CBK could be a change in the major shareholders of the digital lender or in the senior officials where they do not meet the fit and proper criteria upon assessment by the CBK. This may also occur where the digital credit provider is engaged in practices that are likely to offend the provisions of the Act or acts in a manner that is not in the best interests of its customers.
9.	Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT)	The draft regulations require digital credit providers to provide CBK with evidence of their source of funds invested or proposed to be invested. They also require that proper identification of customers is done while performing transactions	a. Since CBK will require evidence of AML/CFT policies and procedures of the digital credit provider, it would be important for organizations to bolster their Know Your Client Requirements that are used during on boarding of customers. Further, it would be prudent to also include in its AML/CFT policies and procedures, its risk assessment

			<p>and risk classifications, the relevant training to be conducted by employees as well as the monitoring, recognition and responses to AML/CFT.</p> <p>b. It would also be important to ensure that there it has in place proper corporate governance structures in place that ensure integrity, legitimacy and sound risk management.</p>
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The digital credit providers are required to Apply for their licences within Six **(6) months** of publication of the Act **(7<sup>th</sup> June, 2022)** This calls for digital credit providers to move swiftly to ensure compliance within the stipulated timelines. CBK has already issued draft regulations that govern digital credit providers. We anticipate that there will be further regulations rolled out to give force to the Act.

Regulation tends to follow innovation, and this is the case with digital lending. Digital lenders’ practises were initially welcome until certain players engaged in practices that were considered against consumer and data protection. This is in addition to other pertinent questions that were raised on their corporate governance structures and sources of funding. In the past, the regulator’s approach towards new digital offerings was to observe market dynamics and international standards before it can offer a concise position on regulatory approach. With this new legislative enactment and regulations, we anticipate a paradigm shift in the operations of a majority of digital lenders to conform with the requirements. Some of the changes we anticipate include robust compliance frameworks, changes in corporate structures, product design changes and regular regulator engagements. As a law firm offering regulatory advise in the fintech and data privacy areas, we highly recommend initialisation of compliance at the earliest.