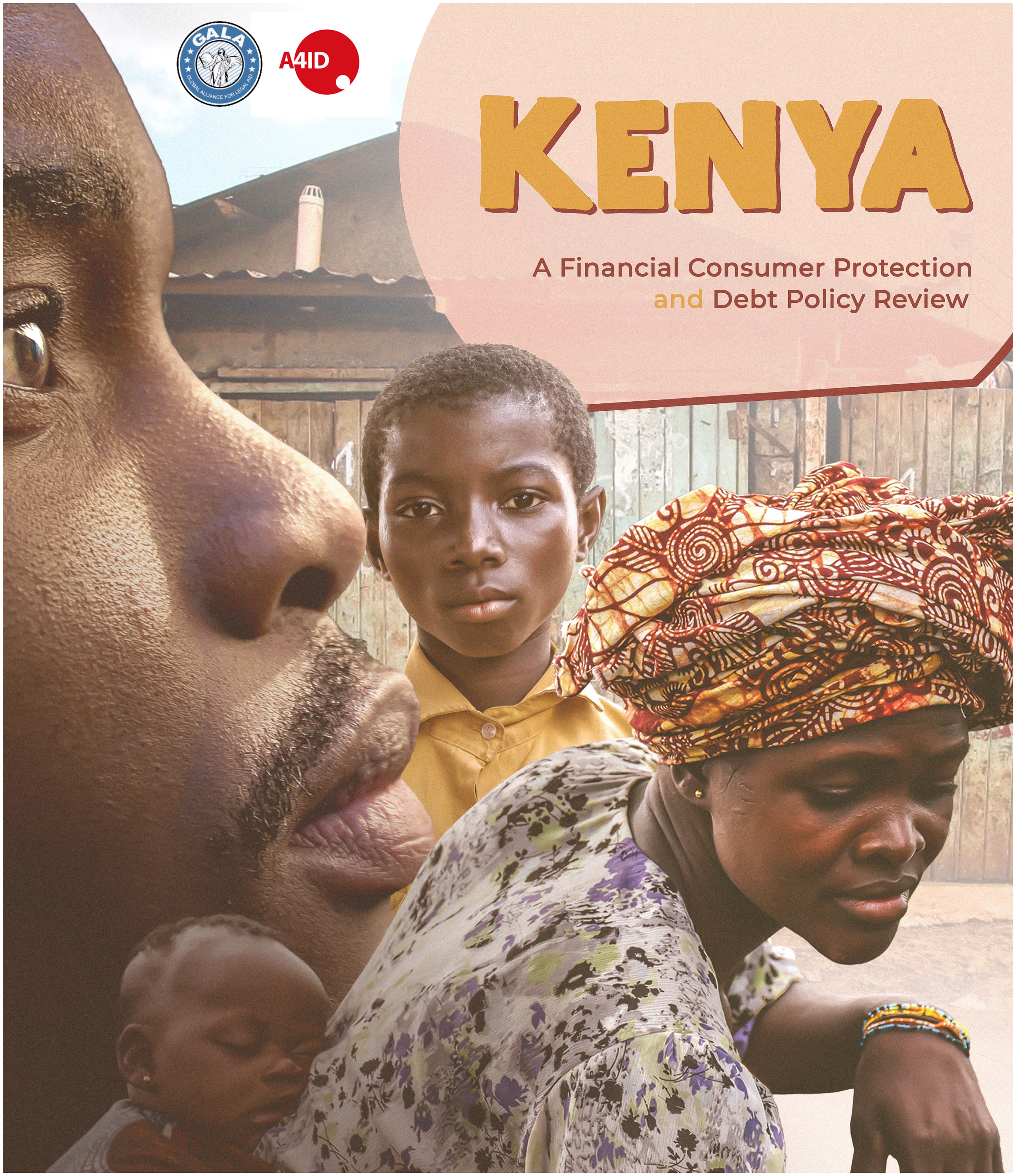

KENYA

A Financial Consumer Protection and Debt Policy Review

Global Alliance for Legal Aid

GALA is a nonprofit corporation established in 2013 pursuant to the laws of the State of North Carolina (USA). GALA supports access to justice and engages in public interest advocacy primarily in developing countries. Legal aid is an essential component of access to justice, yet most of the poor cannot afford legal services nor court filing fees. GALA engages in public interest advocacy and coordinates pro bono legal support for human rights and consumer advocacy organizations on a variety of topics; including debt relief for the over-indebted, advocacy for victims of financial fraud, environmental justice and prison reform, as well as access to legal aid; in particular for incarcerated individuals. GALA is supported by an international community of lawyers who act in an advisory capacity, and it is a development partner of A4ID.

Advocates for International Development

A4ID is a global charity, founded in 2006, that operates in over 130 countries working at the intersection of law and development. A4ID enlists lawyers to provide pro bono advice and assistance to non-profit NGOs, developing country governments and intergovernmental organizations such as the World Bank and United Nations agencies on various projects that advance the Sustainable Development Goals. In doing so, the legal community is able to use their skills and expertise contribute the eradication of global poverty. A4ID also facilitates training programs on law and development and business and human rights for the legal, development and business communities and civil society.

The Debt Incarceration Project

In 2021, GALA and A4ID undertook an ambitious program to document the legal ramifications of over-indebtedness for the poor, and the lack of debt relief available to them by law. This country report is part of a joint advocacy campaign to abolish laws which allow for the incarceration of the poor for defaulting on their contractually incurred debts.

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The legal research for this report was conducted by the DLA Piper Africa office in Nairobi whose lawyers undertook an extensive analysis of local financial consumer protection and insolvency laws. Any errors in the legal analysis remain the responsibility of the lead author.

Cover Design by Ivy Kimani for GALA.

Consumers have the right … to the protection of their health, safety and economic interests …

***Constitution of Kenya*, 2010**
Chapter 4: The Bill of Rights
Art. 46(1)(d) Consumer Rights

Introduction

Kenya is considered a lower middle-income country by the World Bank where 35.6% of the population lives on less than $1.90 USD per day.[1] Over 80% of Kenyans work in the informal sector of the economy, and are thus unprotected by labor laws and more vulnerable to economic shocks, such as the ongoing global pandemic.[2] Furthermore, the World Bank predicted that one in three Kenyans are probably working for a firm that is likely to temporarily or permanently close due to the impact of COVID-19.[3] These individuals and households are unlikely to have emergency savings, or other assets that they could sell off to endure a prolonged financial crisis. Consequently, only 51% of respondents to the World Bank's 2017 *Global Findex* survey thought they could come up with emergency funds if required.[4]

In recent years, international development stakeholders and government policy makers have embraced financial inclusion policies as a means to achieve national development goals, including poverty alleviation. Kenya, like many other low- and middle-income countries (LMICs), enacted policies to facilitate greater *access* to financial services for its population. In 2011, the Central Bank Governor affirmed Kenya's commitment to develop national financial inclusion policies.[5] By 2017, 82% of Kenyans had access to a formal financial account according to the World Bank's *Global Findex Database* (up from only 43% in 2011).[6]

The leading financial service used by Kenyans is mobile payments. Safaricom's M-PESA remains the largest money mobile service provider, with over 31 million subscribers, representing 98.8% of market share.[7] Payments via mobile devices have proved highly beneficial to Kenyans and the Kenyan economy; particularly in facilitating rural to urban trade.

Simply having access to a formal financial account is not a meaningful measure of financial inclusion; consumers need an array of affordable, quality financial services.

Having access to a transactional or deposit account, however, is neither a meaningful measure of financial inclusion, nor a development indicator. Consumers need an array of affordable, quality financial services. These include credit, insurance, investment, and pension products, all of which should suitably meet their lifelong financial service needs. Simultaneously, consumers also

[1] World Bank Group. (2018). Kenya Economic Update: Policy Options to Advance the Big 4. *Kenya Economic Update*, no. 17. Washington, D.C.: World Bank Group. https://documents1.worldbank.org/curated/en/327691523276540220/pdf/125056-WP-P162368-PUBLIC-KenyaEconomicUpdateFINAL.pdf
[2] International Labor Organization (2021). *The Informal Economy in Kenya* at https://www.ilo.org/wcmsp5/groups/public/---ed_emp/---emp_ent/documents/publication/wcms_820312.pdf
[3] World Bank Group. (2020). Kenya Economic Update: Navigating the Pandemic (English). *Kenya Economic Update,* no. 22. Washington, D.C.: World Bank Group. http://documents.worldbank.org/curated/en/957121606226133134/Kenya-Economic-Update-Navigating-the-Pandemic
[4] World Bank (2017) *The Global Findex Database 2017* at https://globalfindex.worldbank.org/
[5] Alliance for Financial Inclusion (2011) *Maya Declaration* at: https://www.afi-global.org/sites/default/files/publications/MD_Central%20Bank%20of%20Kenya.pdf
[6] World Bank (2017) *The Global Findex Database 2017* at https://globalfindex.worldbank.org/
[7] Communication Authority of Kenya, *First Quarter Sector Statistics Report for the Financial Year 2020/2021* at https://www.ca.go.ke/wp-content/uploads/2020/12/Sector-Statistics-Report-Q1-2020-2021.pdf

need to possess at least a basic level of financial literacy in order to understand potential risks, while evaluating the suitability of financial services. Consumers should be able to trust that they are adequately protected by strong financial consumer protection policies; including access to fair and efficient redress and debt relief mechanisms should they become insolvent or over-indebted — a real possibility for impoverished consumers working in the informal sector.

Moreover, the harsh reality is that Kenya is not performing well in terms of financial inclusion indicators, including gender equity measures. For instance, the majority of people who remain without access to any formal financial services are Kenyan women.[8] Other important shortfalls include:

- Only 27% of Kenyans save in a financial institution, in contrast to the 35% of Kenyans who are saving with savings clubs (*chamas*) and in other informal ways (e.g., at home).[9]
- Only a small portion of the population is covered by a pension scheme with access to retirement funds. The most recent data from a Retirement Benefits Authority survey in 2019 indicates that only 19% of Kenyans employed in the formal economic sector, and a mere 1.3% of Kenyans in the informal sector, have a pension.[10] Approximately 80% of the population have no plans nor means to save for retirement, and will likely become elderly, poor and lack adequate means of support.[11]
- These meager levels of savings are further compounded by the low insurance rates (both personal and life insurance) amongst the Kenyan population; with the Central Bank of Kenya (***CBK***) indicating that insurance penetration had declined with the ratio of insurance premiums to GDP at less than 2.3% throughout 2019 and 2020.[12]

As manager of the Competition Authority of Kenya (***CAK***), the Kenyan national agency mandated to regulate all sectors of the economy, Boniface Kamiti proposed that stakeholders and regulators of financial services need to be more concerned about the overall *financial health* of consumers; as opposed to financial inclusion rates, noting that the financial health of Kenyans had deteriorated in recent years.[13] Kamiti defined financial health as the extent to which a person can manage current financial obligations and settle bills as they come due, with resources left over. He further noted that the lack of financial health was typical for the majority of digital borrowers, specifically highlighting that:

> *The adoption of services such as digital finance is associated with consumer risks such as over indebtedness, which could be attributed to the high fees, which vary between 7.5% and 10% per month. Other concerns in digital finance include data privacy breaches, hidden charges, and lack of customer redress mechanisms.*

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[8] Of the one-fifth of Kenyans who have never had a financial account with a formal sector institution, two-thirds are women: CryptoGuru (2018) 'Financial Inclusion in Kenya: Where are we now?' *BitcoinKE*, at https://bitcoinke.io/2018/08/financialinclusion-in-kenya-where-are-we-now/

[9] World Bank (2017) *The Global Findex Database 2017* at https://globalfindex.worldbank.org/

[10] Retirement Benefits Authority (2020) Classification of Informal Sector Workers and Employers for Appropriate Pension Targeting: Report at https://www.rba.go.ke/download/classification-of-informal-sector-workers-andemployers-for-appropriate-pension-targeting/#

[11] World Bank Informal Sector dataset available online at https://www.worldbank.org/en/research/brief/informal-economy-database .

[12] Central Bank of Kenya (2021) *Financial Stability Report 2021*, p. 28 at https://www.centralbank.go.ke/uploads/financial_sector_stability/48936558_Kenya%20Financial%20Sector%20Stability%20Report%202020.pdf

[13] Kamiti, Boniface, *Consumers' Financial Health: Key Lessons for Digital Lenders*, 18 March 2022, available online at https://cak.go.ke/consumers-financial-health-key-lessons-digital-lenders-boniface-kamiti-manager-consumer-protection

Overall, the above data suggests that neither the traditional financial services sector, nor the newer fintech companies, are serving all the financial needs of a significant portion of all Kenyans at critical moments during their lifetime.[14]

Access to a single, formal financial service account is not a reliable indicator of financial health, especially when the bulk of Kenyans surviving in the shadows of the formal economy are left vulnerable to existing predatory lending, data privacy abuses, abusive collection practices, and over indebtedness. More financial services, which are flexible, affordable, and safe, with clear avenues of redress and debt relief where warranted, must be accessible to all Kenyans in order to achieve *financial health* for all.

The Consumer Lending Landscape for the Poor

In total, consumer loans from financial institutions represent 28% of gross outstanding loans in Kenya.[15] Data from the CBK shows that the non-performing loan rate for the consumer and household loan segment is an alarming 16%.[16] Underlying this worrying statistic are the evolving structural changes in the financial services sector—in particular, the rise of digital financial services. Telecommunication service providers are now the leading financial service providers for both the poor and vulnerable Kenyan consumers.[17]

Prior to developing credit and savings products in partnership with commercial banks, mobile phone companies offered payment services. In 2007, Safaricom, the most successful mobile phone company in Kenya, began by offering mobile money with its *M-PESA* product, later followed by its *M-Shwari* credit product, launched in 2013. Within a few years, digital credit became accessible to the masses. By 2018, more people were borrowing from a digital source than from a non-formal digital source (13.5% vs. 8.6%).[18.]

Digital Borrowers Are More Likely to Become Over-Indebted

While digital credit is more convenient and accessible for borrowers than taking a formal loan from a brick-and-mortar bank branch, concerns exist that digital borrowers may be more susceptible to over-indebtedness. Digital borrowers are nearly twice as likely to default on loans than non-digital borrowers.[19] Alarmingly, one in two digital borrowers report having to borrow more, sell assets, reduce expenditure on food, or take a child out of school, in order to repay a loan taken in the prior 12 months.[20]

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[14] World Bank (2017) *The Global Findex Database 2017* at https://globalfindex.worldbank.org/node?field_databank_country_target_id=107

[15] Id., page 42.

[16] Central Bank of Kenya (2020) *Bank Supervision Annual Report 2020* at https://www.centralbank.go.ke/uploads/banking_sector_annual_reports/468154612_2020%20Annual%20Report.pdf

[17] Kimenyi, M and Ndug'u N.S., (2009) 'Expanding the Financial Services Frontier: Lessons from Mobile Banking in Kenya', *Brookings* at https://www.brookings.edu/wp-content/uploads/2016/06/1016_mobile_phone_kenya_kimenyi.pdf

[18] Federation of Kenyan Employers (2021) *The Informal Economy in Kenya*, p. 43 at https://www.ilo.org/wcmsp5/groups/public/---ed_emp/---emp_ent/documents/publication/wcms_820312.pdf

[19] Gubbins, P (2019) *Digital Credit in Kenya: Facts and figures from FinAccess 2019*, p. 12 at https://fsdkenya.org/wp-content/uploads/2020/07/Focus-Note-Digital-Credit-in-Kenya_Updated.pdf

[20] Ibid.

In May 2021, GALA's affiliate, MicroJustice Kenya, conducted interviews with a small sample of debt distressed borrowers, finding results that were congruent with the abovementioned statistics. Furthermore, the study revealed that in addition to having digital loans that they could not repay, 57% of distressed borrowers also carried multiple loans from other lenders, such as Savings and Credit Cooperatives (SACCOs) and moneylenders. Thus, digital credit may indeed be aggravating a situation where debtors are already insolvent. Moreover, the MicroJustice survey indicated that a large portion of borrowers were harassed and threatened by debt collectors to the point of causing serious and adverse mental health consequences.

Digital borrowers are nearly twice as likely to default on loans than non-digital borrowers

Impact of Debt Policies on Over-Indebted Consumers: Interview with the Debt Distressed

GALA's partner MicroJustice Kenya conducted 27 in-person interviews in May 2021 near the Toi Market in Nairobi. Respondents were randomly identified before and after they conducted business at the market, and do not necessarily represent a cross-section of the Kenyan public.

Despite a small and opportunistic sample of people, the findings are alarming, nevertheless:

- 81% had only ever used digital loans for formal lending.
- 70% had a digital loan at the time of the interview; of which 52% had more than one digital loan, with one subject indicating a total of six digital loans.
- 57% of those with a digital loan also held at least one other outstanding loan with a bank, SACCO, cooperative, or moneylender.
- 59% were not able to repay their loan on time.
- 68% of those in arrears had received threats or menacing calls or texts from the creditor.
- 59% stated that at the time of the interview, they were in a situation whereby the debts were causing high degrees of stress and anxiety, or otherwise adversely impacting their health and quality of life.

When GALA/MicroJustice Kenya offered to provide debt relief in the form of funds to several of the over-indebted respondents, the debtors indicated funds would only help in the short-term. They expressed that it was not a sustainable solution because they were currently not even earning enough to meet their daily household needs, and would therefore need to rely on additional loans to cover future deficits. This unexpected finding underscores the susceptibility of a large number of people to not only predatory lending procedures, but ultimately, a debt trap they may never be able to escape.

Source: Ondari, Angela (MicroJustice Kenya). Interviews with 27 over indebted consumers in Toi Market, May 2021, (unpublished).

While digital payment services have undoubtedly benefited the lives of many Kenyans, some dubious practices have emerged in the digital lending space. These practices mirror the financial consumer protection problems that have long plagued traditional lending, such as a lack of pricing transparency, expensive interest rates, and abusive collections behavior.[21] With the advent of digital financial services, however, there have also been significant increases in data privacy violations, as well as an increase in

[21] BBC, *Kenya Outrage Over Debt Collectors' Shaming Tactics*, 5 August 2021 at https://www.bbc.co.uk/news/world-africa-57985667

consumer financial fraud.[22] Digital loans, as currently offered, are particularly ill-suited not only the poor, but those with irregular and unreliable incomes. The following reasons, highlighted in Appendix I, explain this peril in further detail.

The True Cost of Digital Credit and Defaults is Soaring

Even though new digital credit products are more accessible to underserved individual consumers and micro and small businesses, they still come at a high cost. Having a highly leveraged, large, informal economy living at or near the poverty line during a global pandemic should warrant extra vigilance by the government.

Tenures for digital loans are also quite short; ranging from only seven days up to a month with interest rates that are charged as flat rates.[23] For example, a loan from the leading Kenyan digital lender, Safaricom's *M-Shwari,* costs 9% monthly, or 108% expressed as an annual percentage rate (***APR***). There is an additional 7.5% fee charged on top of the interest if the loan is paid late or *rolled over* onto another payment period.[24]

Other digital lenders, Tala and Branch, both use the *M-PESA* platform and charge higher fees which vary depending upon the loan size and tenure. A Branch loan, for example, could carry an interest rate of 13-29% per month, or up to 348% expressed in APR.[25] Similarly, Tala's interest rates vary depending on the loan amount and tenure, but could cost up to 19% per month or 228% APR.[26]

Unsurprisingly, in a low-income population where unemployment is rising and markets are slowing down, easy to obtain digital loans are a quick fix for consumers' cash shortfalls. However, these loans may not be *affordable,* nor suitable, creating a mismatch between long-term earnings and short-term debt obligations.

> **Digital lenders charge interest rates from 13-29%, *per month***

Several studies undertaken prior to, and during the pandemic, had already begun indicating that borrowers are experiencing debt difficulties as a result of digital loans. For example, a MicroSave study based on pre-pandemic data from 2016-2018, revealed that 86% of the loans taken out by Kenyans were from digital lenders; amongst those borrowers, 2.2 million had non-performing digital loans; and 980,000 Kenyans, or 49% of those with non-performing loans had borrowed less than $10 USD.[27] A similar study conducted by the Consultative Group to Assist the Poor (CGAP), confirmed that as many as 50% of Kenyan respondents had paid digital loans late, thereby incurring late fees, and 12% of Kenyans had defaulted.[28]

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[22] Mugendi, J. (2021) 'M-PESA Fraud on the Rise in Kenya', *iAfrikan* at https://www.iafrikan.com/m-pesa-fraud-on-the-rise-kenya-safaricom/

[23] Flat interest rates are calculated on the whole principal, as opposed to the declining balance due, making them a more expensive type of loan.

[24] For more information on Safaricom's products, see the terms and conditions here: https://www.safaricom.co.ke/personal/index.php/m-pesa/credit-and-savings

[25] Onamu, A. (2020) 'Here's a List Of Mobile Loan Apps in Kenya and Their Rates', *Gadgets Africa* at https://gadgets-africa.com/2020/03/26/heres-a-list-of-loan-apps-and-their-rates-in-kenya/

[26] Id.

[27] MicroSave Consulting (2019) *Making Digital Credit Truly Responsible: Insights from analysis of digital credit in Kenya* at https://www.microsave.net/wp-content/uploads/2019/09/Digital-Credit-Kenya-Final-report.pdf

[28] Izaguirre, J., Kaffenberger, M. Mazer, R. (2018) *It's Time to Slow Digital Credit's Growth in East Africa*, CGAP at https://www.cgap.org/blog/its-time-slow-digital-credits-growth-east-africa

More recently, in 2021, the Competition Authority of Kenya and Innovations for Poverty Action (IPA) published a joint study indicating that 77% of mobile home loan borrowers were charged late penalties and were forced to roll over their debts.[29] Additionally, 33% of those surveyed mentioned they had multiple digital loans, while 12% indicated that they were using loans to pay off other loans.[30]

Inappropriate Financing for Micro, Small and Medium Sized Enterprises

Another critical concern is that most digital lenders offer a 'one size fits all' loan, without tailoring credit products to micro or small business needs in the informal sector. despite the importance of this sector to the economy. Micro, small and medium sized enterprises (***MSMEs***) contribute 40% of the nation's GDP and account for 83% of total employment in the country.[31] Setting special terms to qualify for and repay loans, such as trade financing, extended grace periods on loans for small holder farmers, and earmarked savings requirements, makes financing for MSMEs more accessible and effective in promoting economic growth.

The Kenyan Government has indicated that the informal economy has the potential to be a significant driver of economic growth, employment creation, and poverty reduction. This potential is highlighted in *Kenya Vision 2030*, the doctrine outlining the Government's aspirations to achieve full middle-income country status by 2030. However, because most informal sector enterprises are not registered with local authorities, they often fail to qualify for traditional bank loans. Instead, they resort to informal lending from family, friends, and community organizations, as well as the uniform, but unsuitable, consumer loans from digital lenders for their capital requirements.

Yet, the Kenyan Government appears to be embracing digital lenders for the purpose of MSME lending,[32] even allowing digital lenders to participate in a new Treasury guarantee scheme for MSME loans. This guarantee scheme was initially rolled out in December 2020 with seven participating banks, then in 2022, KSh1 billion (approximately 8.6 million USD) was added to boost the scheme, and digital lenders are welcome to participate.[33]

Flagrant Data Privacy Violations and Abusive Collection Practices Continue

Fintech companies in the business of digital lending are able to access mobile phone contact and transactional data to predict, within an acceptable margin of error, whether a borrower is likely to, or able to repay a loan. Until recently, if a borrower made a late payment or defaulted, various digital financial service providers texted or called the borrower's contacts, and spread their private financial information across social networks. Digital lenders are owned by mobile operators—and in accordance with the lending terms and conditions of Safaricom's *M-Shwari*—they have the option of seizing funds loaded by the borrower as airtime, as well as taking funds from any linked deposit accounts.

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[29] Putman, D., Mazer, R., Blackmon May, W. (2021) *Report on the Competition Authority of Kenya Digital Credit Market Inquiry*, Competition Authority of Kenya at https://www.cgap.org/blog/its-time-slow-digital-credits-growth-east-africa
[30] Id.
[31] Wakiaga, P, *The Focus on SMEs is a Welcome Intervention*, Kenya Association of Manufacturers at https://kam.co.ke/the-focus-on-smes-is-a-welcome-intervention/
[32] The Government of Kenya has also taken the unprecedented action of waiving the application of the *Microfinance Act* to the digital lender branch, allowing it to acquire more than 25% interest in a Kenyan bank. See: Money254 (2022) 'Treasury waives law allowing branch to buy Kenyan bank'at https://www.money254.co.ke/post/treasury-waives-law-allowing-branch-to-buy-kenyan-bank-news
[33] Munda, C. (2022) 'Treasury to Pay Part of Defaulted Mobile Loans', *Business Daily Africa* at emgage

Regulation of the digital lending sector was non-existent until December 2021, when Parliament passed *The Central Bank of Kenya (Amendment) Act 2021* (***CBK Amendment Act***), which now provides CBK with the mandate to set interest rate caps and to penalize digital lenders for abusive market conduct.[34] Unfortunately, the CBK Governor has signaled that there is no intention to intervene on pricing of digital loans beyond its expectation that lenders will treat their borrowers well.[35]

As penalty for default, digital lenders can seize funds loaded by the borrower and convert it to airtime, or even take funds from any linked accounts

Unless CBK intervenes, the status quo is unlikely to change. The volume of high-priced loans that are repaid still allows for a substantial profit margin for lenders, which offsets the significant volume of consumers who default. Borrower late fees also generate large profits. In the case of *M-Shwari* for instance, late payers get an additional 7.5% late fee—known as a "facilitation fee"[36]—added onto the loan. Borrowers' habitual late payments may have inspired Safaricom to develop a new overdraft service, called *Fuliza,* which allows for mobile money clients to transfer funds beyond what is available in their payment accounts, effectively operating as short-term credit for customers.[37] *Fuliza and M-Pesa* generates close to 40% of *Safaricom's* corporate earnings.[38]

Creditors, likewise, have the option to report late payments to the Credit Registry Bureau (***CRB***), which has an inordinately negative impact on debtors who are unable to repay small loans. The Kenya Federation of Employers conducted a study in collaboration with the International Labour Organization which confirmed that many informal traders who had borrowed from digital platforms such as *M-PESA*, *M-Shwari*, *Fuliza* and *Eazzy*, had been blacklisted by the CRB.[39] As a result, these individuals are left unable to borrow from any other formal sources. The study also found that many of the MSMEs owned by young and inexperienced entrepreneurs never clearly understood the true cost of the loan, nor the implications of default on digital loans, nor the process of clearance from CRB.[40]

As previously mentioned, CBK recently promulgated the Central Bank of Kenya (Digital Credit Providers) Regulations 2021, under the *Central Bank of Kenya Act,* which do contain financial consumer data privacy protections. The regulations still allow lenders to report a consumer to the CRB for a default of as little as 1,000 Ksh (approximately $8 USD).[41] As a result, defaults on loans of extremely low value could effectively *exclude* a large percentage of the Kenyan population.

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[34] *The Central Bank of Kenya (Amendment) Act, 2021* available online at http://kenyalaw.org/kl/fileadmin/pdfdownloads/Acts/2021/TheCentralBankofKenya__Amendment_Act_2021.pdf

[35] Omondi, D (2021) 'Central Bank Will Not Cap Interest Rates Charged by Digital Lenders,' *The Standard* at https://www.standardmedia.co.ke/business/news/article/2001430611/cbk-will-not-cap-interest-rates-charged-by-digital-lenders

[36] For more information on Safaricom's services, see https://www.safaricom.co.ke/faqs/faq/273#:~:text=If%20you%20have%20not%20paid,on%20your%20outstanding%20loan%20balance.

[37] See Safaricom's product description online at https://www.safaricom.co.ke/personal/m-pesa/credit-andsavings/fuliza last accessed on 25 April 2022.

[38] Amandala, V. and Nyawira, S. (2021) 'Safaricom eyes Sh110bn full year profit as Fuliza reigns supreme', *The Star* at https://www.the-star.co.ke/business/kenya/2021-11-10-safaricom-eyes-sh110bn-full-year-profit-as-fuliza-reigns-supreme/

[39] Federation of Kenyan Employers (2021) *The Informal Economy in Kenya*, p. 44 at https://www.ilo.org/wcmsp5/groups/public/---ed_emp/---emp_ent/documents/publication/wcms_820312.pdf

[40] Ibid, p. 39.

[41] Id.

Kenyan lenders are allowed to report consumers to the Credit Registry Bureau for a default as little as 1,000 Ksh

Effectively, persons with a negative CRB listing appear to be growing in tandem with the increase in digital lending. Data from 2017 indicated that there were up to 2.7 million Kenyan borrowers listed on the CRB.[42] By December 2021, that figure had grown to 4.6 million Kenyans, with a third of all credit-active Kenyans blacklisted according to credit rating agency TransUnion.[43] The process for removing one's name from the negative CRB listing requires payment of the debt, in addition to a fee of KSh 2,200 or approximately $22 USD, to obtain a credit clearance certificate from the CRB. That sum may be unaffordable for the overindebted, pushing them to take out additional loans, opening people up to further financial exploitation.[44]

Additionally, there does not seem to be a viable procedure for contesting erroneous negative reports to the CRB. A Kenyan lawyer indicated that she was recently reported to the CRB mistakenly by a leading digital lender, and was thus blacklisted as a result.[45] Potential consequences of remaining on the CRB blacklist include not being able to receive future loans, and potentially being disqualified from employment.

Insolvency Laws for Natural Persons Can Provide Protection, But at a Cost

A larger problem for debt distressed Kenyans is that once a debtor of limited means falls into the debt trap, there may not be a legal pathway out of debt. Unfortunately, for most low-income Kenyans formal debt can perpetuate for years, with no reprieve in sight.

In many countries, bankruptcy and insolvency laws were historically drafted with the intent to guide and supervise *corporate* restructuring related to insolvency, as well as to protect creditors' rights. In many LMICs, it is rare to find affordable and accessible systems in place for natural persons (individuals or households) to obtain debt relief through existing bankruptcy and insolvency laws.

The Kenyan system, at least on paper, allows for natural persons to file under its *Insolvency Act, 2015*. However, any actual debt relief through this channel is unlikely for an over-indebted and poor consumer. The ability of a poor consumer with multiple debts to afford a lawyer who can navigate the 400 pages of complex insolvency legislation is improbable. Nor is a debt distressed person likely to be able to pay the required insolvency practitioner and the court filing fees.[46]

Practically speaking, in order to file for relief under the *Insolvency Act*, a person must have amassed total debts of at least Ksh 100,000 (approximately $876 USD) and have no means to repay any amount towards those debts.[47] This relatively high threshold is likely to ensure that the bulk of the digitally overindebted individuals—those with loans of $10 USD for example—will not qualify for any relief. Although $10 USD

[42] Kimani, Elijah, *Fin-tech in Kenya should not cause poverty in pursuit of financial inclusion*, London School of Economics Blog, Jan. 20, 2020.
[43] Otiatu, G. (2021) *A Third of Borrowers now on CRB's Blacklist*, Business Daily at https://www.businessdailyafrica.com/bd/economy/third-borrowers-now-crbs-blacklist-3647572
[44] https://ke.creditinfo.com/faq/
[45] Solli, Jami, Interview with Anonymous Kenyan Lawyer, 16 March 2022, unpublished.

[46] *Insolvency Act, 2015* (Kenya) available online at http://kenyalaw.org/kl/fileadmin/pdfdownloads/Acts/2015/Insolvency_Act18of2015_-_compressed.pdf

[47] Id. Section 345.

may seem an inconsequential sum for middle-class borrowers, it is a considerable amount for those with limited income and assets.

Debtor Incarceration is Enforced

Defaulting on a civil loan in Kenya can result in even more dire consequences than blacklisting or creditor harassment on social networks. The *Civil Procedure Act Chapter 21, Laws of Kenya* and *Civil Procedure Rules 2010,* permits incarceration of a borrower for default.[48] Despite multiple challenges to the constitutionality of these laws, on various occasions, courts have held that commitment to civil jail is lawful where the judgment debtor is in a position to pay and has refused or neglected to do so.[49]

Serving a sentence, which can be as long as six months per default, nevertheless does not resolve the underlying debt.[50] Therefore, once released from prison, the debt must still be repaid. However, the inmate lost potential earnings while incarcerated, and since he or she will forever thereafter carry the stigma of being an ex-convict, and will likely face discrimination in trying to earn future income. He or she will also face negative individual, family, and societal impacts for years to come. In addition to individual-level impacts, high incarceration rates have macro-level consequences; and prison expenses detract from public spending on healthcare, education, pensions, and infrastructure for the public good.

The mere fact that debtor incarceration is protected by *live* laws on statute books leaves the vulnerable poor open to potential abuse

In 2019, 648 Kenyans were incarcerated for debt; this number dropped to 200 in 2020.[51] Pursuant to an order from the Chief Justice, inmates on minor offences serving less than six months were released following a review of their file by a High Court Judge, as a way to manage the coronavirus outbreak in congested prisons.[52] By 2 April 2020, 4,800 inmates had been released, and within five months of the implementation of the "decongestion programme," 12,000 prisoners had been released.[53] Large numbers of prisoners on remand—56,813[54] to be precise—who are awaiting their trials, intermingle with the general population, posing further difficulty in ascertaining exact numbers of persons

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[48] Sections 38(d), 40-43 of the *Civil Procedure Act* and Order 22; Rules 31-34 detail the procedure for execution of decrees for the arrest and detention of debtors. Available online at www.Kenyalaw.org.

[49] See *Hussein Marshallo Guraha v Marhallo Guracha & Another* (2021) eKLR at http://kenyalaw.org/caselaw/cases/view/215758; *Mary Nduku Ndunda vs. Attorney General & 4 Others* (2016) eKLR at http://kenyalaw.org/caselaw/cases/view/118923/; *Charles Lutta Kasamani v Concord Insurance Co. Ltd. & Deputy Registrar Milimani High Court Commercial and Admiralty Division* (2018) eKLR at http://kenyalaw.org/caselaw/cases/view/147944/; *Beatrice Wanijiku & Another vs. Attorney General & Anor* (2012) eKLR at http://kenyalaw.org/caselaw/cases/view/81477/

[50] Section 42(2) of the *Civil Procedure Act*.

[51] Kenya Prisons Service, *Prison Population*, 2011-2020.

[52] DLA Piper (2020) *A Global Analysis of Prisoner Releases In Response to COVID-19*, page 19 at https://www.dlapiper.com/~/media/files/insights/publications/2021/03/dla-piper-prison-population-during-covid-19.pdf?la=en&hash=F5C1EBBA0D3D86BDDA58FAC87DB9EF3CAE3815DF.

[53] Institute for Crime and Policy Research (2021) *Keeping COVID out of Prisons: Approaches in Ten Countries*, page 11 at https://www.prisonstudies.org/sites/default/files/resources/downloads/keeping_covid_out_of_prisons.pdf See also CNN (2020) *Kenya has freed nearly 5000 inmates via newly adopted Skype court sessions* at https://edition.cnn.com/2020/04/02/africa/kenya-courts-on-skype/index.html.

[54] Kenya Prisons Service, 2011-2020; data available online at www.statistica.com/statistics/1241807/number-of-convicted-and-unconvicted-prisoners-in-kenya/ N.B. The authors, however, have seen varying figures with regard to the Kenyan prison population as well as remand figures.

in prison for debt default.[55] In the case of minor offenses, remand status for the duration of the maximum sentence is not inconceivable.

In Kenya, debtor incarceration laws are clearly being enforced. Even if they were not, the mere fact that these are *live* laws on the statute books leaves the vulnerable poor open to potential abuse. This is of particular concern in jurisdictions with scarce legal aid available to the population. In Kenya, legal aid is effectively only available to persons charged with capital offenses, such as murder.[56] In all other cases, unless the accused can afford a lawyer, they will be unrepresented in court. Additionally, court business is conducted in English, thus the rural poor often end up in proceedings not understanding the charges due to a lack of interpreters. Such conditions are ripe for miscarriages of justice.

Unless the provisions criminalizing debt default are repealed, the post-pandemic recovery will likely see incarceration numbers rise again in light of the emerging digital credit bubble. From a legal policy perspective, these purely punitive provisions are bad law in terms of the costs to the individual and more broadly to families and society. Further, there seems little likelihood of gain to the creditor, as any prospects for debt recovery would diminish due to the incarceration. Instead, incarceration is likely to instigate a series of adverse consequences for the prisoners and their immediate families, including:

- The loss of employment or income generated in the informal sector.
- Families lose a source of monetary and non-monetary contributions to the household.
- Children of the imprisoned debtor suffer from lack of care from a parent, as well as diminished access to education. Since Kenya has been witnessing a rise in the incarceration of females, more young children are accompanying their mothers into prison, exposing more children to increased levels of harm.[57]
- Lengthy pre-trial detention puts new cost burdens on families, including travel costs to visit family members in prison, as well as food and other necessities for detainees. Although the state is supposed to supply these provisions, it normally does not, effectively resulting in poor households subsidising imprisonment.
- Inmates are at risk for severe health consequences and even death, especially in heavily overcrowded prisons with poor sanitation and health care services.

On the societal level, debtor incarceration is tantamount to criminalizing poverty. These discriminatory laws disproportionately impact the vulnerable and marginalized. Contrary to the criminal law objectives of community protection and crime reduction, debtor incarceration only serves to further marginalize the poor. Additionally, it places an unnecessary burden on an already overcrowded prison system bursting at the seams. Worse, through their exposure and institutionalization with other more serious criminals, there is an increased risk of *learned* criminality.

Aside from being counterproductive and simply unjust from a policy perspective, Kenya is also in violation of its international legal obligations in particular Article 11 of the *International Covenant on Civil and Political Rights* (***ICCPR***)[58] which it has signed and ratified. That provision expressly prohibits imprisonment due to an inability to fulfil a private contractual

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[55] Kenyan Prisons Service, Prison Population, 2011 – 2020.
[56] Submission by Kenya Association for the Intellectually Handicapped to the Office of the High Commissioner for Human Rights, dated 8 May 2017, p. 22 at https://view.officeapps.live.com/op/view.aspx?src=https%3A%2F%2Fwww.ohchr.org%2FDocuments%2FIssues%2FDisability%2FRightAccessJusticeArticle13%2FCSO%2FKenyaAssociationIntellectuallyHandicapped.doc
[57] See the short documentary on BBC, *Growing Up Behind Bars in Kenya: 'Children believe prison is home'* at https://www.bbc.co.uk/news/av/world-africa-59983357.
[58] 999 UNTS 171 (adopted 16 December 1966, entered into force 23 March 1976).

obligation. This is one of the few provisions of the ICCPR that is conferred the special status as an *absolute right*, on par with the prohibition against torture, that cannot be derogated from nor compromised when there are competing tensions between this and any other rights.

New Financial Consumer Protection Policies Are Favorable, Yet More Must Be Done

Multilateral organizations promote consumer protection legislation in a variety of settings. The UN Sustainable Development Goals (SDGs) outline a roadmap for the eradication of poverty by 2030. Consistent with the principle that 'no one be left behind,' development gains can only be achieved if financial inclusion is supported by regulatory safeguards that protect the most vulnerable. Within SDG 10, to reduce inequality within and among countries, specifically Target 10.5, requires countries to '*improve the regulation and monitoring of global financial markets and institutions and strengthen the implementation of such regulations.*' This goal is further articulated in the International Monetary Fund's (IMF) Financial Soundness Indicators, which includes the ability to service household debt as a metric of national financial health.

Having sound legislation and regulations in place to protect consumers are important aspects of building a more just system, but change will not materialize without regulatory champions with the will to enforce the laws effectively. The CBK regulates and licenses financial institutions, but financial consumer protection (***FCP***) is not one of its core functions. It has only recently been granted the legal mandate to license and supervise the digital credit providers, and to determine the parameters for pricing digital credit.[59] In a disconcerting announcement, however, Central Bank Governor Patrick Njoronge, stated that the CBK will not be exercising its authority to place limits on interest rates.[60]

Unsurprisingly, predatory lending and abusive collection practices have been present long before the digital lenders came onto the scene. Since the digital era has ushered in a tremendous increase in the volume of lending, the intensity of abusive practices has been magnified due to the absence of adequate FCP laws and regulations and market conduct supervision.

CBK's *Guidelines on Financial Consumer Protection*, issued under section 33(4) of the *Banking Act*, empowers the CBK to issue guidelines for institutions to maintain a stable and efficient banking and financial system. Yet, the application of the Guidelines is limited to institutions licensed under the *Banking Act*.[61] For example, paragraph 3.2.1 (d)(i) states that:

> *to ensure prudent lending, an institution shall take steps to assess the proposed consumer's general understanding and appreciation of the risks and total cost of the proposed credit agreement and his rights and obligations under the agreement, his debt repayment history for credit, his existing financial means, prospects and obligations; and whether there is a reasonable basis to conclude that any commercial purpose may prove to be successful, if the consumer has such a purpose in applying for credit.*

Transforming these guidelines into enforceable FCP law which applies to all financial service providers—not just those licensed under the *Banking Act*—would go far towards improving the state of financial inclusion in Kenya. Such guidelines codified as law would ensure that financial institutions are selling fair products to consumers, and enable consumers to demand products which are suitable and affordable.

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[59] *The Central Bank of Kenya (Amendment) Act 2021*

[60] "If you mean ourselves having caps, obviously the answer is no. We are not going to that part of the world again," said the CBK Governor in a virtual press conference. See Reuters (2021) Kenya's president signs law change to regulate digital lenders at https://www.reuters.com/markets/rates-bonds/kenyas-president-signs-law-change-regulate-digital-lenders-2021-12-07/

[61] CBK Prudential Guidelines for Institutions Licensed under the Banking Act CBK/PG 22, available online at https://www.centralbank.go.ke/wp-content/uploads/2016/08/PRUDENTIAL-GUIDELINES.pdf

Another FCP gap relates to the supervision and monitoring of market conduct by financial services providers and their agents. In particular, debt collection activities are largely unregulated and unsupervised. As mentioned earlier, data privacy violations, such as calling a debtor's mobile contacts and publicly shaming debtors on social networks, have been commonly used abusive debt collection tactics went unregulated. Harassment has been so intense that borrowers develop mental health problems, and, in the most extreme cases, instigated suicide.[62]

The Digital Credit Providers Regulations 2021 now seeks to address these predatory practices. It prohibits digital credit providers from making unauthorized or unsolicited calls or messages to a customer's contacts, engaging in improper or unconscionable debt collection conduct, or deploying any other tactics whose consequence is to harass, oppress, or abuse any person in connection with the collection of a debt.[63] These regulations are seen as a triumph for consumer protection law. Time will tell if they are indeed effectively enforced.

Obtaining and using data otherwise, without the consumer's explicit consent, is currently in contravention of the Kenyan *Data Protection Act 2019*.[64] In accordance with the Act, the Data Protection Commissioner should be responsible for regulating and investigating allegations of data privacy abuses. In addition to regulatory enforcement, providing consumers with a cause of action against debt collectors who engage in abusive conduct, and allowing for damages to be awarded by statute, would go far toward ending the abuses.

In addition to monitoring market conduct, as mentioned earlier, the CBK should also endeavor to monitor over indebtedness rates of consumers and households. This is distinct from simply collecting data on non-performing loans. The CBK indicated that although it recognizes the concept of *over-indebtedness*, and has a definition for it,[65] it does not monitor the percentage of consumers and households that are considered over-indebted.[66] In light of the CAK report, and the millions of Kenyans reported to the CRB blacklist every year, monitoring levels of consumer and household over-indebtedness would play an important role in curbing it.

Current Complaint Redress Mechanisms Are Inadequate

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[62] Daily Sabah (2021) Public humiliation follows Kenyans opting for easy credit, at https://www.dailysabah.com/business/finance/public-humiliation-follows-kenyans-opting-for-easy-credit

[63] Central Bank of Kenya, draft (Digital Credit Providers) Regulations (2021)

[64] *Data Protection Act, 2019*, s. 25 states 'Every data controller or data processor shall ensure that personal data is — (a) processed in accordance with the right to privacy of the data subject; (b) processed lawfully, fairly and in a transparent manner in relation to any data subject; (c) collected for explicit, specified and legitimate purposes and not further processed in a manner incompatible with those purposes; (d) adequate, relevant, limited to what is necessary in relation to the purposes for which it is processed; (e) collected only where a valid explanation is provided whenever information relating to family or private affairs is required;…' available online at http://kenyalaw.org/kl/fileadmin/pdfdownloads/Acts/2019/TheDataProtectionAct__No24of2019.pdf

[65] *Central Bank of Kenya Prudential Guideline on Consumer Protection* (CBK/PG/22) provides that a consumer is over-indebted if the available information at the time a determination is made indicates that the consumer is or will be unable to satisfy in a timely manner all the obligations under all the credit agreements to which the consumer is a party, having regard to that consumer's:

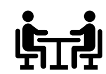
i. financial means, prospects and obligations; and

ii. probable propensity to satisfy in a timely manner all the obligations under all the credit agreements to which the consumer is a party, as indicated by the consumer's history of debt repayment and other relevant factors prevailing at the time of credit assessment.

[66] There are various definitions of over indebtedness but generally speaking it means that consumers or households cannot service their debts without making unacceptable trade-offs such as limiting food consumption or foregoing medical treatment or the purchase of medicines.

Access to redress is a fundamental component of FCP,[67] which is noticeably inadequate in Kenya. Marginalized groups are at a particular disadvantage. A Kenyan consumer who has a dispute with a financial services provider is limited to complaining to the financial services provider or resorting to the courts, an option not affordable to the poor. There is no specialized financial ombudsman, or extra-judicial dispute resolution mechanism; such as affordable extrajudicial debt counseling or mediation centers, for low-income debtors.

The CAK has the mandate to accept consumer complaints regarding *false or misleading representations and unconscionable conduct, as well as the supply of unsafe, defective and unsuitable goods*[68]. However, the CAK investigates only a small volume of consumer complaints annually: 314 in 2021 across all goods and services sectors.[69] The low volume of complaints for all goods and services in the country may mean consumers are either unaware that they can utilize the CAK for redress, or that they believe it to be ineffective, and therefore do not use it. CAK is now digitizing some processes; perhaps that will aid in its efficiency and effectiveness in fulfilling its role as a consumer champion.



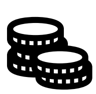
Only 38% of Kenyans understand basic financial concepts, such as how to calculate interest

A feasible improvement to the system would be to have a regulator with both financial sector expertise and a consumer protection mandate that establishes an alternative dispute resolution (***ADR***) scheme. This dual-purpose mechanism would be in the best interest of both debtors and creditors.

Low Financial Literacy Rates Prohibit Financial Health

To have *meaningful* financial inclusion which leads to sustainable development, it is important to have a firm focus on empowering consumers. This can be accomplished both by improving financial literacy and ensuring that strong financial consumer protection measures are in place as a safety net. While over 80% of Kenyans may have access to basic formal financial services, the financial literacy rate in the country remains quite low. Only 38% of Kenyans understand basic financial concepts,[70] such as how to calculate interest, the impact of inflation on the value of money over time, or the benefit of risk diversification in investing.

Low financial literacy rates mean that consumers may face difficulties comparing financial products or appreciating risk. They may also be ineffective in assessing whether a financial product is right for their specific financial needs. For example, a farmer taking a short term, high interest microfinance loan for crop expenses would probably encounter repayment difficulties, because planting and harvesting crops usually occurs over several months, while microcredit and digital loans often have short repayment periods of a month or less. Understanding contradictions in the system, in combination with adequate systems of redress, can enable a consumer to make demands for more appropriate financing.



[67] Pursuant to the OECD's *High Level Principles on Financial Consumer Protection* available online at https://www.oecd.org/daf/fin/financial-markets/48892010.pdf

[68] The *Competition Act, 2010* available online at http://kenyalaw.org:8181/exist/kenyalex/actview.xql?actid=No.%2012%20of%202010

[69] Kivuvu, E. (2022) 'New CAK app to help deal with complaints', *Business Daily* at https://www.businessdailyafrica.com/bd/corporate/technology/new-cak-app-to-help-deal-with-complaints-3703134

[70] Klapper, L., Lusardi, A., Oudheusden, P. (2016) Financial Literacy Around the World: Insights from the Standard & Poor's Ratings Services Global Financial Literacy Survey at https://gflec.org/wp-content/uploads/2015/11/3313-Finlit_Report_FINAL-5.11.16.pdf?x49160

Furthermore, a consumer who is not financially literate is more likely to fall victim to predatory industry practices and outright fraud—then not know where to turn for redress. Kenya has had such an abundance of deleterious pyramid or 'ponzi' schemes, that in 2009 the Kenyan Government established a national Taskforce on Pyramid Schemes to address the issue.[71] Joblessness and the desperation of poverty were cited as the main factors explaining why consumers believed criminal Ponzi schemes are valid investment opportunities.

Conclusion

Believing genuine financial inclusion to be beneficial to the Kenyan people, we make the following financial inclusion, financial consumer protection, and financial literacy related suggestions to the Kenyan Government:

Recommendations

1) The CBK should be given the mandate to protect all financial consumers regardless of financial service type used. Government should explicitly invest in developing financial regulatory and supervisory capacities to issue and enforce guidance about acceptable digital financial products and processes.

2) The CBK should consider a permanent moratorium on the reporting of low value debt default and related late payments to the CRB, and set shorter time limits for how long this data may be retained by credit bureaus. It is suggested that a retention period of six months to one year is sufficient for low-value loans. Credit clearance certificates should be issued for free and upon application by consumers who have repaid their debts.

3) Kenya should repeal sections 38(d) and 40-43 of the *Civil Procedure Act* and Rules 31-34 of the *Civil Procedure Rules* which allow for the arrest and detention of civil debtors. Incarcerating the poor who cannot repay their debt obligations is inconsistent with Kenya's international legal obligations including the *International Covenant on Civil and Political Rights,* which Kenya has signed and ratified. Incarceration of the poor, in addition to being unfair, also adds an unnecessary cost to the public judicial system.

4) Kenya should consider the establishment of debt mediation centers for low-income debtors. This could be structured as a joint Government-Private and Profession-civil society collaborative partnership. GALA/A4ID would be available to assist the relevant authorities to develop such an initiative, for example, by enlisting the private legal profession on a pro bono basis and establishing legal clinics within universities.

[71] Republic of Kenya, Ministry of Co-operative Development and Marketing (2009) *Report of the Taskforce on Pyramid Schemes* at https://www.slideshare.net/guestd260ae/report-of-the-taskforce-on-pyramid-schemes. Ponzis are still alive and well but now operating in the cryptocurrency space: see Mwaura, W (2021) 'Letter from Africa: The lure of the get-rich-quick scam in Kenya', *BBC* at https://www.bbc.com/news/world-africa-57255600. Kenya was a focus country in the UN's International Telecommunication Union's research on unlicensed digital investment schemes, Financial Inclusion Global Initiative, Security, Infrastructure, and Trust Working Group (2020) *Unlicensed Digital Investment Schemes* at https://www.itu.int/en/publications/Documents/tsb/2019-Unlicensed-Digital-Investment-Schemes/index.html

5) Kenya should consider amendments to the *Insolvency Act, 2015*, allowing for no asset, low-income debtors to obtain debt write-offs where appropriate. The minimum threshold of total debts should be lowered significantly taking into account the digital loan market context. There should be an easy procedure for the poor to have court fees waived, and proceedings should be simplified and fast-tracked.

6) Kenya already has a formal definition of 'over-indebtedness.' As a next step, CBK should monitor the rate of the population that is over-indebted, and apply appropriate policy interventions to address both prevention and cure.

7) CBK should encourage financial institutions and digital lenders to have restructuring protocols in place which are communicated to clients at the point of sale. When the lender notes that borrowers may be in debt distress due to late payments or other indicative consumer behavior, they should proactively offer restructuring or refinancing options.

8) The debt collection industry should be monitored by the appropriate government agency, with consumers granted a right to bring a complaint with the appropriate regulator, ADR mechanism or court, and be awarded compensation when consumers demonstrate creditors or their agents engaged in abusive collection practices. This could be an appropriate role for the Data Protection Commissioner or, it could be a new, independent financial ADR mechanism.

9) Kenya should consider establishing an office of a Financial Services Ombudsman or other similar ADR mechanism for financial service complaint handling. The Financial Services Ombudsman can also play a complementary role to that of the CBK in that it aggregates close to real-time data on financial market conduct, informing financial sector policy interventions. This entity can also play a role in assisting over-indebted consumers to mediate with creditors (e.g., as does the Australian Financial Complaints Authority or AFCA).[72]

10) Invest significantly in financial literacy and debt counselling to be delivered by consumer protection and public interest advocacy organizations. Funding could come from fines levied on financial services providers for demonstrable market misconduct.

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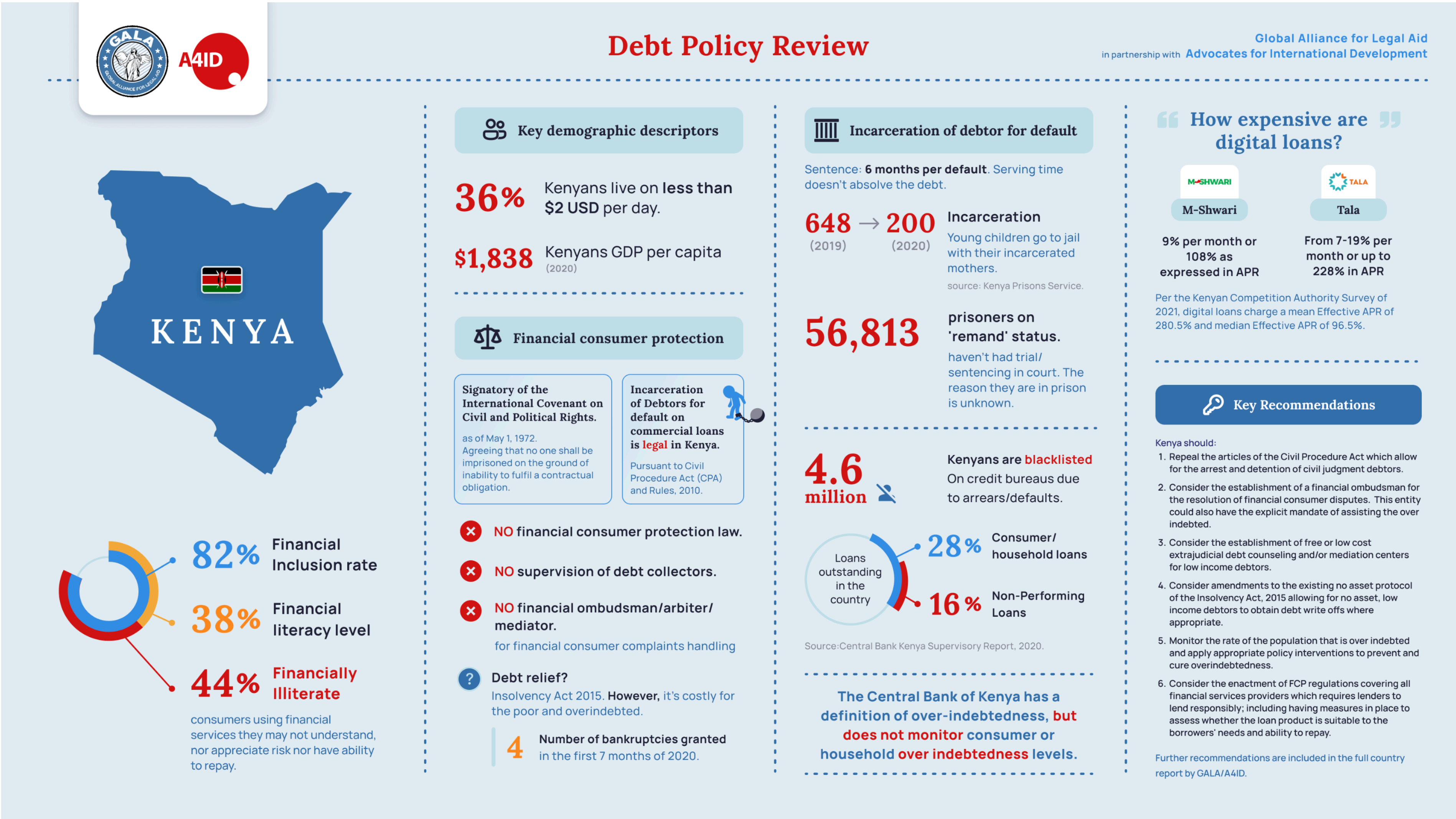
[72] AFCA has the specific mandate to assist financial consumers in debt difficulty. See https://afca.org.au/make-acomplaint/financial-difficulty

Appendix I: Kenya Debt Policy Review Summary[73]



[73] Found at: https://globalalliance4legalaid.org/portfolio/kenya/