

SUBMISSIONS ON THE CENTRAL BANK OF KENYA (AMENDMENT) BILL 2020

About the Lawyers Hub Kenya

The Lawyers Hub is a Legal-Tech organization incorporated within the Republic of Kenya serving the global south. It exists to provide innovative and technology-driven solutions to policy, legal practice and access to justice with a particular focus on technology-driven enterprises and policy alternatives. In the year 2020 alone, the Lawyers Hub has convened policy makers, academia and legal-tech organizations from 20+ countries within the African Continent, curated rapid tech solutions under the Global Legal Hackathon and developed key policy briefs for the African Continent on Artificial Intelligence, Data Privacy & Digital Identity, Tech and Migration, and Taxing the Digital Economy. In this regard, we offer our submissions on the proposed regulations.

Introduction

The Central Bank of Kenya (the CBK), established by Cap 491 of the laws of Kenya, is the principal regulator of banking business (Banking Act Cap 486), microfinance business (Microfinance Act 2006) and payment systems (National Payment Systems Act 2011) in Kenya.

The objectives of CBK regulation include to enforce prudential practices that protect depositors and borrowers. The CBK Prudential Guidelines of 2013 only protect bank customers for regulated banking institutions against things like loss of privacy and lack of full disclosure. However due to its scope, the CBK lacks the mandate over some digital financial service providers who are outside the regulatory framework of banks and microfinance institutions.

On the **10th of August 2020** the Lawyers Hub held a discussion on the CBK Amendment Bill 2020. The over **462 attendees** include persons from the banking sector, legal professionals (lawyers, practitioners, in-house counsel and academia), digital lenders, civil society organizations and members of the public. More information on this is available at the end of this document. Context of the Problem

The CBK Amendment Bill proposes the inclusion of the regulation of digital financial products, services and providers under the mandate of the CBK. The Bill envisions a broad and potentially all-inclusive of present and future facilities and arrangements that allow for investment, risk or non-cash payments. However broad the definition, the public's attention was drawn to digital loans and credit issues where an already large and growing consumer base has experienced numerous challenges with these lenders. Non-bank digital lenders have caused the most significant stir with reports of:

- i. aggressive and embarrassing debt collection;
- ii. the use of social media data and algorithms to make crucial decisions such as eligibility and the amount to lend; and
- iii. As the matter has advanced, it has also arisen that these digital lenders are incorporated

elsewhere and the data collected is resident in foreign jurisdiction, in spite of financial data being considered sensitive personal information under the Kenyan Data Protection Act.

For many, this amendment has been seen as an effort to rein in these non-bank digital lenders, albeit a significantly insufficient one.

The discussion raised the following issues in digital financial regulation generally and with the Central Bank Amendment Bill 2020:

a. Issues in Digital Finance Regulation

The telco-bank interplay

Since the entrance of M-Shwari into the market, the potential of telco-bank collaboration has been explored by many more players. M-Shwari is a digital loans and savings product of the collaboration between Safaricom and the Commercial Bank of Africa (now NCBA), KCB M-pesa of Safaricom and Kenya Commercial Bank and Equitel of Equity bank and Airtel to mention a few. This trend is creating unprecedented convergence points between these two already regulated sectors in ways that are challenging existing regulation.

While the collaboration has produced great value to consumers, the new business models and products are revealing gaps in regulation and questions of appropriate regulators between banking regulator CBK and telco regulator Communications Authority.

Non-monetary lending

In continuing with the new business models issue, Kenya has witnessed the rise of restricted utilities borrowing products. Consider products such as Okoa Stima, where a user subscribed to Safaricom can borrow money to pay for their electricity bill and Okoa Jahazi an airtime credit advance to users. With such products, questions arose as to whether they are understood as loans and credit and the implied regulatory effect of that classification.

Data flows and residency

A Privacy International report from 2017 shed light on the data practices of digital lenders. Many of the nonbank digital lenders are companies with foreign incorporation. Included in their business model is widespread data collection in Kenya, with this data stored in other countries, usually the country of incorporation. With this data stored in countries with different data protection laws or a lack, in the case of the United States, the data is afforded less protection than the standards required in Kenya. In addition, in case of a merger or acquisition with such company, data as an asset of the company is transferable to the new company with its own unique data regimes and practices. Given the nature of financial and other personal data, the data flows, transfer and residency are a matter of interest for the nation of Kenya.

Practices violating consumer privacy and data protection

Some of these lenders set as a condition for borrowing the widespread collection of data on the mobile device. This data includes access to financial statements such as M-Pesa messages and call logs and the permission to contact certain persons in the case of a default on repayments. These practices have violated the privacy of borrowers by exposing their details of their financial information. This practice is defended by the argument that borrowers gave their consent, however this consent is unduly stressed by the fact that they will not access the service without agreeing to these terms, which though legally sound violates rights to privacy and consumer right to full information on the product.

Algorithmic bias and credit decision making

Implicit in their business models, these lenders use data science and machine learning algorithms in order to determine questions such as eligibility and amounts for lending. Given the nature of non-financial data such as social media and call log data, it is necessary to consider the prejudicial effect of such data on algorithmic decision making. The Kenyan legal system under s35 of the Data Protection Act 2019 presently regulates against these procedures and methods that result in automated decision making. Nevertheless, the enforcement of the regulation remains a challenge.

Uncapped interest rates

A 2019 FSD report shows that the annulated interest rates from digital lenders went as high as 300%. In Kenya, monetary policy is set by the Monetary Policy Committee of the CBK. Although the rate caps were repealed in 2019, borrowers have been subject to default resulting from high lending interest rates. This lending activity creating tension and debt stress among borrowers requires a more comprehensive consideration within the wider framework of lending in Kenya.

Issues specific to the Bill

1. Brevity and ambiguity of scope

It was found that generally the bill was too brief with overly broad generalizations over the scope of the bill. The definitions of digital financial products were found to be unclear as to what was included given nonmonetary digital lending products that could not be placed within the scope of the Act.

Concerns on public participation

Participants were concerned that the bill as is, being a private bill, lacks the multi-stakeholder participation as from the beginning. The result of this is that many of the divergent views of different groups already stood excluded. This was especially recommended for a sector such as financial technology that is innovation driven and that could see significant drawbacks should regulation not take the service providers into account.

Concerns over the CBK as regulator

Though the general consensus was that the sector does require regulation, it remained an issue whether the CBK is the proper regulatory body since digital finance is a sector heavily involving telecommunication which is subject to a different regulator. The concern was that the CBK is growing in its regulatory mandate and becoming what can be called a 'super' regulator.

Alternative regulators and regulatory models

In connection to the question of whether the CBK should be the sole regulator of digital financial products, it was pointed out that this sector, with its innovative core and utilization of mobile devices also could fall within the ambit of the Communication Authority, that regulates telecommunications.

c. Discussion outcomes

The discussion concluded with the following points:

- Sector players agree that regulation of non-bank digital lenders will allow greater business prospects and growth in business volume, investor confidence and sector certainty.
- The Kenyan digital financial sector is made up of players regulated by a variety of bodies with a variety of financial sector regulators with the Central Bank, Office of the Data Protection Commissioner and Communications Authority being among them, due to the collaboration and partnership sector players are leveraging.
- Due to this multi stakeholder and multi regulator environment created by the digital financial sector, Kenya is faced with potential over regulation of the sector, which will burden sector players. A light regulatory environment, with implementation of existing laws would be ideal.
- Giving the CBK sole regulatory jurisdiction over the digital financial sector defeats the multi-stakeholder approach preferred by sector players, digital lenders in particular. Alternative regulators could be the Communications Authority or an entirely new body.

d. Recommendations on digital financial sector regulation

Existing regulators

- a. Amend the Banking Act to include non-bank/non-deposit taking digital lenders under the Banking Act so these lenders are covered by sector guidelines and regulations as far as possible affecting such lenders.
- b. The CBK could amend the following regulations and guidelines to include in their scope these lenders, affecting strategic points affecting the issues raised above:
 - i. CBK Prudential Guidelines 2013, Guidelines on Consumer Protection
 - ii. Credit Bureau Regulations 2013
 - iii. Any future interest rate policy affecting lending in Kenya
- c. The Communications Authority can develop a Consumer Protection Regulation specific for mobile app based non-bank lenders taking a consumer rights approach.
- d. The Office of the Data Protection Commissioner can develop the Digital Financial Services Data Protection Rules.

A hybrid regulator model

Responding to the question who the right regulator is for the digital financial services sector, there emerged a recommendation for a hybrid regulator. The features of this include:

An independent regulatory body developed under its own Act of Parliament.

Representative of the multi-stakeholder set up of the financial services and technology sector.

Responsible for developing sector regulation.

Section	Proposed Amendment	Comment
Add Section 3	<p>a. The CBK shall lead the creation of a hybrid regulator that is multi-stakeholder to be comprised of representatives from the following:</p> <ul style="list-style-type: none"> i. The CBK ii. Communications Authority of Kenya iii. Bankers Association of Kenya iv. Digital Lenders Association of Kenya v. Data Protection Office vi. National Treasury <p>b. This team will focus on the development of digital financial sector regulations and guidelines through the following principles</p> <ul style="list-style-type: none"> I. Collaboration li. Innovation lii. Inclusion lv. Consumer protection <p>c. The team will serve a 2-year term from the effective date, after which their mandate comes to end.</p> <p>d. This sector regulator operates under the supervision of the Central Bank of Kenya.</p>	<p>This is in reference to the issue of collaboration in the process of developing regulation, policy and guidelines affecting the digital finance sector. This approach requires and mandates a multi-stakeholder collaboration to regulate the sector, with a time limit and an end in sight.</p>
Add Section 4	<p>In the meantime, the following CBK regulations apply to digital financial product, service and credit providers</p> <ul style="list-style-type: none"> i. CBK Prudential Guidelines 2013, Guidelines on Consumer Protection ii. Credit Bureau Regulations 2013 iii. Any future interest rate policy affecting lending in Kenya iv. Any other relevant laws applicable in Kenya on privacy and data protection, consumer protection and any other law. 	<p>This section combines the acknowledged need for regulation with strategic application of existing regulations under the CBK framework while awaiting the development of sector specific laws as the multi-stakeholder team works. This section targets the sensitive areas of consumer and data protection, credit scoring and rate capping which for digital credit in particular have been most aggressive against Kenyans.</p>

Regulating Digital Lenders:

Public Discussion on the Central Bank Of Kenya (CBK) Amendment Bill

Monday 10th August, 2020



Registered

741



Attended

462



Duration

122



Attendance Rate

62%



Participants Demographic



