EVALUATING THE ADEQUACY OF THE LEGAL AND REGULATORY FRAMEWORK OF MOBILE MONEY TRANSACTIONS IN KENYA

UNIVERSITY OF NAIROBI
SCHOOL OF LAW

RESEARCH SUBMITTED IN PARTIAL FULFILMENT OF THE MASTER OF LAWS (LLM)
(GPR 699)

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G62/75402/2014

OCTOBER 2019

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DEDICATION

To my lovely wife and children

ACKNOWLEDGEMENT

I would like to express my gratitude to Dr. Peter G. Munyi for his guidance and direction to produce this work. I also thank all the various professors and lecturers who taught us in this program.

I would also like to acknowledge my classmates and colleagues in the profession. It was great to share a platform with them.

Finally to the University of Nairobi for granting me the opportunity to pursue a Master of Laws (LL.M) degree.

LIST OF ABBREVIATIONS

AML- Anti Money Laundering

ATM-Automatic Teller Machine

BCLB - Betting Control and Licensing Board

CBK-Central Bank of Kenya

CDD - Customer Due Diligence

CFL- Combating the Financing of Terrorism

CMA-Capital Markets Authority

FSD - Financial Services Development

FDCF - Financial Deepening Challenge Fund

ICT- Information Communication Technology

IMF- International Monetary Fund

IRA-Insurance Regulatory Authority

KBA Kenya Bankers Association

KYC - Know Your Customer

MMTs- Mobile Money Transfer services

MNO- Mobile Network Operators

MFS- Mobile Financial Services

MVNO-Mobile Virtual Network Operator

NSSF-National Social Security Fund

SACCO-Savings and Credit Cooperative Society

SAP- Structural Adjustment Programs

UK- United Kingdom

USD- United States Dollar

CHAPTER ONE: INTRODUCTION

1.1 Introduction

The advent of mobile money transactions has without doubt revolutionized the financial services sector.[1] It has greatly promoted financial inclusion in many countries, with the rural and marginalized communities now able to access financial services with greater efficiency, through this technological innovation. Mobile money has enabled financial institutions to offer services through reduction of transaction points as well as offering alternative to paper dependency in transactions.[2] Additionally, the economic growth in many developing countries has been attributed to this development.[3]

Whereas great success is being ascribed to the evolution of mobile money transfers and payment services, its existence has inevitably occasioned the integration of several sectors which were previously independent. The most affected are the financial and communication sectors.[4] This assimilation has led to the development of mobile money services, which has also necessitated the need to adapt new legal and regulatory framework to accommodate this innovation. Regulation of mobile money is thus accredited to the fact that in the offering of services, the consumers, service providers as well as stakeholders' needs must be protected.[5] Additionally, technological innovations are known to also pose several risks which are likely to affect the economic structure, and thus must be supervised and controlled.[6]

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[1] Muthiora B, '*Enabling Mobile Money Policies in Kenya: Fostering a Digital Financial Revolution*' Bill and Melinda Gates Foundation (2015)

[2] Barnes S.J and Corbitt B. "Mobile banking: concept and potential"; *International Journal of Mobile Communications*, 1, 3, 273-288 (2003).

[3] Kato G.K. 'Mobile Banking and Performance of Commercial Banks in Kenya' *International Journal of Current Research Vol. 6, Issue, 12, pp.10670-10674,*(2014)

[4] Makin, P., 'Regulatory Issues Around Mobile Banking: *New initiatives to bank the poor are straining the world's financial Regulatory Systems.'* http://www.chyp.com> accessed 25 June 2016

[5] Muthiora B, '*Enabling Mobile Money Policies in Kenya: Fostering a Digital Financial Revolution'* Bill and Melinda Gates Foundation (2015)

[6] Ibid (n.1)

The launch of MPESA[7], a mobile money transfer application set Kenya in the global sphere as a pioneer in mobile commerce transactions. Subsequently, its growth has led to Kenya being viewed as successful in its implementation of mobile money transactions.[8] Despite this appreciation, the regulatory framework for mobile money transactions in Kenya has not developed proportionately. To date, Kenya's regulatory framework adopts both the aspects of communication technology and banking sectors in regulating mobile money services. At the inception of this innovation, the preexisting banking regulations were used to regulate the market, which overtime proved ineffective.[9]

Kenya has since then continually struggled to formulate dynamic legislations to regulate mobile money transactions, until 2011 or thereabouts when it substantially drafted sector specific guidelines, with the help of stakeholders.[10] The Electronic Money Issuers and Electronic Retail Transfer Regulations of 2011[11] were the first guidelines to be created to regulate mobile money transfers and payment services in Kenya. Subsequently, the National Payment Systems Act[12] was enacted.

Notwithstanding the enactment of legislation and resultant regulations and other enabling guidelines, several challenges continue to arise in the implementation of the law. First, policy makers and regulators still grapple with difficulties in drawing parallels between mobile money transactions and traditional banking services.[13] Although there have been attempts to distinguish the two by trying to adopt various implementation models, there appears to be no clear framework to be adopted.[14] The second shortcoming is attributed to the risks that span across the financial, communication and technology sectors. This interlink has obviously created coordination challenges which has led to

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7 Klein M & Mayer C., 'Mobile Banking and Financial Inclusion: The Regulatory Lessons' *Frankfurt School – Working Paper Series* No. 166 (2011)

8 Kato G.K. 'Mobile Banking and Performance of Commercial Banks in Kenya' *International Journal of Current Research Vol. 6, Issue, 12, pp.10670-10674,* (2014)

9 Muthiora B, '*Enabling Mobile Money Policies in Kenya: Fostering a Digital Financial Revolution'* Bill and Melinda Gates Foundation (2015)

10 ibid

11 Electronic Money Issuers and Electronic Retail Transfer Regulations, 2011

12 National Payment Systems Act, 2011

13 Barnes S.J & Corbitt B. "Mobile Banking: Concept and Potential"; *International Journal of Mobile Communications*, 1, 3, 273-288. (2003.)

14 Makin, P., 'Regulatory Issues Around Mobile Banking: *New initiatives to bank the poor are straining the world's financial Regulatory Systems.'* http://www.chyp.com> accessed 25 June 2016

inconsistent and contradictory regulations.[15] Similarly, analysts have raised concern over the need to strike appropriate balance over the need to regulate the sector without stifling innovation and growth.[16]

It is in the appreciation of these shortcomings in the application of mobile money transactions regulatory framework that this study proceeds to evaluate the adequacy of the existing mobile money transfers and payment services legal and regulatory framework in Kenya. The study will attempt to provide its recommendations on the most viable regulatory framework that should be considered for Kenya.

1.2 Statement of the Problem

Commercial transactions have traditionally been undertaken on a cash basis over the counter, which also involves personal interactions.[17] However, this new paradigm now involves such transactions being conducted through mobile phones and other wireless devices[18]. The evolution of mobile money services has thus integrated both banking and communication technology sectors.[19]

Consequently, due to the complexities and other incidental risks, there is need for enhanced regulation over this innovation to protect both consumers and service providers.[20] Although the Kenyan mobile money sector has tailored legislation to regulate mobile money transactions, there are several shortcomings which arise from the inter link in the different sectors.[21] Additionally, the existing laws are still inappropriate and inadequate to cater for the evolving mobile money sector.[22]

1.3 Research Objectives

The objectives of this study are:

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[15] Ibid (n.14)

[16] Muthiora B, '*Enabling Mobile Money Policies in Kenya: Fostering a Digital Financial Revolution*' Bill and Melinda Gates Foundation (2015)

[17] Barnabas Andiva, '*Mobile Financial Services And Regulation In Kenya'* Competition Authority of Kenya (2014)

[18] Abigael J, Sangoro *O,* 'Effects of Mobile Banking on Customer Satisfaction: A Case of Equity Bank of Eldoret Town' *International Journal of Innovative Research in Management,* (Issue 2 volume 3 March 2013)

[19] Barnes S.J & Corbitt B.. "Mobile banking: concept and potential"; *International Journal of Mobile Communications*, 1, 3, 273-288. (2003)

[20] Muthiora B, '*Enabling Mobile Money Policies in Kenya: Fostering a Digital Financial Revolution'* Bill and Melinda Gates Foundation (2015)

[21] Barnabas Andiva, '*Mobile Financial Services And Regulation In Kenya'* Competition Authority of Kenya (2014)

[22] Ibid (n.9)

a. To examine, the development of Kenya's legal and regulatory framework for the mobile money services

b. To review the existing legal and regulatory instruments governing the mobile money services and payment transactions in Kenya today

c. To analyze the shortcomings of the existing legal and regulatory framework for mobile money services in Kenya

d. To make recommendations for the formulation of an appropriate legal and regulatory framework model that would facilitate the smooth operations of mobile money services in Kenya.

The study addresses its objective by seeking answers to four pertinent questions derived from it. These questions are stated herein below.

1.4 Research Questions

This research endeavors to answer the following questions:

a. How has the development and growth of mobile money services and payment systems in Kenya evolved to date

b. What are the existing legal and regulatory instruments that presently govern mobile money services in Kenya

c. What are the inadequacies of the existing legal and regulatory framework which hampers effective regulation in mobile money services transactions in Kenya

d. What would be the most viable legal and regulatory framework that would facilitate the efficient regulation of mobile money services in Kenya?

1.5 Hypothesis

a. The existing legal and regulatory framework of Kenya's mobile money transfers and payment services is insufficient and inappropriate. This scenario continues to expose the consumers and service providers to many economic legal risks with lack of appropriate redress mechanisms.

b. Since the evolution of Kenya's mobile money services is considered as successful, many developing countries may use it as a case study. Unless the legal and regulatory framework is adequately formulated, then there is likelihood that other jurisdictions may replicate its inadequate model.

c. Mobile money transactions adopts both banking and communication technology aspects. Due to its unique nature, it requires customized regulations, which are unique to the market within which it is applied, in order for both consumer and stakeholder interests to be protected.

1.6 Research Methodology

The initial approach was to consider the problem of regulation from a purely legal perspective. However, several theoretical factors made this legal approach inadequate on its own to evaluate the adequacy and the development of the regulatory framework governing mobile money services in Kenya. Subsequently, the research study heavily relied on secondary sources. The study was through desktop analysis of statutes, working papers, theses, reports, journals, peer-reviewed and non-peer reviewed articles, electronic journals, as well as complimentary laws and international or local jurisprudence that aided in understanding the regulatory framework for mobile money payment services in Kenya.

1.7 Justification of the Study

Mobile money services has greatly promoted financial inclusion[23] in Kenya and also impacted on the economic growth of the country.[24] This study is influenced by the peculiarity of mobile money

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[23] Barnabas Andiva, '*Mobile Financial Services And Regulation In Kenya'* Competition Authority of Kenya (2014)

[24] Abigael J, & Sangoro O 'Effects of Mobile Banking on Customer Satisfaction: A Case of Equity Bank of Eldoret Town' *International Journal of Innovative Research in Management, (*Issue 2 volume 3 March 2013)

transactions and the fact that its development has encompassed the necessity for service providers and consumer protection thus requiring supervision and regulation of its operations.[25]

Despite the growth of the sector in Kenya, the legal and regulatory framework continues to be in its formative stages of development and hence the numerous changes that continue to evolve require an effective model for regulating the sector.[26] Currently, the several shortcomings witnessed in the sector are evidence of the insufficient legal and regulatory provisions for mobile money services in Kenya.[27] This study offers insight on how mobile money service providers, regulators, and policy makers can enhance the legal and regulatory framework in order to strike a balance between offering prudential and risk-based supervision and encouraging innovation, efficiency, and financial inclusion.

This study increases awareness of the shortcomings of the existing regulatory framework of mobile money and serves as a guide for future regulatory models that would be drafted by developing countries. Finally, it offers recommendations which could be adopted by stakeholders to lobby for policy refinement and engage in collaborative discussions with the regulators and policy makers on the regulatory reforms that are necessary to develop innovative financial systems.

1.8 Limitations

This study is limited on mobile money transactions in Kenya. It therefore does not look into the broader aspects of regulation of mobile commerce, which includes banking and other intermediaries. While there are many theories on regulation, this study focuses only of the economic theory to regulation.[28] Further, the study also focuses on mobile commerce service providers, consumers, the regulators and policy makers. The major limitation to this study is the inability of the researcher to conduct interviews with the regulators and other stakeholders due to time constraints. However, this limitation will be overcome by reliance on secondary sources for data and information.

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[25] Barnabas Andiva, '*Mobile Financial Services And Regulation In Kenya'* Competition Authority of Kenya

[26] Muthiora B, '*Enabling Mobile Money Policies in Kenya: Fostering a Digital Financial Revolution'* Bill and Melinda Gates Foundation (2015)

[27] Ibid (n.26)

[28] R. Baldwin & M. Cave, *Understanding Regulation: Theory, Strategy, and Practice*, (Oxford: Oxford University Press, 2, 1999.)

1.9 Theoretical Framework

This study relies on Lessig's Theory on Regulation.[29] Baldwin and Cave[30] state that regulation may refer to a specific set of commands devised for a particular purpose and covers all government action designed to respond to a particular type of behavior or activity. It may also refer to any form of influence that affects behavior whether or not this emanates from the state or other sources, such as the market.[31]

Lawrence Lessig[32] describes the modalities of regulation to include law, norms, market and architecture. His main thesis is simple and applicable beyond the technological realm, hence his theory is considered successful by researchers'. According to his theory, which is popularly understood as a command of the sovereign coupled with the threat of an *ex post*[33] sanction for a violation. These, he identifies to be only one of the ways in which behavior may be regulated, and not necessarily the most efficient one. He also offers other factors or restraints that may have an impact on our behavior which include social norms, markets and what he refers to as 'architecture'.[34]

According to Lessig, social norms control how we behave in different circumstances and therefore exert a regulatory effect. For instance, prices within a market can regulate the extent to which people are able to communicate and therefore impact their lifestyle.[35] By 'architecture', Lessig means 'the physical world as we find it,' which obviously has consequences for the way in which we behave. Thus, the state cannot only use the law to achieve a certain desired results but it can also influence and change the other three factors through regulation.

In this case regulation is indirect and often invisible to the subject, because it is channeled through non legal modalities. As an illustration, Lessig uses the example of the regulation of smoking and the consumption of cigarettes (that is, market regulation); it may provide a public education programme

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29 L. Lessig (1997a) *Code: And Other Laws of Cyberspace*. New York: Basic Books. The same ideas are discussed more in depth in Lessig (1999b). 506

30 R. Baldwin & M. Cave, *Understanding Regulation: Theory, Strategy, and Practice*, (Oxford: Oxford University Press, 2. 1999)

31 Ibid (n.30)

32 Ibid (n.29)

33 For the purpose of this paper, *ex post* refers to measures that arise in reaction to the decisions and activities of entities while *ex ante* is used in respect of regulatory measures that proactively control the structure and/or behavior of market players going forward.

34 Lessig (n. 86 above) 507; Lessig also calls architecture 'code' hence the title of his book (1999a).

35 Lessig (n.29)

(that is, an attempt to regulate social norms); or it may control the amount of nicotine in cigarettes (that is, changing the 'architecture' of cigarettes). Clearly, all these may have an effect on the consumption of cigarettes, to the benefit of the regulation, though each also has a cost attached. Given the value that society places on autonomy, it may be that the education approach is preferred to the 'architectural' regulation. A common feature of regulation by architecture is that it removes the individual's ability to choose whether or not to comply. Alternatively, 'norms', 'market', and 'architecture' can be left untouched by the regulator, who may leave it to the individuals to protect themselves as well as they can.[36]

In the context of mobile money transfer and payment services, codification comes to the forefront of the regulatory debate, because the entire regulatory domain is man-made and thus easily manipulated by private or public actors.[37] Critics of this theory argue that mobile commerce should not be regulated. They argue that behavior in the mobile commerce sector ought to be beyond government's reach.[38] Further, that the multinational nature of mobile commerce makes control by government impossible. This argument assumes that the nature of mobile commerce is fixed, that its architecture, and the control it enables, cannot be changed or that government cannot take steps to change this architecture. Neither assumption is correct. Mobile money has no particular architecture that cannot be changed. Thus influencing the architecture of mobile commerce to achieve a regulatory objective becomes a highly attractive option for the regulator.[39]

Codified regulation[40] on the other hand has numerous advantages. First, compliance with codified regulation is compulsory hence it exhibits high rates of compliance. Although, as Lessig notes, the modalities interact with each other, and the use of indirect regulation via code may result in negative social or market responses. Secondly, codification is self-enforcing, thus saves significant costs that would be associated with ordinary law enforcement. Finally, in compliance, the subject needs not have any awareness of it nor of the legal duties that the codification implements. In contrast, to ensure compliance with direct regulation, it is necessary for the government to raise awareness of the law, because such awareness is prerequisite for the subject's decision to comply with it.

[36] Ibid (n.29)
[37] Ibid (n.29)
[38] Ibid (n.29)
[39] Ibid (n.29)
[40] R. Baldwin & M. Cave, *Understanding Regulation: Theory, Strategy, and Practice*, (Oxford: Oxford University Press, 2. 1999)

Codification[41] as a regulatory tool also has its shortcomings. Firstly, because codification does not need visibility to be effective, the state can easily influence behavior without attracting much attention.[42] Thus, codified regulation may lack transparency and proper democratic accountability. Lessig argues that the government gets an effect at no political cost. It gets the benefit of what would be an illegal and controversial regulation, without even having to admit any regulation exists.[43]

Secondly, codified regulation omits the concept of 'moral agency' or personal autonomy.[44] The subjects do not get to decide whether to comply with the law or not, because that decision is forced upon them through the physical restraint.[45] Critics however argue that this is not bad because the habitual compliers simply do what they would have done anyway and those that have broken the law are forced to comply with it. The result is an end to freeloading and greater fairness all around.[46] The greatest critique to Lessig's theory, Brownsword[47] argues that, liberal society gives people the freedom to comply or not to comply with the law. This is not simply legal indulgence, but an essential attribute of liberal society in which personal choices (even if they are bad and later penalized) are respected as a requirement of human dignity and being an autonomous actor.[48]

The theoretical framework to this study assists the author in making the arguments for the need of an efficient and effective legal and regulatory framework for mobile money transactions. Additionally, it supports the case for the need for the protection of the interests of the service providers, consumers and other stakeholders in the mobile money services sector.

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41 Ibid (n.40)
42 Lessig (n.29)
43 Ibid (n.29)
44 Ibid (n.29)
45 R. Brownsword 'Code, control and Choice: Why east is east and west is west' (2005) 25 *Legal Studies* 1.
46 Ibid (n.46)
47 Ibid (n.46)
48 Ibid (n.46)

1.10 Literature Review

To buttress the necessity of exploring the regulatory aspect with respect to mobile money transactions in Kenya, Maore and Mutembei[49] reaffirm that an enabling legal and regulatory environment is important in the development of mobile money services. The authors' arguments are important to the study as they assist in the formulation of the hypothesis that unregulated mobile money markets operating in inappropriate regulatory frameworks poses economic risks to the consumers of mobile money services with no recourse for compensation.[50]

Duncombe and Baoteng[51] articulate that extensive literature on mobile money tends to over emphasize on economic theories to explain the rapid development of mobile money. The authors delve on the theoretical approach, which has been adopted by this study. They also state that that most of the studies on mobile money concentrated on adoption and market analysis of mobile money thus neglecting other aspects. In view of this, we focused the study on regulation, which plays quite a fundamental role in the development of mobile money.

Brian Muthiora[52] offers insights on Kenya's revolutionary journey in the adoption of mobile money services. It gives a historical summary of the progress of mobile commerce in Kenya, and a further analysis of the MPESA application, which was developed in Kenya in 2007. The author also discusses some of the factors that have led to the successful implementation of mobile money services in Kenya. The author notes that the broad access to financial services has been made possible by mobile network operators (MNOs) leveraging their technology, ubiquitous distribution networks, and partnerships with banks to deliver mobile financial services to unbanked and underserved segments of the population.[53] Mobile money has enabled anyone in Kenya with access to a mobile phone to perform basic financial transactions without having to use a bank account or rely on riskier, less efficient methods like delivering cash in person. The insights provide by this

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49 KE Maore & C. Mutembei 'Critical Literature Review on Mobile Banking Regulatory Overlap and Gap in Kenya' Research paper Submitted to the 2011 Operation Research Society of Eastern Africa (ORSEA) Conference, Nairobi: University of Nairobi. Available at <www.orsea.com> [accessed 19 June 2016]

50 Ibid (n.49)

51 R. Duncombe & R. Boateng 'Mobile Phones and Financial Services in Developing Countries: A Review of Concepts, Methods, Issues, Evidence and Future Research Directions, 30 (7) *Third World Quarterly*, 1237-1258. (2009)

52 Muthiora, B., '*Enabling Mobile Money Policies in Kenya: Fostering a Digital Financial Revolution'* Bill and Melinda Gates Foundation (2015)

53 Ibid (n.52)

author are specifically beneficial to Chapter two of this study, which looks at the historical development of mobile commerce in Kenya and the existing legal and regulatory framework.

Michael Klein and Colin Mayer[54] set out a framework for considering the design of regulation of mobile banking. They discuss the features of mobile banking and further state that many countries have replicated the regulatory framework in Kenya, based on the success of MPESA. Despite this, they attest that Kenya and many jurisdictions continue to struggle with adapting banking regulation to mobile banking because minimal thinking has been developed so far about how mobile money may be different from traditional banking. Existing attempts according to them include the distinction between "bank-based" and "telco-based" mobile money schemes.[55] The authors have articulated the research problem of this study and they describe the various alternative regulatory approaches to the risks inherent in the different components of financial services. The authors also summarize basic approaches that can be taken to assessing regulatory and competition policy implications of "mobile" payments and saving services and discusses the wider implications of the analysis for the regulation of banking and financial services in developed as well as developing economies.

Barnabas Andiva[56] examines the concerns in Mobile Financial Services (MFS) in regard to regulation in Kenya and attempts to address them by giving suggestions that are geared towards minimizing exposure of consumers. He acknowledges that mobile commerce transactions is a fast changing sector because of the technological advancement and thus there is a danger of the legislative framework not evolving as fast which brings the questions of whether the regulators have the technical capacity and competence to regulate effectively. The author attempts to contextualize the existing mobile money services sector in Kenya and also offer solutions of mitigating the challenges in this sector in Kenya.[57]

Kinuthia and Akinnusi[58] come up with an array of factors which tends to inhibit the adoption of money services in Kenya. These include first, the lack of resources and that this was one of the

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[54] Michael Klein and Colin Mayer, 'Mobile Banking and Financial Inclusion: The Regulatory Lessons' *Frankfurt School – Working Paper Series* No. 166 (2011)
[55] Ibid (n.54)
[56] Barnabas Andiva, '*Mobile Financial Services And Regulation In Kenya'* Competition Authority of Kenya (2014)
[57] Ibid (n.56)
[58] Kinuthia and Akinnusi, '*The Magnitude of Barriers Facing e Commerce Businesses in Kenya*' (2009)

reasons why banks had resulted to alliances in order to pool resources. Second is the constant change in technology and time available to develop systems. They note also that a major challenge was the lack of spread of accessibility and use of Internet by the general population, especially in the rural areas. They observe that e-banking introduced new risks requiring new risk management strategies, including Internet security, customer and legal related issues. The study concludes by emphasizing the role of Kenya Government in achieving a secure environment for e-banking activities.[59] The government needs to put in place clear laws, rules and regulations, provide relevant technical training to the regulatory authority to empower them to enforce the laws effectively.

Vivienne Lawack-Davids[60] discusses the South African Regulatory framework on mobile commerce transactions. She articulates that South Africa has elaborate legislation for the regulation of mobile commerce through various Acts which include the Independent Communications Authority of South Africa Act 2000 (ICASA Act),[61] Interception and Monitoring Act 2002,[62] Electronic Communications and Transactions Act 2002 (ECTA)[63] and the Communications Act of 2006[64] which will regulate the convergence of technologies in the ICT sector.[65] She argues that the usage of mobile banking and in particular, payments by means of mobile phones, has increased in recent years, with consequent impacts viewed from a legal and regulatory point of view. This paper seeks to examine the legal and regulatory framework pertaining to mobile banking, and in particular, mobile payments in South Africa. Regulatory gaps and areas for improvement are highlighted. The author argues for a more flexible approach to regulation in South Africa.[66]

Orioki[67] and Aloo[68] both discuss the regulatory framework governing mobile money transactions' in Kenya. Their studies were however conducted prior to the enactment of the National Payment

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[60] Lawack-Davids, K., 'The Legal and Regulatory Framework of Mobile Banking and Mobile Payments in South Africa' *Journal of International Commercial Law and Technology* Vol. 7, Issue 4 (2012)

[61] Independent Communications Authority of South Africa Act 2000

[62] Interception and Monitoring Act 2002

[63] Electronic Communications and Transactions Act 2002

[64] Communications Act of 2006

[66] Lawack-Davids, V., 'The Legal and Regulatory Framework of Mobile Banking and Mobile Payments in South Africa' *Journal of International Commercial Law and Technology* Vol. 7, Issue 4 (2012)

[67] Orioki F 'Mobile banking regulation in Kenya: which way, bank-based or telco-based?' Thesis in Partial Fulfillment of Master of Laws, (University of Nairobi, 2011).

[68] Aloo L.O 'Mobile *Banking in Kenya Recent developments – A Legal Practitioner's Perspective'* Paper presented at UNICITRAL International Colloquium on Microfinance, (Vienna, 2011).

Systems Act[69] and the e-money regulations[70] and, therefore, their arguments were solely anchored on advocating for a regulatory framework to govern mobile money and thus end the uncertainty as to who between the Communications Authority of Kenya[71], as it then was and the Central Bank of Kenya[72] had the legal mandate to regulate the sector. On the other hand, this study is being carried out after the legislative and regulatory enactments thus enabling us to evaluate the regulatory framework with the benefit of hindsight.

1.11 Chapter Breakdown

Chapter one introduces the research topic in the area of mobile money transactions in Kenya. It also discusses the background, the hypotheses and the research questions which the study seeks to address. Literature review and research methodology used have also been highlighted. The conceptual framework of the study is also addressed.

Chapter two attempts to analyze the origins and development of mobile money transactions. This analysis is backed by the adopted theoretical approach. This chapter is important because it creates a platform for the following discussions on the quest for an appropriate legal and regulatory framework in the development of mobile money transfers and payment services in Kenya.

Chapter three discusses the existing legal and regulatory framework in Kenya. In so doing, it defines the existing legal and regulatory model of mobile money transactions in Kenya. This chapter attempts to identify the shortcomings of this framework in addressing the identified challenges as well as other emerging trends in the market.

Chapter four undertakes an analysis of the specific shortcomings of the existing legal and regulatory framework on mobile money transactions. The aim of this analysis is to identify some of the areas of improvement which may be adopted by Kenya in streamlining its regulatory model. Chapter five gives a summary of the study and provides its recommendations which could be adopted for the mobile money market in Kenya. This chapter also addresses the hypothesis that has been made in the study.

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69 National Payment Systems Act No. 39 of 2011 Laws of Kenya

70 Electronic Money Issuers and Electronic Retail Transfer Regulations, 2011

71 Kenya Information and Communications Act, Chapter 411A Laws of Kenya

72 Central Bank of Kenya Act Chapter 491 Laws of Kenya

CHAPTER TWO: THE DEVELOPMENT OF KENYA'S LEGAL AND REGULATORY FRAMEWORK FOR MOBILE MONEY TRANSACTIONS

2.1 Introduction

Mobile money is considered as fast evolving in the financial sector with new developments arising frequently. This is primarily because of the dramatic increase in the number of mobile network operators, the number of people having access to mobile phones and the number of commercial banks that have adopted agency banking; and second, the prominent presence of Mobile Money Transfer services (MMTs) and payment services on the financial scene. Many commercial banks are now offering mobile money financial products. Many scholars have attributed the emergence, growth, and success of the mobile money market in Kenya to various factors such as the regulatory environment;[1] the landscape of the mobile phone market;[2] retail landscape;[3] and, product design[4] among others.

This Chapter discusses the background of the origins and development of the regulatory framework governing mobile money transactions in Kenya. It also analyses how this evolution has shaped the different approaches that have existed in the regulation of mobile money transactions and thus looks at the most appropriate model for Kenya's case. For purposes of this Chapter, M-PESA being the main proxy for mobile money transactions in Kenya will be used as a case study because of its success and longer history.

2.2 Historical Background of Mobile Money in Kenya

Mobile money is monetary value that is readily available to a user for purposes of conducting transactions through a handheld device. It is acceptable as a means of payment by parties apart from

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[1] CGAP. "Interoperability and the Pathways: Towards Inclusive Retail Payments in Pakistan." June 2012; A. Heyer & I. Mas (2011) "Fertile Grounds for Mobile Money: Towards a Framework for Analyzing Enabling Environments" January 2011; International Finance Corporation (IFC, 2011) "IFC Mobile Money Study 2011". International Finance Corporation; B. Cobert, B.Helms & D. Parker. (2012) 'Mobile Money: Getting to Scale in Emerging Markets.' (McKinsey on Society, 2012)

[2] A. Heyer & I.Mas 'Fertile Grounds for Mobile Money: Towards a Framework for Analyzing Enabling Environments' (2011.)

[3] A. Heyer & Mas (n.74)

[4] B. Cobert, B. Helms & D. Parker. 'Mobile Money: Getting to Scale in Emerging Markets.' (McKinsey on Society, 2012.)

the issuer, issued on receipt of funds in an amount that is commensurate to the available monetary value, redeemable for a cash equivalent and electronically recorded.[5]

Over the past twenty years, mobile money has developed rapidly, having begun in the Philippines in 2001. SMART Communications, a leading national mobile telecommunications operator in the Philippines launched SMART money in December 2000 with objectives to differentiate itself in the market where text and voice services had become commoditized, and in the process reduce customer complaints.[6] This launch thus positioned SMART Communications as a pioneer provider of mobile transactions[7] in the world.

Similarly, Kenya is considered as a pioneer provider of mobile transactions in Africa. The M-PESA application is considered the most successful in mobile money.[8] Prior to the introduction of M-PESA, Kenya was already uniquely positioned for an alternative approach to traditional banking. From the 1990s, most of rural Kenya was excluded from the conventional banking sector as a result of the effects of structural adjustment programs (SAPs)[9] that had been designed and funded by the

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5 Ndirangu, M., '*Kenya Today: Breaking the Yoke of Colonialism in Africa*. (New York: Algora Publishing 2005); See also JK Rono 'Impact of Social Adjustment Programmes on Kenyan Society. 17(1) *Journal of Social Development in Africa* 81-98 (2002).

6 Wishart, N.A., 'Micro-Payment Systems and their Applications to Mobile Networks.' An InfoDev Report Washington, DC: The International Bank for Reconstruction and Development/ The World Bank. (2006)

7 Standard mobile transactions include pre-paid airtime top-up, transfer between accounts; cash deposits, withdrawals and transfers; ability to be able to receive deposits from third parties; and retail purchases and bill payments.

8 M-PESA is a money transfer product that is operated by Safaricom Limited, Kenya's largest mobile operator network but owned by Vodafone through a trust company. The prefix "M" is for mobile while "Pesa" is the Kiswahili word for money. M-PESA simply put is an electronic payment as well as store of value system that can be accessed via mobile phones.

9 They are sets of economic and institutional policies that that were designed by the World Bank and the IMF to reduce and eventually eliminate unsustainable internal and external imbalances in economies. They evolved as a result of three global crises, that is, oil crisis, debt crisis and "the international recession from the late 1970s to the early 1980s."Developing countries were the hardest hit by these consecutive international economic crises. Additionally, rapid population growth, mismanagement of the economy due to corruption and political instability compounded the economic deterioration in Sub-Saharan Africa. It was in response to these that the IMF and the World Bank formulated these policies. The purpose of the structural adjustment policies was to increase the flexibility of the economy to respond to changes, promote the efficiency of resource utilization, reduce trade deficits, and balance government expenditures and revenues. According to both the IMF and the World Bank, structural adjustment is a logical (and in many situations inevitable) avenue to achieve sustained economic growth and address long-term development needs. More information available at <http://wwwnew.lowson.edu/polsci/ppp/sp97/imf/POLSAP1.htm> accessed 12 August 2016.

International Monetary Fund (IMF) and World Bank, and later adopted by major financial institutions.[10]

This exclusion deprived many people in the rural areas the access to financial services, especially with regard to credit facilities and savings.[11] Thus, while a section of the population was unable to access traditional banking services because factors such as illiteracy,[12] stringent rules of the existing financial institutions,[13] distribution of banking services, among others and were thus forced to rely on their working family members and relatives[14] to send money to them through a combination of formal and informal channels, such as post office and friends, both of which had their own shortcomings.[15] On the other hand, there were the working or employed members of the society, most of who resided in the urban areas who needed an inexpensive albeit reliable means of sending money to their unemployed family members and relatives back in the rural areas.

Financial exclusion and shortcomings of the existing modes of sending money were key factors that played a critical role in setting up the stage for the development of a new system. M-PESA thus

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10 M. Ndirangu '*Kenya Today: Breaking the Yoke of Colonialism in Africa*. New York: Algora Publishing (2005); See also JK Rono Impact of Social Adjustment Programmes on Kenyan Society. 17(1) *Journal of Social Development in Africa* 81-98. (2002)

11 Manica L & Vescovi M., 'Mobile Telephony in Kenya; is it Making the Life Better?' (2009). <http://www.it46.se/projects/UNITN_ict4sd/assignments/ICT4SD_ manica_vescovi.pdf> accessed 16 August 2016.

12 A vast majority of the "unbanked population" was illiterate meaning that they were unable to complete the requisite documents needed to open a traditional bank account.

13 Existing financial institutions required one to maintain a certain a minimum amount of money in the account that allows it to be operational. Further, banks would close accounts that were inactive for extended periods of time. These factors evidently made the idea of opening and maintaining bank accounts "unattractive and expensive" for a large segment of the population. On the other hand, one would only need cash to open and operate an M-PESA accounts. Fees are not charged for deposits or withdrawals. "The only time one needs to pay fees is when sending money. Even then, the amount of fees paid per transaction is far less compared to what traditional banks charge".

14 A large percentage of "seniors, the poor, the unemployed and young adults" relied on their employed family members and relatives for financial support. According to the Results of the 2006 National Survey carried out by Financial Services Development (FSD), prior to the launch of M-PESA there were five popular methods of sending money to family, relatives and friends by 2007. Polling at 58%, the most popular method of sending money was through family or friends who were going to the same place as where "one intended to send the money." Its shortcomings, however, were its randomness, unpredictability, and the remoteness of the possibility that someone would be going in the same intended direction. Public bus companies, though second most popular (27%) were unreliable due to frequent cases of theft either "from bus employees, passengers or carjackers." At 24% and the third favorite, postal services (through money orders) were thought to be expensive because of the high commission charges plus they had poor service delivery. Depositing money into the receiver's account was the fifth most popular (at 11%) because it "assumed that the [receiver] had a bank account which was often not the case." The least popular was official money transfer companies such as Western Union which polled in at 9%. This was mostly because it "charged high commissions and was not always available in most regions, particularly in rural areas."

15 Nearly all the informal and formal local remittance options were either unavailable to the majority of the Kenyan populace or where they were available, most Kenyan consumers experienced "service gaps, inefficiencies, and unmet demand, particularly among the low-income population."

revolutionized money transfers in Kenya by bringing this segment of the unbanked population into the financial grid. According to a survey done prior to the launch of M-PESA by Financial Services Development (FSD), 14.3% of Kenyans relied on money transfers from family, relatives and friends as their main source of livelihood.[16] Furthermore, those who had bank accounts with the conventional banking institutions were also seeking for an alternative method that was simple, safe, fast, inexpensive, reliable, and efficient[17] with regard to sending money and paying for salaries since banks charged exorbitant fees for the services they offered.[18]

Thus the origins of the mobile money transfer service, M-PESA, as a means of addressing these needs can be traced to Vodafone's efforts to understand its role in addressing the underlying market needs.[19] Vodafone's approach involved the use of mobile phones to provide access to financial services which would subsequently facilitate entrepreneurial activity by creating wealth through trade, job opportunities and economic activity.[20] Thus, unlike SMART communications and Globe Telecom, both telecommunication operators in the Philippines, which entered the mobile transactions market using a commercial, profit-oriented, business investment approach, *Vodafone*[21] entered the mobile transactions market in Kenya, with its local affiliate, *Safaricom*, using a business experiment approach.[22] The research in this novel area of business was financed by the United Kingdom's Department for International Development (DFID) through the Financial Deepening Challenge Fund (FDCF)[23] which was subsequently awarded to *Sagentia*[24] to conduct the research.

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16 FSD Kenya (2009) FinAccess National Survey 2009: Dynamics of Kenya's Changing Financial Landscape. <http://www.fsdkenya.org/finaccess/documents/09-06- 10_FinAccess_FA09_Report.pdf accessed 18 August 2016.

17 Ngugi B, et.al 'M-PESA: A Case Study of the Critical Early Adopters' role in the Rapid Adoption of Mobile Money Banking in Kenya. '*The Electronic Journal on Information Systems in Developing Countries.* (2010)

18 Ngugi, Pelowski & Ogembo (n.89)

19 Hughes N & Lonie S 'M-PESA: Mobile Money for the "Unbanked": Turning Cell-phones into 24-Hour Tellers in Kenya.' *Innovations,* Mobilizing Markets, Special edition for GSMA Mobile World Congress (2009). p.79. Available at http://mitpressjournals.org/innovationsinnovationsjournal.net accessed 12 August 2016.

20 Hughes & Lonie (n.53 above).

21 Kramer, W et.al (2007) 'The Role of Information and Communications Technology Sector in Expanding Economic Opportunity.' *Corporate Social Responsibility Initiative Report* No.22. Cambridge, MA: Kennedy School of Government, Harvard University. 26.

22 Private sector organizations such as Vodafone are legally bound to use their shareholders capital to achieve the best returns. However, many organizations use internal competition to allocate funds to their projects, and this competition is pegged on potential returns on investment. As a result, you find that any initiatives that relate to the development agenda usually get cut.

23 It was established in 2000 by the U.K. government's DFID to make available £15m for joint investments with the private sector on projects that help improve access to financial services. So far, twenty eight projects have been funded in South Asia and Africa. The money is usually awarded on a match basis and a competitive bid process.

24 This is the company that was contracted by Vodafone and tasked with developing the M-PESA system as well as conducting needs assessment research on the ground in Kenya.

In partnership with FAULU Kenya,[25] a deposit taking microfinance institution, *Sagentia* introduced a pilot study of digital mobile banking using a mobile phone as a channel that allowed customers to receive and repay loans advanced to them by FAULU Kenya. The pilot study was so successful that the customers could deposit their weekly loan repayments from the comfort of their homes without having to travel to the city center. The success of this pilot study was such that it attracted the attention of market watchers acknowledged that the evolution would turn out to not only benefit consumers but also play the most crucial role in paving the way for to the introduction of M-PESA services.

Since its launch in 2007, the growth of M-PESA services has been phenomenal. In July 2007, there were just over 268,000 registered users.[26] Two years later, the number increased to 7.5 million, representing 34% of the population[27] with a growth of 2600%.[28] The frequency and value of transactions also increased rapidly; the former by 4600% and the latter by 3700%.[29] This explosive growth was also mirrored in the growth of M-PESA agents which grew to over 18,000 locations by April 2010, from a base of approximately 450 in mid-2007.[30] By contrast, Kenya only had 491 bank branches, 500 post bank branches, and 352 ATMs.[31] In July 2007, the value of M-PESA transactions was approximately 2% of commercial bank deposits. In two years, this increased to 4.4%.[32]

Further, between April 2007 and November 2009, P2P money transfers per month grew from US$1 to US$328 million while total mobile money amounted to KShs 205 billion, which is 7.5 million,

[25] It is a deposit taking microfinance limited liability Company that is duly incorporated in Kenya under the Company's Act. It later changed its name to Faulu Kenya Deposit Taking Microfinance Limited in 2008 as part of the requirements that were needed to obtain a deposit taking license from the Central Bank of Kenya. It was founded by the Food for the Hungry International (FHI)-a Christian relief organization, as a loan scheme program that targeted the economically active poor in Mathare.

[26] Morawczynski O., (2010) 'Examining the Adoption, Usage, and Outcomes of Mobile Money Services: The Case of M-Pesa in Kenya.' *Science and Technology Studies*- University of Edinburgh.

[27] According to the CIA (2010) 57% of 39 million of the population is over the age of 15. This means that just over 22 million of the population can be considered as adults. 7.5 million customers represents 34% of the adult population.

[28] Morawczynski, O (n.98)

[29] Ibid (n.98)

[30] Vaughan P., (2007) "Early lessons from the deployment of M-PESA, Vodaphones's own mobile transactions service" In the Transformational Potential of M-transactions, *Vodaphone Policy Paper Series,* No.6. Available at http://www.vodaphone.com/m-transactions accessed 18 August 2016.

[31] Ignacio M. & Ng'weno, A., 'Three keys to M-Pesa's success: Branding, channel management and pricing,' mimeo, Bill and Melinda Gates Foundation, December (2009).

[32] Morawczynski (n.98)

representing 34% of the population.[33] This is a growth of 2600%.[34] In 2012, over KShs 800 billion constituting about 30% of Kenya's GDP- was transferred within the mobile money system.[35] Drawing from the figures mentioned above, it is factual that mobile money makes substantial contribution to the economy.

Evidentially, the growth of M-PESA has surpassed other technologies in the country such as the internet, fixed line telephones as well as the mobile phone, which is infamously regarded as the fastest growing technology in Africa.[36] In light of the above data, the case of M-PESA demonstrates that ICTs can grow rapidly even within resource poor communities. Devoid of the fact that United Kingdom (UK) government provided the funding for the initial conceptualization, it was a mobile network operator that introduced the system into the market and instigated growth.[37] As such, it can be argued that M-PESA necessitates further investigation because it can reveal invaluable lessons to both developed and developing countries.[38]

2.3 Regulation of Mobile Money Transactions

Mobile money in Kenya as discussed above developed in an unregulated market. Its rapid growth over and above other money transfer methods such as bus companies, post office among others is what evidently caught the government's attention thus causing it to adopt regulations. Upon its inception in Kenya, the government employed traditional banking regulations to the regulation of mobile money.

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33 According to the CIA (2010) 57% of 39 million of the population is over the age of 15. This means that just over 22 million of the population can be considered as adults. 7.5 million customers represents 34% of the adult population.

34 Morawczynski (n.98)

35 Vaughan P., (2007) "Early lessons from the deployment of M-PESA, Vodaphones's own mobile transactions service" In The Transformational Potential of M-transactions, *Vodaphone Policy Paper Series*, No.6. Available online at http://www.vodaphone.com/m-transactions accessed 9 August 2016.

36 Aloo L.O.,(2010) 'M-Banking in Kenya: Consumer Protection Issues and Proportional Risk Regulation' IDLO Microfinance Publications (2010).

37 Hughes N & Lonie S., (2007). 'M-PESA: Mobile Money for the "Unbanked": Turning Cell-phones into 24-Hour Tellers in Kenya. *Innovations,* Mobilizing Markets, Special edition for GSMA Mobile World Congress (2009).
Available at http://mitpressjournals.org/innovationsinnovationsjournal.net accessed 22 August 2016.

38 Vaughan p (2007) *Early Lessons from the deployment of M-PESA: Vodafone's own Mobile Transaction Services- The Transformational Potential of M-Transactions*. London: Vodafone group.

Theorists such as Lessig[39] argue that in the fast evolving sector of mobile money transfer and payment services, there is need to employ regulation which ensures that the regulatory goals of the industry are met. The regulations must thus be not only dynamic, but also one that improves efficiency, predictability, transparency, legitimacy, and readability of the regulatory system.

2.4 Impact of Unregulated Mobile Money Transfer Services

There are many views on mobile money regulation. Some argue that the industry is substantial to economic development, hence need for regulation. In order to come up with sufficient rationale to regulation, one must consider the legal framework under which mobile money markets operate. There are two plausible aspects to regulation which must be considered.

First is the structure and operation of the mobile money market itself as distinct from the transactions taking place in the market. In an unregulated mobile money market, there is unrestricted and free access to the market place for mobile network operators and consumers of mobile money. These means that, there would be no requirement for licensing as a condition for engaging in a particular activity, nor are there likely to be standard rules governing the conduct of the market players.[40]

Second is the legal framework governing transactions in the mobile money market. In principle, a market can operate without regulation in circumstances where the law is sufficiently developed to provide certainty in respect of ownership interests,[41] their transfer and to provide enforcement mechanisms. Whereas many industries operate successfully without any regulatory intervention, an unregulated mobile money market may be difficult to operate without being regulated.[42]

In the case of M-PESA services, the payer, who in this case is the customer who deposits to or withdraws cash from his M-PESA account has a contractual claim against the MNO agent, who

[39] Lessig L., (1997a) *Code: And Other Laws of Cyberspace*. New York: Basic Books. The same ideas are discussed more in depth in Lessig (1999b). 506

[40] Such 'market rules' can be distinguished from contract law although both govern the conduct of contracting parties. The former are concerned primarily with the structure and operations of the market, the latter with the rights and obligations of the contracting parties. Market rules are associated with organized markets whereas ad hoc contracting can be governed only by contract law.

[41] M-PESA, the mobile money transfer and payment system, is considered by Safaricom Ltd and Vodafone as a financial investment. That said it is important to note that ownership rights in financial investments are essentially contractual rights which are considered to be 'property'.

[42] Ogus A., '*Regulations: Legal Form and Economic Theory*. (Oxford: Clarendon Press. 1994) chapter 3 & 10.

gives out and receives either cash or electronic money. This contractual claim can only be satisfied if the MNO agent has sufficient funds[43] to meet the claim. The payer does not own the money in the legal sense as the electronic value of the money stored with the MNO agent is owned by the MNO. Instead, the payer relies on the on-going ability of the MNO to repay the money stored with its agent when they fall due.[44] The trust placed by the payer in the financial soundness of the MNO is central to the transaction but, in most cases, is something that the payer cannot independently verify. Without regulation, such a market becomes open to abuse of trust by scrupulous operators running a mobile network in a way that not only threatens the interests of the payers as well as the integrity and stability of the entire financial system.

Unrestricted access to mobile money markets is thus a poor way of approaching the industry. Evidentially, there are several theoretical reasons which affirm that self-regulation on the part of market participants restricts market access thus affecting the existence or scale of the market.[45] The already analyzed development of mobile money transfer services in Kenya supports this view. Having initially operated in an unregulated environment,[46] the Central Bank of Kenya came into the mobile money market and issued operational guidelines. The net effect was to enhance and expand the capacity of the mobile money market, as regulation seemingly offered control and thus provided a higher level of confidence among market participants.

43The electronic money that the MNO agent has must always match the real money in the MNO's account.

44 For instance when a Payer (the customer) wants to 'deposit' KShs 300 to their M-PESA account, he or she will first have to go to a Safaricom mobile money agent and make a physical payment of KShs. 300. Once the payer does this, the Safaricom agent then gives him or her electronic money equivalent to the KShs 300 which the payer gave. The issuance of electronic money is not done physically but virtually. What this means is that the Safaricom agent credits the payer's (customer) account with the KShs 300 which he or she had received. You find that a mobile money agent can accept deposits until they exhaust their store of e-money. In the case of a withdrawal, the payer will undergo same process except that as opposed to giving out cash, he or she will be the one receiving money from the agent although subject to transaction fees.

45 Spencer P., '*The Structure and Regulation of Financial Markets*. Oxford: (Oxford University Press, 2000) 30-33; and for a historical perspective, CC Day 'Bits and Pieces and Moral Authority: The Paradox of Success in the "Unregulated" 19th Century New York Capital Markets' available at <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=572163> accessed 18 August 2016.

46 Safaricom got a 'no-objection' letter from CBK to launch M-PESA as there were no specific laws governing mobile money at the time. This was primarily because M-PESA was a peculiar concept that traversed previously "distinct and independent areas of regulation", most notably, the (ICT) and financial sectors. This essentially meant that it attracted regulation from both the telecommunication and financial regulators. However, being aware of the risk presented by "premature regulation" of the mobile money market, the telecommunication regulator, CAK (formerly CCK) and the financial sector regulator, that is, the Central Bank of Kenya (CBK) took a somewhat "open and flexible stance" towards mobile network operators that sought to bring the unbanked populations in Kenya into the financial grid by through mobile money services.

2.5 Regulatory Models for Mobile Money Markets

Since regulation of mobile money markets is paramount, it is thus important to address the issue of first, the most ideal form of regulation.[47]Regulation is majorly offered by either the government, the market itself or by both government and the market. The former is usually referred to as statutory regulation, the second as self-regulation and the later as co-regulation (hybrid).

Statutory regulation is attractive as it removes regulation from the control of market players and provides a clear logical framework for the exercise of the regulator's powers. For instance, M-PESA was launched in a vacuum of regulations given its novelty. This meant that the mobile money market could only self-regulate as there was an apparent lack of specific rules to govern it. However, with its rapid growth and lobbying from commercial banks, the government was forced to formulate regulations which had the effect of shifting control from the mobile money service providers to the government.

Self-regulation, on the other hand, offers the potential for regulation that is flexible and responsive to the market developments. It however, inevitably suffers from the risk that the system will evolve in a manner which favors the interests of market players over the broader public interest. While many countries now acknowledge that over reliance on self-regulation is no longer appropriate in the mobile money services sector, some such as Kenya, have allowed some degree of self-regulation within the mobile money market.[48] One particular reason why self-regulation has the propensity to be effective is that those directly involved with the activity themselves become the repository of the relevant expertise and information. Similarly, self-regulators have special appreciation of reasonable regulatory demands, which inevitably leads to higher levels of voluntary compliance and consequent regulatory efficiency.[49]

The division of regulatory models into discrete categories, while useful for theoretical discussions of particular regulatory techniques, is less helpful when engaging in actual regulation.[50]The level of this debate between these two regulatory extremes can sometimes foster the presumption that the two

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[47] Page A & Ferguson R., '*Investor Protection'*. (London: Weidenfeld & Nicolson. 1992) Chapter 6.

[48] Prosser, T.. 'Self-regulation, Co-regulation and the Audio-visual Media Services Directive' 31(1) *Journal of Consumer Policy*. 99, 100 (2008)

[49] Baldwin, R et.al '*A Reader on Regulation.' (*Oxford: Oxford University Press, 1998) 27.

[50] Ayres I & Braithwaite J., '*Responsive Regulation: Transcending the Deregulation Debate*.' (Oxford: Oxford University Press 1992). 157.

regulatory extremes of government regulation and self-regulation are mutually exclusive.[51] This is not the case and instead a hybrid system or co-regulation is usually needed.[52] Co-regulation or the hybrid system combines aspects of both statutory and self-regulations.[53]

The second issue to be considered is the manner in which the scope and operation of the system of regulation is defined. The two possibilities include either a functional or institutional regulation. Both have strengths and weaknesses. Functional regulation defines a particular activity and regulates any person engaging in this type of activity. Functional regulation takes into account the fact that particular activities are often carried out by different institutions. This is because there is evident blurring of the different activities between different types of financial institutions. The main challenge with this system is that it can give rise to problems of coordination where different regulators are responsible for different parts of an entity's business.

Institutional regulation on the other hand focuses on particular types of institutions and regulates whatever business is conducted by that institution. Institutional regulation allows the entire business to be controlled by a single regulator. This may lead to variable regulatory treatment of institutions in respect of the same business, where different regulators are responsible for different aspects of the institution's business.

There are various techniques that can be used to regulate the mobile money services sector. The most appropriate system of regulation is thus one that represents a mixture of disclosure, registration and compensation as techniques of mobile money regulation. These techniques are discussed hereinafter.

The purpose of disclosure is to resolve the information asymmetry which comprises a significant part of the rationale to regulation. It aims at making information available so as to enable consumers to make well-informed decisions, with the effect that the market functions optimally. Allied to disclosure there are a number of related devices such as registration.[54] Registration aims at making

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51 Sinclair D., 'Self-regulation versus Command and Control? Beyond False Dichotomies' *Law and Policy* 19(4) (1997) 529, 530-3.
52 Brownsword R., 'Code, Control and Choice: Why East is East and West is West' *Legal Studies* 3(2005) 25.
53 T. Prosser (n. 50) 111.
54 Page & Ferguson (n. 122) 30 distinguish between registration in principle from certification and licensing but note that, historically, there has been a tendency to combine registration with licensing.

information available to the public at large so that it can be used for any purpose in connection with the relevant company. For instance, with respect to mobile money in Kenya, the Central Bank of Kenya[55] has reserved the right to publish information across competing mobile money providers. Such information may include their transaction fees and quality of service as a way to protect consumers.

No modern system of financial regulation relies entirely on disclosure and nowadays, authorization or licensing has become a standard technique. The aim is to develop a perimeter from which unauthorized persons are excluded and within which the regulator can exert control over authorized persons. Here, the power of the regulator evidently lies on its ability to enforce sanctions on the non-compliant, with exclusion from the regulated activity. Usually, the regulator has wide latitude to grant or deny authorization. Presently, mobile money in Kenya is managed by MNOs. Although MNOs do not engage in banking business,[56]they are required to receive authorization from the Central Bank of Kenya[57] in order to deal with money. In order to receive clearance to operate, MNOs have to meet certain minimum requirements[58] established by the CBK.[59]

Compensation schemes are also a regulatory technique. Prudential supervision attempts to protect customers from insolvency, but it cannot provide a guarantee that insolvency will not occur not. Ordinarily, the purpose of compensation schemes is to provide a guarantee to the consumers that they will be compensated for losses resulting from the insolvency of an authorized person. The

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[55] Electronic Retail Transfers Regulations, 2011 (S. 12c)

[56] Banking Act, cap 488 of the Laws of Kenya (S. 2) provides for the licensing of banking business and defines banking business as: "Banking business means

a) the 'accepting' from members of the public of money on deposit repayable on demand, at the expiry of a fixed period or after notice;
b) the accepting from members of the public of money on current account and payment on and acceptance of cheques and finally;
c) the employing of money held on deposit or on current account, or any part of the money, by lending, investment or any other manner for the account and at the risk of the person employing the money."

Although mobile money operators accept money from the public as described in (a), they do not employ the money held on deposit as set out in (c), and therefore based on this definition, they are not licensed under the Banking Act as undertaking banking business.

[57] Central Bank of Kenya is established under the CBK Act, cap 491 Laws of Kenya. It regulates the banking system under the Banking Act, cap 488 of the Laws of Kenya

[58] While these requirements for a license are not in the public domain, Section 5 of the Electronic Money Issuers Regulations outlines them as: being a limited liability company, having a core capital of 60 million and financial stability, experienced persons to control the issuers (mobile money providers) processes, proper administrative and accounting procedures, good technology systems, effective audit functions, Know-Your- Customer (KYC) regulations, adequate business recovery plans among others.

[59] UNCTAD (n. 153) 19

requirement that a mobile money operator should have a compensation scheme, in the event of insolvency, is one of the techniques at the regulator's disposal that is used to bolster consumer confidence with the mobile money operators. Sometimes, compensation incorporates aspects of co-insurance where customers bear a proportion of the loss and limit the size of any financial award. For example, Kenya Bankers Association (KBA) has been urging the regulator to establish deposit-insurance regulations in respect of mobile money that can set minimum standards of funds recovery in the event of insolvency of the bank or of an MNO.[60]

2.6 Regulation of Mobile Money Services Prior to the National Payment Systems Act, 2011[61]

The common perception is that Kenya's mobile money market was dominated by self-regulation before the enactment of the National Payment Systems Act.[62] This perception is partly true to the extent that statutory intervention had less significant influence on the operation of markets than self-regulatory rules. However, there were also several instances of statutory intervention in the operations of the money transfer market.

Money transfer in Kenya was made in different forms which included individuals sending money through commercial banks, post office, couriers, bus companies, and friends. The Banking Act[63] and the Kenya Information and Communication Act[64] were subsequently enacted in 1991 and 1998 respectively to regulate money transfer services in Kenya. During this time, the use of mobile phones as a medium of communication had not developed in Kenya and by extension the rest of Africa. The use of mobile phones only took shape in the mid-2000s following the reduction in the costs of purchasing the mobile handsets. Even with the surge of the usage of mobile phones, primarily for communication, it took at least another eight years before the concept of mobile money transfer become a reality.

In 2007, when M-PESA was launched, there were no specific regulations governing mobile money. However, Safaricom Limited was issued with a letter of no-objection by the Central Bank of Kenya.

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60 Kimospo A., 'Banks Revive Battle with Mobile Money Service Providers' *Daily Nation* (Kenya, Nairobi) 28 January 2014, 3.

61 National Payment Systems Act 2011

62 National Payment Systems Act 2011

63 Banking Act, Chapter 488. Laws of Kenya

64 Kenya Information and Communication Act

This set the pace for the regulation of mobile money sector in Kenya. The launch of MPESA and the lack of clear regulations on its operation created conflict with banks which viewed M-PESA as competition. These conflicts still persist to date with banks trying to persuade CBK to enforce stringent rules upon mobile money service operators. With the rapid development of mobile money, the Central Bank of Kenya launched draft regulations intended to guide electronic retail transfers by banks and non-banking institutions.

These regulations came at a time when the Kenyan banking industry had increased their lobbying for a payments law that would more rigorously control electronic transactions.[65]The National Payment Systems Act was the result of the lobbying.[66] The Act brings all payment service providers, including mobile phone service providers, into one regulatory framework and provides the CBK with direct oversight of these providers to ensure their safety and efficiency.[67]

2.7 Conclusion

The Mobile Money Transactions (MMTs) and payment services industry in Kenya is peculiar, having evolved as a result of sporadic combination of both banking and telecommunications. As a hybrid system, it suffers from various challenges which include the overlap of functions amongst regulators and coordination failure among others. Therefore, unless the regulation is specifically tailor-made for this industry, the consumers and the service providers will continue to be jeopardized with economic risks described herein.

This chapter analyzed the impact of unregulated mobile money transfer on users and service providers. It thus confirms that there is need for customized regulation in the mobile money market. The chapter also discussed the regulation of mobile money services in Kenya prior to the enactment of the National Payment Systems Act and confirmed that before both self and statutory regulations were employed before its enactment.

[65] Buku M & Meredith M., 'Safaricom and M-Pesa in Kenya: Financial Inclusion and Financial Integrity' *Washington Journal of Technology and Arts* (2013) 375 394 available at <http://digital.law.washington.edu/dspacelaw/handle/1773.1/1204> accessed 17 August 2016.
[66] Buku & Meredith (n. 10).
[67] Buku & Meredith (n. 10).

This chapter also analyzed the different regulatory models that may be employed, while also taking into consideration ideal regulatory techniques. It reviewed the pros and cons of both self-regulation and statutory regulation. It thus came to the conclusion that in a practical market, the use of a mix of regulatory techniques is appropriate in order to achieve an effective solution. Since both statutory and self-regulations are both at the extreme opposites of each other, the chapter argues that a hybrid system or co-regulation provides a good starting point for an appropriate regulatory framework. However, the hybrid system needs to have proper oversight and enforcement mechanisms if it is to be successful as a regulatory model.

In the next chapter, the study thus analyzes the existing mobile money regulatory framework. It will review the National Payment Systems Act 2011, the draft e-money regulations, and an overview of the Kenya Information and Communication (Amendment) Act 2013 with a view of identifying their shortcomings.

CHAPTER THREE: ANALYZING KENYA'S EXISTING LEGAL AND REGULATORY FRAMEWORK

3.1 Introduction

The previous chapter analyzed the evolution of mobile money in Kenya. It also looked at some of the factors which necessitated the regulation of the mobile money in Kenya. It also discussed regulation that existed in Kenya, prior to the enactment of the NPS Act and the e-money regulations. Kenya is considered the most successful implementer of mobile money in Africa.[1] Since the launch of MPESA, other MNOs such as Airtel and Telkom as well as other banking led initiatives have since emerged in Kenya. Despite this proliferation in MNOs, there has unfortunately been an apparent lack of uniformity in the implementation of mobile money and incidental services.

This chapter examines the legal and regulatory system governing mobile money transfers and payment services in Kenya. It provides an overview of the structure and objectives of regulation, the role of the regulator and the techniques that are employed in regulating mobile money transactions, service providers and users. This examination will not only help to identify the shortcomings of the existing framework but also in developing practical proposals for developing an effective regulatory framework.

3.2 Existing Regulations on Mobile Commerce

The Central Bank of Kenya Act[2] provides the basis for the regulation of products offered by non-banking institutions. The Act authorizes the regulator to formulate and implement such policies as to best promote the establishment, regulation and supervision of efficient and effective payment, clearing and settlement systems. Mobile money services are currently governed by the Central Bank of Kenya Act[3], the Banking Act[4], National Payment Systems Act[5], the e-money regulations, and the Kenya Information and Communications (Amendment) Act[6] and other legislations.

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[1] Hughes N & Lonie S., 'M-PESA: Mobile commerce for the "Unbanked" Turning Cellphones into 24-Hour Tellers in Kenya'. *Innovations, 2*(1-2), (2007). 63-81.

[2] Section 4A 1(d) Central Bank of Kenya Act

[3] Central Bank of Kenya Act Chapter 491 Laws of Kenya

[4] The Banking Act

[5] National Payment Systems Act 39 of 2011

[6] Kenya Information and Communications (Amendment) Act 2013

3.2.1 The National Payment Systems Act

The origins of the National Payment Systems Act can be traced back to the shortcomings associated with use of traditional banking regulations. The Central Bank of Kenya subsequently adopted the existing system of regulation to regulate mobile money services. Though the failings were regarded as serious, it was less obvious that they were indicative of a failure in the model of regulation.

NPS Act is termed as a fundamental change in the system of financial regulation. It has not only been able to bring mobile money services under its ambit but also attempts to impose a single statutory regulator for the entire mobile money sector. The introduction of the Act also shifted regulation of mobile money services from the self-regulatory regime.

The object of the Act is to make provision for the supervision and regulation of payment systems and payment service providers. It sets out the responsibilities of payment system operators and the powers of the regulator. Though not explicitly stated by the Act, its objectives can be inferred from sections 3(1) and 3(6) (1). The first is maintaining market confidence of the financial system. In this case, market confidence does not imply a policy of preventing all failures but involves minimizing potential failures and providing mechanisms for consumer protection.[7] This objective includes the regulation of payment systems and instruments. It extends beyond regulated activities such as regulation of the entire financial market.

Second, in the protection of consumers the CBK must have regard to risk, expertise, the need for information and advice and the general principle that consumers should take responsibility for their choices.[8]Lastly, the reduction of financial crime through the regulation of business carried on by the regulated persons.[9]Financial crime in this case means any offence involving fraud; dishonesty; misconduct in, or misuse of information relating to a financial market; or handling the proceeds of crime. Though not defined, the Act itself establishes offences falling within the scope of this objective such as use of confidential information for personal gain,[10] and providing misleading statements[11] among others.

[7] NPS Act 2011 Section 3(1)(c), s. 6(1) (c)
[8] NPS Act 2011Section 3(1)(b), s. 6(1) (b)
[9] NPS Act Section 3(1)(a), s. 6(1) (a)
[10] NPS Act S. 27
[11] NPS Act S. 20

The Central Bank of Kenya is mandated to carry out regulatory functions conferred to it by the Act. Although the CBK existed prior to the Act, it is the main regulator in the financial sector and it is subject to the provisions of the Central Bank of Kenya Act,[12] Banking Act[13] and regulations and guidelines created under these Acts. The NPS Act gives the Central Bank of Kenya the express authority to regulate and supervise payment systems, including mobile commerce service providers. Under sections 3(1) and 6(1) of the NPS Act, the CBK has the mandate to bring a payment system[14] or payment instrument[15] under the ambit of regulation if it considers it appropriate to do so. This mandate considers certain thresholds such as public interest, systemic risks among others. Additionally, the Act gives the Central Bank of Kenya the power to grant,[16] suspend,[17] vary[18] and revoke[19] any authorization that is given to payment system operators and payment instrument service providers.[20] Section 18 further gives the CBK powers to prohibit the issuance of any payment instrument on grounds such as public interest and systemic risks.

Section 16 (4) of the Act mandates payment system operators and providers to furnish the Central Bank of Kenya with a copy of the application for winding-up orders issued by a court of competent jurisdiction.[21] This is geared at protecting not only the soundness of the payment system but also the interests of market participants. Additionally, Section 20 requires payment system operators and providers to facilitate the full disclosure of any information necessary to protect the integrity,

12 Central Bank of Kenya Act

13 Banking Act

14 National Payment Systems Act (S. 2) of the defines payment system as "a system or arrangement that enables payments to be effected between a payer and a beneficiary, or facilitates the circulation of money, and includes any instruments and procedures that relate to the system." M-PESA can be considered as a system in light of this definition.

15 Section 2 of the NPS Act defines a payment instrument as "any instrument, whether tangible or intangible, that enables a person to obtain money, goods or services, or to otherwise make payment." Cheques, money orders as well as e-money (in the case of M-PESA) can be considered as payment instruments in the sense that it facilitates the transfer and payment of money between payers and beneficiaries,

16 NPS Act, Sections 3(1),6(1)(2),15

17 NPS Act, Section 15

18 NPS Act, Sections 3(4), 3(7), 3(8), 6(5), 6(6), 6(7), 6(8), 15

19 NPS Act, (n. 10)

20 Section 2 of the NPS Act defines a payment service provider as: " (i) a person, company or organisation acting as provider in relation to sending, receiving, storing or processing of payments or the provision of other services in relation to payment services through any electronic system; (ii) a person, company or organisation which owns, possesses, operates, manages or controls a public switched network for the provision of payment services; or (iii) any other person, company or organization that processes or stores data on behalf of such payment service providers or users of such payment services."

21 NPS Act Section 16 (4)

effectiveness and security of the system.[22] Section 21 further provides for a dispute settlement mechanism between the Central Bank of Kenya and the payment system operators and providers. It however fails to make any mention of resolution of disputes between the payment system operators and providers with the users of such systems or instruments respectively.[23]

3.2.2 E Money Regulations, 2013

This Regulation is issued in terms of section 57(1)[24] read with section 4A of the Central Bank of Kenya Act which requires the Bank to formulate and implement policies to promote the establishment, regulation and supervision of efficient and effective payment, clearing and settlement systems[25] and Section 31 of the National Payment System Act which authorizes the Minister to make regulations generally for the better carrying into effect the provisions of the National Payment System Act.[26]

The purpose of this Regulation is to provide for: (a) the authorization of e-money issuers and the conduct of the business of e-money issuing; (b) the appointment of agents by e-money issuers and the registration of such agents; and (c) appropriate measures to protect the interests of the clients of e-money issuers. This Regulation applies to all issuers of e-money who are not licensed as banks or financial institutions under the Banking Act; and banks and financial institutions licensed under the Banking Act to the extent that they conduct the business of an e-money issuer in addition to banking business or financial business as defined under the Banking Act.[27]

The Regulations issue authorization for e money users and provides that no person other than a bank or financial institution shall conduct the business of an e money issuer unless that person is authorized to do so under this Regulation. The Regulations offer compliance requirements[28] to its users, which includes: an individual transaction limit that shall not exceed seventy five thousand Kenya Shillings and an aggregate monthly load limit of one million Kenya Shillings, put in place systems to maintain accurate and complete records of e money accounts opened, the identity of e-

[22]Section 20 NPS Act
[23] Section 21 NPS Act
[24] Section 57(1) NPS Act
[25] section 4A of the Central Bank of Kenya Act
[26] Section 31 of the National Payment System Act
[27] Section 2, Banking Act
[28] NPS Act Section 7

money holders, transactions undertaken by e money holders and the individual and aggregate balances held by e-money holders.

The Regulations require e-money issuers to enter into a written agreement with every e-money account holder for whom they open an e-money account. The agreement shall, amongst others, clearly identify the e-money issuer who is responsible to the e-money account holder and if the payment system utilizing the e-money account is operated by a person other than the e money issuer, the name of the payment service provider.

The Regulations also provide for provision for liquid assets[29] and agency requirements[30] which includes: the procedure for recruiting agents; the proposed geographic location of agents; proposed standard agency agreement or agreements; policies and procedures approved by the e-money issuer for the provision of services through agents, including anti-money laundering controls to be implemented by agents in terms of the Proceeds of Crime and Anti-Money Laundering Act;[31] description of the technology to be used for delivering agency services; risk assessment report of the provision of services through agents including the control measures that will be applied to mitigate the risks; the security measures to be adopted for agent premises; and the agent manual and any materials used for training agents. Others include record keeping,[32]outsourcing,[33]consumer protection[34] and oversight and reporting.[35]

3.2.3 Retail Transfers Regulations, 2013

This Regulation is issued in terms of Section 31 of the National Payment System Act which authorizes the Minister to make regulations generally for the better carrying into effect the provisions of the National Payment System Act, 2011.[36]

[29] Retail Transfers Regulations, Section 8
[30] Retail Transfers Regulations Section 9
[31] Proceeds of Crime and Anti-Money Laundering Act
[32] Retail Transfers Regulations Section 10
[33]Retail Transfers Regulations Section 11
[34] Retail Transfers Regulations Section 12
[35] Retail Transfers Regulations Section 12
[36] Retail Transfers Regulations Section 2

The purpose of this Regulation is to define retail transfers and provide for the delivery of retail transfers by Payment Service Providers as defined in the National Payment System Act, 2011; to facilitate the provision of electronic payment services without compromising the safety and efficiency of the national payment system; and to provide standards for consumer protection and risk management to be adhered to by all providers of retail transfers.[37]

This Regulation applies to all retail transfers utilizing an electronic payment system; including mobile payment service providers; and with respect to its authorization requirements, to all payment service providers. It provides for authorization of payment service providers, other than a bank or financial institution licensed under the Banking Act or a Deposit Taking Microfinance business licensed under the Microfinance Act, 2006[38] The Regulations give Central Bank of Kenya the mandate to pursue any or all remedial actions provided under Sections 30, 31 and 32 and 6 of the National Payments System Act, 2011, if a provider is found to contravene any of the conditions set out by the Regulations.[39]

It provides minimum capital requirements capped at ten million Kenya Shillings [40] and permits for cash merchants to carry out services[41] provided the payment service provider can execute the retail transfers that support the cash services in real time. The Regulation also provides provisions to regulate outsourcing of services,[42] compliance requirements and risk management[43]to encourage interoperability with other payment systems in the country and internationally.[44]

Ring fencing and safeguarding mechanisms[45] have been provided for to safeguard the funds which have been received from payers or from other payment service providers for the execution of retail transfers. For instance, the payment service provider shall employ appropriate risk mitigation

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[37] Retail Transfers Regulations Section 3
[38] Retail Transfers Regulations Section 5
[39] Clause Retail Transfers Regulations Section 5.8
[40] Retail Transfers Regulations Section 6
[41] Retail Transfers Regulations Section 7
[42] Retail Transfers Regulations Section 8
[43] Retail Transfers Regulations Section 9
[44] Retail Transfers Regulations Section 9.1
[45] Retail Transfers Regulations Section 10

strategies to ensure that funds held by a custodial trustee are sufficiently diversified and placed in strongly rated commercial banks or government securities in consultation with the Central Bank.[46]

Other salient provisions include the execution of payments,[47] consumer protection requirements for disclosure,[48] customer care services,[49] client service agreements,[50] confidentiality and privacy,[51] record keeping,[52] reporting requirements and oversight by the Central Bank of Kenya.[53]

3.2.4 Kenya Information and Communications (Amendment) (KIC) Act 2013.

This Act as read together with the Kenya Information and Communications (Amendment) Act 2009 is the principal Act used by the Communications Authority of Kenya (CAK) to regulate mobile network operators (MNOs). The KIC Act 2013 amends the KIC Act 2009 in an effort to bring it in conformity with the Constitution of Kenya, 2010. It provides for a statutory framework that satisfies the requirements of the constitution with regard to governing the communications sector.

The objective of the Act is to enhance the regulation in the ICT sector by providing for the handling of new regulatory challenges in the communications sector caused by the rapid technological innovations such as mobile money services. The KIC Act 2013 provides for the relationship between the CAK ("Regulator") and Mobile Network Operators ("Issuers") on one hand and the relationship between Mobile Network Operators ("Issuers") and the consumers on the other. The salient factors of this relationship are examined hereunder.

3.2.4.1 The Regulator and Issuers Relationship

The regulatory powers and supervision of the Communication Authority of Kenya (CAK) over mobile money transfers and payment services has been widened by virtue of section 2 of the Act. The section has changed the definition of telecommunication services to mean "any financial transaction, including banking, money transfers or similar service, carried out through a

46 Ibid (n.184)
47 Retail Transfers Regulations Section 11
48 Retail Transfers Regulations Section 12
49 Retail Transfers Regulations Section 12.2
50 Retail Transfers Regulations Section 12.3
51 Retail Transfers Regulations Section 12.4
52 Retail Transfers Regulations Section 13
53 Retail Transfers Regulations Section 14

communication system."[54] Further, by virtue of the newly introduced Part VIA, electronic transactions now fall within CAK's ambit.

Additionally, section 27D gives CAK powers to make regulations on confidentiality and disclosure of consumers' information.[55] Here Issuers are obliged to grant the regulator access to their systems, premises, records and any other relevant data that the regulator requires. This Regulation has been criticized on the grounds that it provides the regulator with unlimited discretion and access to consumers' confidential information such that private information of mobile money users risk becoming available to it without the requirement for a court order; and that it contravenes Article 31 of the Constitution[56] that guarantees the privacy rights of citizens. Although the regulator has come out in defense of this Regulation, the abundance of information to which the regulator has access will not necessarily allow for greater regulatory efficiency. With the development of ICT, information can be produced and accessed by anyone from anywhere such that the regulator not only has to worry about the acquisition of information, but also its use after the acquisition.

Regulation 3 of the Kenya Information and Communications (Dispute Resolution) Regulations, 2010[57] vests the regulator with the power to adjudicate over disputes between the issuers and the consumers on the one hand and the issuers as amongst themselves on the other. The same section gives the regulator power to hold hearings, inquiries, and investigations where necessary. In the event that any party is aggrieved by the decision of the regulator, Regulation 8 of the KIC (Dispute Resolution) Regulations, 2010 provides for an appeals mechanism whereby an appeal has to be lodged to the Appeals Tribunal within fifteen days of the decision. This provision, however, contradicts the Appeal Tribunal's rules which state that the prescribed period for instituting an appeal is thirty days. The regulations are however unclear on whether or not the banks that collaborate with the MNOs in offering MMTs and payment services are included among the parties that can bring a dispute to the regulator for determination notwithstanding that they are licensed under the Banking Act.

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[54] Section 2, Kenya Information and Communications (Amendment) Act 2013

[55] Section 27D, Kenya Information and Communications (Amendment) Act 2013

[56] Article 31 states that "every citizen has the right to privacy, which includes the right not to have (c) information relating to their family or private affairs unnecessarily required or revealed; or (d) the privacy of their communications infringed."

[57] These regulations are made pursuant to section 2 of the KIC Act 2013 and section 27 of the KIC Act 1998 that gives the Cabinet Secretary of ICTs the power to make regulations with respect to telecommunication services.

3.2.4.2 Issuers and Consumers Relationship

The Kenya Information and Communications (Consumer Protection) Regulations, 2010 enacted pursuant to section 2 of the KIC Act 2013 protects the rights of consumers. According to Regulation 3(1),[58] consumers have a right to receive clear and complete information about the rates, terms and conditions and charges for available and proposed services. Further, consumers have a right to personal privacy and protection against unauthorized use of personal information by the issuers.

On the aspect of disclosure of information, Regulation 4 requires issuers to disclose to the consumer any potential risks that lie within and outside the scope of measures that they have taken.[59] Under Regulation 15, the issuers are prohibited from disclosing or monitoring the content of any information of any consumer that is transmitted through their systems.[60] In the event that they intend to collect such data, they must establish mechanisms that will provide the consumer with a choice of whether or not to permit the collection of such data. The KIC (Consumer Protection) Regulations 2010 are therefore, a great improvement from the 2009 regulations that offered minimal protection to consumers in terms of access to information and restrictions on disclosure of information held by the issuer.

For simple reasons, the abundance of information in the mobile commerce age is, from a regulatory perspective, not an entirely positive phenomenon. For instance, although consumers appear to have a greater choice of MMTs and payment services, as well as access to tools such as price comparison manuals, and feedback sites, it is questionable whether these actually allow for better, more efficient decision-making and a more responsive, consumer-friendly market. More likely than not, even in the mobile commerce age, consumer protection regulation is likely to retain its value.

3.2.5 Proceeds of Crime & Anti Money laundering Act, 2009

This Act is the primary statute on Money Laundering n Kenya and contains ongoing reporting requirements for financial institutions in Kenya.

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[58] Regulation 3(1) Kenya Information and Communications (Consumer Protection) Regulations, 2010

[59] Regulation 4 Kenya Information and Communications (Consumer Protection) Regulations, 2010

[60] Regulation 15, Kenya Information and Communications (Consumer Protection) Regulations, 2010

The Proceeds from Crime and Anti Money Laundering Regulations, 2013 also regulate money laundering activities in Kenya. Financial institutions are required to report any transaction of USD ten thousand or more to the Financial Reporting Centre and to demonstrate supporting documentation of the same. The Law imposes stiff penalties on those found culpable in addition to identification, tracing, freezing, seizure, and confiscation of the proceeds of crime. The legislation also formalizes the establishment of the Assets Recovery Agency which handles all cases of recovery of proceeds of crime as a result of money laundering.

Mobile commerce institutions are 'reporting institutions' for purposes of the Act and have a duty to report suspicious activity. Although most mobile transactions are limited to the amount that can be transacted at any one time, this legislation fails to adequately address how the proceeds of money laundering can be minimized through mobile money platforms.

These features include greater anonymity, for users where identity verification is not required, elusiveness (the ability to cover up usage patterns), velocity (the high speed at which transactions are carried out) and poor oversight because not all models and services are currently covered by this legislation. Many of these vulnerabilities are shared with other electronic payment instruments. On a relative basis, the vulnerability of existing payment instruments to money laundering and financing of terrorism, such as cash, are greater in all respects except for the speed of transactions. Susceptibility to these risks may be greatest among agents of mobile network operators, who have higher limits than end users and more functionality, but this risk applies to financial services agents in general.[61] Risks can be managed by introducing appropriate controls, such as limits on a transaction's value, turnover, and account balance, as well as real-time monitoring of accounts, reporting of suspicious transaction patterns, and close screening, training, and surveillance of agents.[62]

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61 Statschen. S and Meagher. E., 'Basic Regulatory Enablers for Digital Financial Services' in http://documents.worldbank.org/curated/en/692101533183892208/pdf/129138-WP-PUBLIC-Focus-Note-Basic-Regulatory-Enablers-for-DFS-May-2018.pdf> accessed 10 July 2019

62 Ibid

International standards for AML-CFT set by the Financial Action Task Force and regional bodies allow for regulators to implement risk-based approaches.[63] A commonly used approach is to tier Customer Due Diligence (CDD) procedures[64] for account opening so that the scope and intensity of verification procedures rises with the functionality and transactional limits on the account. AML-CFT regulation extends well beyond CDD to include other aspects such as record keeping and training. In addition, the system must be capable of monitoring the velocity of transactions, identifying suspicious transaction profiles, and reporting on them.[65] Nevertheless, there remains a relatively high degree of uncertainty among regulators about how to apply a risk-based approach in practice, and a forthcoming World Bank report updates the earlier findings.[66]

The specifics of the chosen framework or approach must ensure that account opening is simple and straightforward in order for mobile money services to proliferate. This is because a high volume of transactions is needed for this type of business model to be profitable and to prosper. In particular, in the case of mobile payments focused on low value transactions and low value storage, the risks posed by money laundering and terrorism financing lie well below a worrisome threshold if adequate transactional limits, and monitoring requirements, are imposed. Under this scenario, the benefits of allowing for flexible CDD procedures outweigh the risk of rendering mobile financial services unviable, especially at the early development stage.

3.2.6 Kenya Deposit Insurance Act

This Act is established to provide for the establishment of a deposit insurance system and for the receivership and liquidation of deposit taking institutions, to provide for the establishment of the Kenya Deposit Insurance Corporation and for connected purposes.

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[63] FATF (Financial Action Task Force). 2012. "International Standards on Countering Money Laundering and the Financing of Terrorism & Proliferation—The FATF Recommendations." Paris: FATF, February 2017. "FATF Guidance: Anti-Money Laundering and Terrorist Financing Measures and Financial Inclusion with a Supplement on Customer Due Diligence." Paris: FATF

[64] Risk-Based Customer Due Diligence (CDD). A proportionate anti-money laundering framework is adopted, allowing simplified CDD for lower-risk accounts and transactions. The latter may include opening and using e-money accounts and conducting over-the-counter (OTC) transactions with DFS providers.

[65] ibid

[66] ibid

Section 24 of the Kenya Deposit Insurance Act[67]states that any institution licensed by the Central Bank shall be a member of the fund. Mobile money service providers, however, fall short of the definition of an 'institution' under the Central Bank Act[68]. As such, the money deposited by the users of the various services are not insured individually. Instead, the money amount that is held in trust by the mobile money providers, is covered by deposit insurance due to the fact that the commercial bank(s) that the money is deposited into are members of the Kenya Deposit Insurance Fund.[69]

The Act defines deposits as the unpaid balance of the aggregate of deposits received or held by a member institution from or on behalf of a person in the usual course of the business of deposit taking and shall include:

a. A bank draft, certified cheque or other similar instrument or payment instruction, drawn or made against a deposit account for which the member institution shall be primarily liable;
b. A cheque entered into a payment system notwithstanding any delay or failure by the member institution in crediting the payee's account; or
c. Any other liability or financial instrument as may be specified by the Corporation but excludes:
    i. A deposit that is not payable in Kenya;
    ii. Bearer negotiable instruments of deposit;
    iii. Any sum of money payable under a repurchase agreements;
    iv. Interbank transactions; and
    v. Any other liability or financial instrument as may be specified by the Corporation;[70]

3.2.7 Competition Act

The Act is established to promote and safeguard competition in the national economy; to protect consumers from unfair and misleading market conduct; to provide for the establishment, powers

[67] Kenya Deposit Insurance Act No. 10 of 2012
[68] Central Bank of Kenya Act
[69] Kenya Deposit Insurance Fund
[70] Section 2, Kenya Deposit Insurance Act No. 10 of 2012

and functions of the Competition Authority and the Competition Tribunal, and for connected purposes[71]

The Act focuses on preventing restrictive trade practices which is defined by the Act as practices as agreements between undertakings, decisions by associations of undertakings, decisions by undertakings or concerted practices by undertakings which have as their object or effect the prevention, distortion or lessening of competition in trade in any goods or services in Kenya or a part of Kenya. Restrictive trade practices are generally prohibited, unless they have been expressly exempted pursuant to the provisions of the Act.

3.2.8 Consumer Protection Act

Prior to the promulgation of the Constitution[72] in the year 2010, there was no specific law dealing with consumer protection in Kenya. However, some aspects of consumer protection were covered in various pieces of legislation including the Trade Descriptions Act, Restrictive Trade Practices, Monopolies and Price Control Act (now known as the Competition Act[73]), as well as private law measures in the law of contract and the law of tort.

These and other statutes touching on consumers are criminally oriented as they seek to prohibit malpractices and to prosecute offenders for breach of their provisions. The Act spells out consumers' rights and obligations vis-a-vis product and service liability; it makes provisions for the promotion and enforcement of consumer rights as well as empowering consumers to seek redress for infringement of their rights as consumers; and also provide for compensation.

Part II of the Act gives consumers a wide range of rights including the right to commence legal action on behalf of a class of persons in relation to any contract for the supply of goods or services to the consumer. This right cannot be ousted by any agreement between the parties. Other consumer rights provided for in the Act include the right to full pre-contractual information for the consumer to make an informed choice, the right to complain with regard to quality, delays in provision of rectification, quantity and price of such goods or services as are offered, the right to a

[71] Section 1, Competition Act
[72] Constitution of Kenya, 2010
[73] Competition Act , No. 12 of 2010

reasonable notification of termination of service, particularly in relation to the provision of basic telecommunications services and/or internet access, among other rights.

The Act prohibits 'unfair practices' and proceeds to provide for radical sanctions against a supplier who engages in 'unfair practices'. Such practices include representing that goods or services have a sponsorship, approval, performance or characteristics that they do not have; or representing that goods or services are of a particular standard, quality, grade, style or model, if they are not.

Undoubtedly, the Act is a far-reaching piece of legislation that affects mobile money services and transactions. In this connection, the Act establishes the Kenya Consumers Protection Advisory (CPA) Committee that aids in the formulation of policy related to consumer protection, accrediting consumer organizations, advising consumers on their rights and responsibilities, investigating complaints and establishing conflict resolution mechanisms, amongst other duties. A breach of any regulation made by the CPA, warrants a fine not exceeding five hundred thousand shillings or imprisonment for a term not exceeding two years or both such fine and imprisonment.[74]

The greatest shortcoming in consumer protection regulation in Kenya, is the fragmentation of the current regime and the gaps that it presents as a result of its fragmentation making an argument for at best, consolidation of the legislative instruments for consumer protection of financial services.[75] This is because the regulatory responsibility is divided amongst many bodies and this has engendered calls for rationalization and centralization as in many jurisdictions.[76]

3.2.9 Unclaimed Financial Assets Act, 2011

For a long time, Kenya did not have any comprehensive law governing the handling and disposition of unclaimed assets. The Act provides for public awareness as well as conformation to international best practice with respect to the handling of unclaimed monies, finance and assets held by banks and financial institutions. The Act makes it possible for data concerning unclaimed assets to be made public via searchable databases, giving genuine claimants an equal right to information. Further, the

[74] Oraro, C and Barasa J, 'Consumer Protection Law in Kenya' https://www.oraro.co.ke/2018/10/17/consumer-protection-law-in-kenya/> accessed 5th May 2019

[75] Malala, J, 'Consumer Protection for Mobile Payments In Kenya: An Examination Of The Fragmented Legislation and The Complexities It Presents For Mobile Payments' Centre for Research on Financial Markets and Policy Working Paper Series No. 7 *Kenya Bankers Association* https://www.kba.co.ke/working_paper.php> accessed 30 June 2017

[76] Ibid

Act seeks to benefit widows and orphans whose benefactors die intestate by entitling them to the benefactor's assets.

The need for the implementation of the Act is a result of large sums of money, represented as unclaimed assets, held by banks and other financial institutions in the country. The Act seeks to provide a framework for reporting and dealing with such assets.[77] This Act therefore provides for the process in which unclaimed assets including funds that may be held in mobile money platform, can be claimed.

With the proliferation of mobile money network operators and in consideration of the number of Kenyans who access the services, it is without doubt that there are large sums of money that may be subjected to this Act.

3.3 Conclusion

The analysis of the existing legal and regulatory framework clearly confirms its inadequacy in the regulation of mobile money transfer and payment services in Kenya; and hence, the need for custom-made regulation.[78] In the analysis of the NPS Act 2011, e-money regulations 2013, and Kenya Information and Communications (Amendment) Act 2013, this study identified major shortcomings, such as, inadequate dispute settlement mechanisms, the regulators wide discretion and unlimited access to information, overlapping functions, inadequate consumer protection measures among others.[79]

The study thus makes two contentions. First is that the abundance of information to the consumers does not necessarily equal empowerment.[80] The access to a wide choice of mobile money services and tools such as price comparison manuals is not a guarantee for better, more efficient decision-making and a more responsive consumer-friendly market.[81] That even in the mobile money age,

[77] http://www.dalyinamdar.com/new-summary-on-the-unclaimed-financial-assets-act/> accessed 5th May 2019

[78] Mitheu J, 'The Regulation of Digital Credit In Kenya: The Case for Consumer Protection' Thesis submitted in partial fulfillment of the requirements of the Bachelor of Laws Degree, (Strathmore University Law School 2018)

[79] Ibid

[80] Triki T and Faye I, 'Financial inclusion in Africa' African Development Bank 2013, 25 -- https://www.afdb.org/fileadmin/uploads/afdb/Documents/Project-andOperations/Financial_Inclusion_in_Africa.pdf > accessed on 22 January 2019.

[81] Malala J, 'Consumer Protection for Mobile Payments in Kenya: An Examination Of The Fragmented Legislation and The Complexities It Presents For Mobile Payments,' WPS/02/14 KBA Centre for research on financial markets and policy working paper series, 3.

consumer protection regulation would likely retain its value. Second is that the abundance of information to which the regulator has access to does not portend greater regulatory efficiency. This is because the instances where voluminous information has been accidentally lost or publicized show that the informational abundance also significantly multiplies the risk of data management, with breaches of confidentiality, data protection, and security threats looming in the background.[82]Further, the retention of information as part of a regulatory agenda ought to be coupled with intelligent systems that allow for the efficient use of the information; otherwise, it is worthless.

Finally, there are several regulatory gaps in the existing regulations governing mobile money services in Kenya today. This increases the risk factors in the financial services market and there is an urgent need to review the framework in order to deliver a better regulatory framework for mobile money transactions and payment services in Kenya.

[82] One of the powerful reasons against a one-stop governmental "superdatabase": Afua Hirsch 'Superdatabase tracking all calls and e-mails legitimate, says DPP' (2009) The Guardian 9 January, available online at <www.guardian.co.uk/uk/2009/jan/09/dpp-keir-starmer-superdatabase> accessed 09 October 2016

CHAPTER FOUR: THE CASE FOR EFFECTIVE REGULATION

4.1 Introduction

In order to enhance the effectiveness of the regulatory framework governing mobile money services, there is need to meet certain thresholds.[1] These include but are not limited to: consumer protection and fair competition, enhanced risk mitigation, enhanced regulation for emerging markets such as digital lending, betting and gambling among others.[2] The regulatory framework should be one where the market players obtain efficient and operational outcomes, that a vital for a thriving business environment.[3] The previous chapter analyzed the existing regulatory framework and pointed out some of the glaring loopholes in the same. It concluded that the ideal regulatory framework for Kenya is one which needs to take into account the ever evolving nature of technology and its impact on mobile money services. The following section highlights some of the existing challenges and emerging areas such as digital lending, consumer protection, competition and security issues, among others, which should be subjected to better regulation in order to achieve optimum environment for all stakeholders.

4.2 The need for custom made regulation

Regulation of the MMT and payment services industry in Kenya evolved as a result of an amalgamation of both banking and telecommunications. This has been necessitated by the need to meet the consumers demand for an efficient and effective mobile money services system, which has unfortunately resulted into regulatory inefficiencies. Being a hybrid system, it suffers from various challenges such as overlap of functions amongst regulators, coordination failure, among others.

This chapter thus argues that the current hybrid system of regulation should be overhauled for a tailor made system, to curb the existing risks and to avert the constant regulatory conflicts. Additionally, the study posits that the existing challenges being experienced in the market is as a

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[1] Gutierrez E & Singh S., '*What Regulatory Frameworks Are More Conducive to Mobile Banking? Empirical Evidence from Findex Data Policy* Research Working Paper 6652 (October 2013) World Bank: Finance and Private Sector Development, Latin America and the Caribbean Region.

[2] Maore K & Mutembei C 'Critical Literature Review on Mobile Banking Regulatory Overlap and Gap in Kenya' Research paper Submitted to the 2011 Operation Research Society of Eastern Africa (ORSEA) Conference, Nairobi: University of Nairobi. Available at www.orsea.com> accessed 9 February 2018

[3] Mitheu J., The Regulation of Digital Credit In Kenya: The Case for Consumer Protection' Thesis submitted in partial fulfillment of the requirements of the Bachelor of Laws Degree, (Strathmore University Law School. 2018)

result of this system of regulation. The next section discusses some of these existing challenges which continue to create the need for a custom made regulatory framework.

4.3 Adequate regulation of risks

An ideal regulatory framework for the mobile money market should be able to address some of the following risks including, systemic risk, operational risk, competition and anti-trust.[4] These are the main risks which continue to grapple the ever evolving market and measures should be taken to adequately address the same by a strong regulatory framework.[5]

As of 2018, the value of mobile money transactions grew significantly, where least Sh. 7.85 trillion was transacted in the form of deposits and withdrawals.[6] This was a 35.25 per cent increase from Sh5.8 trillion transacted in 2017.[7]The continued expansion of mobile money transactions in Kenya is driving Kenya closer towards becoming a cash-lite economy.[8] Due to the sheer amount of money being transacted on the mobile network platforms, there is need to increase regulation. The following part thus discusses the risk factors in detail.

4.3.1 Regulation of Systemic Risk

Systemic risk refers to the risk or probability of breakdowns in an entire system. Due to the dependence of entities within the financial system, a collapse of one entity is likely to cause a cascading failure within the system.[9] With the increase in popularity of mobile money transactions in the country and the diversification of the services offered by the service providers, the footprint of the service on the economy is growing.[10] Due to the immense number of money transactions within mobile money systems, the total amount of deposits held in said systems is now significant enough

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[4] Manica L & Vescovi M., (2009). Mobile Telephony in Kenya; is it Making the Life Better? <http://www.it46.se/projects/UNITN_ict4sd/assignments/ICT4SD_ manica_vescovi.pdf> accessed 9 February 2018

[5] Donovan K, 'Mobile Money for Financial Inclusion' World Bank overview *http://siteresources.worldbank.org*> *accessed* on 1 February 2019.

[6] Central Bank of Kenya Statistics https://www.centralbank.go.ke/national-payments-system/mobile-payments/> accessed 10 July 2019

[7] Malala J, 'Consumer Protection for Mobile Payments in Kenya: An Examination of the Fragmented Legislation and The Complexities it Presents for Mobile Payments,' WPS/02/14 KBA Centre for research on financial markets and policy working paper series, 3.

[8] Ilako, C, 'Mobile cash transactions averaged Sh15 million per minute in 2018' The Star Newspaper 2nd April 2019 https://www.the-star.co.ke/business/2019-04-02-mobile-cash-transactions-averaged-sh15-million-per-minute-in-2018/> accessed 5th May 2019

[9] Ibid

[10] Ngugi, et. al 'M-PESA: A Case Study of the Critical Early Adopters' role in the Rapid Adoption of Mobile Money Banking in Kenya. '*The Electronic Journal on Information Systems in Developing Countries.'* (2010)

to be a threat to the stability of the system as a whole if the mobile money systems fail to meet their obligations.[11] It would be wise to implement prudential monitoring on mobile money transactions in order to ensure continued stability of the economy as it seems to serve a significant portion of the population.[12]

The current approach taken to limit systemic risk is simply to impose daily transaction limits on the mobile money services.[13] Although this greatly reduces the net amount of money held within the mobile money system, the risk of a collapse of the economic system due to a collapse of the mobile money systems is not entirely eliminated.

4.3.2 Regulation of Operational Risk

4.3.2.1 Credit Risk

It has been argued that the credit risk on mobile money, considering the structure of mobile money systems, is non-existent. This is because the money transferred to the mobile wallets is fully backed by a cash amount that had been pre deposited by the agent in exchange for the mobile money. The money is then held under a trust, whose beneficiaries are the depositors themselves. As such, the providers are not allowed to interfere with or benefit from the funds. This eliminates the credit risk, as the amount that has been deposited by the users is the same amount, ideally, that should be withdrawn.

Despite the numerous applications of mobile money transactions, the service is essentially a tunnel for money to pass from one person to another. The service providers have absolutely no control over the money in the sense that the money is never actually held by them. Clients depositing their money into mobile money platforms are, as far as the law is concerned, unsecured creditors. As such, the risk of non-repayment of the money deposited is an issue when the payment systems fall into insolvency.

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[11] Mas I & Morawcyznski O., 'Designing Mobile Money Services: Lessons from M-PESA' available at http://www.afminetwork.org> accessed 9 February 2017

[12] Heyer & I.Mas (2011) "Fertile Grounds for Mobile Money: Towards a Framework for Analyzing Enabling Environments" January 2011.

[13] Malala J, 'Consumer Protection for Mobile Payments in Kenya: An Examination Of The Fragmented Legislation and The Complexities It Presents For Mobile Payments,' WPS/02/14 KBA Centre for research on financial markets and policy working paper series, 3.

Presently, the existing structure of mobile money services, and the legal requirement, requires that the money being transferred be held in a commercial bank. The account holder in this case is a trust with the customers as the beneficiaries. With this arrangement, the service providers cannot access funds in this account for whatever reasons that could arise. In the case of bankruptcy, the funds remain the property of the mobile money customers. In addition to this, mobile money transfer services cannot create new money in the way that banks usually do. As such, the money that goes into the account is, at the very least, the amount that should come out of the account.

One issue with this, however, is the fact that accounts in commercial banks earn interest on the principal. In theory, the customers have a beneficial interest in the money. The amount of money that this translates to per person, given the average amount of time that money is in the customer's mobile money account, is negligible and as such, it would be of little use to give it back as interest. Considering, however, the total number of people using the service, the interest that accumulates in the trust account is a rather significant amount. Before, the regulations in place required that the interest be spent on charitable activities. This requirement, however, does not exist anymore.

The fact that the funds are ring-fenced from the service providers lends a sigh of relief to individuals who are worried about the fate of their funds if the service provider were to go bankrupt. The concern over the Trustees' treatment of the funds, however, is not addressed. The fact that the accounts earn an interest means that the banks holding the money are allowed to intermediate on the funds. What, then, is the fate of the customer funds if the bank itself were to go bankrupt? The funds are certainly not double ring-fenced to prevent this outcome. This problem becomes significant when the aspect of Deposit Insurance is introduced. The money deposited by the users of the various services are not insured individually given the fact that the requirements for compulsory membership of the Deposit Insurance Fund are not met.

4.3.2.2 Deposit Insurance

Section 24 of the Kenya Deposit Insurance Act[14]states that any institution licensed by the Central Bank shall be a member of the fund. Mobile money providers, however, fall short of the definition

[14] Kenya Deposit Insurance Act No. 10 of 2012

of an "institution" under the Central Bank Act[15]. As such, the money deposited by the users of the various services is not insured individually. Instead, the money amount that is held in trust by the mobile money providers, however, is covered by Deposit Insurance due to the fact that the commercial bank(s) that the money is deposited into are members of the Kenya Deposit Insurance Fund.[16]

The Act defines deposits as the unpaid balance of the aggregate of deposits received or held by a member institution from or on behalf of a person in the usual course of the business of deposit taking and shall include:

d. A bank draft, certified cheque or other similar instrument or payment instruction, drawn or made against a deposit account for which the member institution shall be primarily liable;
e. A cheque entered into a payment system notwithstanding any delay or failure by the member institution in crediting the payee's account; or
f. Any other liability or financial instrument as may be specified by the Corporation but excludes:
    vi. A deposit that is not payable in Kenya;
    vii. Bearer negotiable instruments of deposit;
    viii. Any sum of money payable under a repurchase agreements;
    ix. Interbank transactions; and
    x. Any other liability or financial instrument as may be specified by the Corporation;[17]

The Act still fails to define deposits generally, using the word itself in its definition, but defines the deposits that may be insured under the Fund. As such, whether a deposit shall be protected depends solely on whether the insured party is a member of the Fund. Given the criteria for compulsory membership, it cannot be guaranteed that every mobile money provider shall have their funds insured.

There are two distinct, and seemingly correct, arguments concerning the protection of user funds by the Deposit Insurance Fund. In both cases, the definition of the mobile money users' funds is

[15] Central Bank of Kenya Act
[16] Kenya Deposit Insurance Fund
[17] Section 2, Kenya Deposit Insurance Act No. 10 of 2012

central to the argument. On one hand, the question of whether mobile money schemes qualify for deposit insurance is met with a negative answer. The argument discourses that first, such funds are not in the strict legal sense 'deposits' as defined under the Banking Act.[18] Second, the beneficial owners of the funds do not have customer/ banker relationships with the institutions in which the Trust fund has been placed in respect of their entitlement under the mobile money scheme. It therefore follows that each mobile money customer's entitlement cannot be considered a protected deposit.

On the other hand, it has been argued that the Act[19], having created a structure where each of the beneficiaries in a Trustee or Joint account has their deposits insured separately, the deposits by the customers are, in fact, protected. This, however, assumes that the mobile money users' funds can be defined as deposits.

In the grand scheme of things, the funds can be considered uninsured given the fact that the insurance is limited to Ksh. 100, 000 and it's meant to cover several million accounts for a mobile network operator. The Act still fails to define deposits generally but defines the deposits that may be insured under the Fund. As such, whether a deposit shall be protected depends solely on whether the insured party is a member of the Fund. Given the criteria for compulsory membership under section 24 of the Act, it cannot be guaranteed that every mobile money provider shall have their funds insured.

4.3.2.3 Privacy Concerns

During the normal course of use of mobile money, a user is required to divulge private information to a cash merchant. The extent to which the web of agents has spread is convenient to the users in that they can get their services from various agents and profitable to the service providers because of the convenience attached to the services. It, however, presents a nightmare with regard to supervision of the individual agents and their conduct, especially in the case of misconduct that is as unnoticeable as divulging private information such as names, ID numbers and corresponding signatures to the wrong persons.

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[18] Banking Act, Chapter 488 Laws of Kenya

[19] Kenya Deposit Insurance Act No. 40 of 2012

When transacting through an agent, a customer is required to present the agent with their identification documents, National ID or passport, and sign to confirm the transaction. This is however not the case as presently, it is possible for one to access funds from mobile money merchants without having to sign, or present identification documents. This already points out to a gap in the security system. One of the ways to bypass the revelation of personal details is simply to withdraw the amount at an ATM machine or to pay for goods and services using your phone at supported outlets. The two services are both offered by all mobile payment service providers in Kenya at the moment.

The matter of privacy presents itself more as an academic problem than an actual one at the moment. This, however, has been argued to be mostly due to the laissez faire attitude that most people have to invasion of privacy under such circumstances.

4.3.3 Regulation of Security Risk

In response to the terrorist attacks over the past two' decades and the increase in movements of cash for illegal purposes e.g. money laundering, drug trade and human trafficking, there has been pressure on financial institutions to help in curbing such occurrences at an early stage. This is a reasonable expectation given the fact that most of these activities have been proven to require immense financing beforehand.

Over time, Know Your Customer (KYC) standards have been developed at an international level to ensure that financial institutions and by extension, mobile network operators know whom they are transacting with. This serves many purposes, save for identifying the party/parties that are transacting with a given account and by extension blacklisting relevant people e.g. those on terrorist watch lists and tracking transactions, where need arises, attached to a specific account.

The Proceeds from Crime and Money Laundering Act[20] casts a broad net definition as far as financial institutions are concerned. Mobile money systems[21] are covered under businesses, formal or informal, that transfer money or value by any means, Mobile money systems, by virtue of being

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[20] Proceeds from Crime and Money Laundering Act, 2011

[21] Section 2, Proceeds from Crime and Money Laundering Act

financial institutions under this definition, are therefore automatically designated as Reporting Institutions.

Under the Act[22], financial institutions are obliged to: monitor any unusual transactions and report any suspicious activity; properly identify any person wishing to enter into business with them; establish and maintain customer records, keep the records of the identities and transactional history for a minimum of 7 years; establish and maintain internal reporting procedures; and register with the Financial Reporting Centre.

In addition, International Anti Money Laundering/ Combating the Financing of Terrorism (AML CFT) standards set by the Financial Action Task Force require that adequate customer due diligence be undertaken on all new accounts and on single payment cash transactions. This process is part of Know Your Customer procedures so that suspicious transactions can be identified.

National laws and regulations are required to give effect to these standards, and they typically require: verification of identity of the client, using a government issued identity document; verification of physical address, for example, by production of a bank statement or utility bill in name of the customer. If this procedure is not followed, the bank or payment agent may be penalized by the relevant authority; or frozen out of international payment systems by other banks concerned about the risk of being associated with illicit activities.

Although legislation has been put in place to curb some of the potential risks with regard to security, the same is not adequately monitored for the sole reason that the service providers and merchants are able to issue funds and transactions without adequately verifying the documentation of the customers. Some of the current challenges relating to security include issues like password theft, user names and sim swaps, which have proliferated with technological advancements and new products relating to mobile money transactions.

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22 Proceeds from Crime and Money Laundering Act, 2011

4.4 Regulations on Competition

The Competition Authority of Kenya[23] has identified telecommunications as one of several markets being scrutinized by the Competition Authority for possible abuses of dominance. Among others, bundling of services has been considered to be an abuse of dominance in cases where the other services are substandard or overpriced but due to one of the services in the bundle, mobile payments in this case, the customers do not have much choice when they intend to use the dominant mobile payments system.

The Act establishes the Competition Authority of Kenya (CAK) as an independent authority that is tasked with enforcement of the Act and especially control of market dominance. The Act defines a dominant undertaking as one that controls at least half of the services or production in a certain marker. While it is not illegal to have a dominant position in the market, a dominant player in the market is subject to increased scrutiny by the Authority.

Abuse of a dominant position, according to the Act, includes: directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions; limiting or restricting production, market outlets or market access, investment, distribution, technical development or technological progress through predatory or other practices; applying dissimilar conditions to equivalent transactions with other trading parties; making the conclusion of contracts subject to acceptance by other parties of supplementary conditions which by their nature or according to commercial usage have no connection with the subject-matter of the contracts; and abuse of an intellectual property right. Contravention of these provisions results in fines of up to 10 million shillings.

4.5 Regulations on Digital lending

Digital credit or lending in Kenya has proliferated in the last five years due to technological advancement.[24] Digital lending relies on digital infrastructure to receive loan applications, determine creditworthiness of borrowers, approve the loan, disburse the funds and receive payment. All this are done through existing subscriptions to mobile phones or mobile money services as well as social

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[23] The Competition Authority of Kenya, is established under the Competition Act No. 12 of 2010 Laws of Kenya

[24] Muturi, R., *Digital Lending: a Sound Regulatory Framework is in Everyone's Interest'* ***May 3, 2019*** https://sokodirectory.com/2019/05/digital-lending//> accessed 27 June 2019

media accounts.[25] Prior to the introduction of digital credit, most Kenyans relied on informal lenders such as shylocks as well as relatives and friends for credit,[26] while banking only provided services to the rich or those with collateral and could afford the attendant charges. The introduction of digital credit revolutionized this status.[27]

Digital credit in Kenya is offered through four business models.[28] The most common and the pioneer business model is the partnership of banks or microfinance institutions and mobile network operators (MNO).[29] The MNOs offer credit algorithm from data on their customers to develop a system that determines creditworthiness. Secondly the MNOs act as channels of disbursing the loans, collect the loans and interact with the clients. The banks or financial institutions run the customers' accounts, offer the capital used for lending and take the high risk of lending. Examples of such partnerships include Safaricom and Commercial Bank of Africa (CBA) to provide M-Shwari, Safaricom M-Pesa and Fuliza, Safaricom partnership with Kenya Commercial Bank (KCB) to provide KCB-M-Pesa loans and Airtel Money and Faulu Bank to offer Kopa chapaa loans.

The second business model is application based digital credit. This involves companies offering loans in their own name without partnership with a financial institution. The providers require the borrowers to install an app and to provide their social media accounts. The application monitors the mobile phone and mobile money usage as well as social media usage. From this data they are able to determine the creditworthiness of the borrowers. Examples of such lenders in Kenya include Tala, Branch and Saida loans.

Peer to peer lending (p2p) is the third business model used in Kenya. This business model is not as rampant as it is in other parts of the world. P2p lenders are an online platform that link lenders and

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[25] Hwang B, Four common features of emerging digital credit offerings, CGAP 2016 http://www.cgap.org/blog/four-common-features-emerging-digital-credit-offerings> accessed on 23 January 2019

[26] Mutunga A, 'Mobile loan game the new shylocks' Nairobi Business Monthly 7 January 2016 http://www.nairobibusinessmonthly.com/mobile-loan-game-the-new-shylocks/> accessed on 10 January 2019

[27] The proliferation of digital credit deployments, Public disclosure authorized brief, World Bank 2016 http://documents.worldbank.org/curated/en/830661467994632311/pdf/106035-BRI-PUBLIC-KNOWLEGDE-NOTE-Brief-Proliferation-of-Digital-Credit-Deployments-Mar-2016-1.pdf> accessed 23 January 2017.

[28]Edoardo Totolo, The Digital Credit Revolution in Kenya: An assessment of market demand, five years on' March 2018, FSDKenya www.fsdkenya.org> accessed 27 June 2019

[29] Francis E et.al, 'Digital Credit in Emerging Markets: A Snapshot of the Current Landscape and Open Research Questions', Bill and Melinda Gates foundation, 2017, 5.

borrowers. They do not lend money but they facilitate the lending process. Such companies in Kenya include Zidisha and Kiva Loans. The last business model, though not common is a bank offering digital services. This emerged as a result of the CBK licensing Mobile Virtual Network Operators (MVNO).[30] The banks do not need partnership with mobile network operators as they develop their own digital infrastructure. An example is Equity Bank, through Equitel. Their telecommunication infrastructure is a lease from Airtel Kenya.

There are several challenges emerging from digital lending and mobile money services in Kenya currently. For instance, the loans are short term and high risk due to the target market.[31] The products are offered to the unbanked population who lack credit history and collateral and therefore offering the products to them makes the products pricy. The short term nature is also due to the fact that these loans are taken out during emergencies or as the consumers await for the next month salary. Consumer protection is also an issue as the data that the digital lenders have on the consumers is subject to exposure without client consent.

By virtue that the platforms used for digital lending vary between telecommunications and banking, there is a challenge of inadequate regulation to govern digital lending.[32] Digital credit is offered by several institutions including banks, non-bank financial institutions and non-financial institutions. All these institutions partner with mobile network operators through different business models. Data on the number and performance of app-based loan accounts are not reported publicly since financial service providers that offer credit but do not take deposits are unlicensed and not regulated by CBK.[33] This means that any person can offer digital credit as long as they are able to partner with mobile network operators. Some of these institutions are unregulated.[34] Currently, there is a lot of

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30 Mugo M and Kilonzo E, 'Community- level Impact of Financial Inclusion in Kenya with Particular Focus on Poverty Eradication and Employment Creation, Central Bank of Kenya, 2017, 13.

31 Kaffenberger M and Chege P, Digital Credit in Kenya, Time for Celebration or Concern? CGAP 2016 http://www.cgap.org/blog/digital-credit-kenya-time-celebration-or-concern> accessed on 23 January 2019

32 Mitheu J, ' The Regulation Of Digital Credit In Kenya: The Case For Consumer Protection' unpublished dissertation Submitted in partial fulfillment of the requirements of the Bachelor of Laws Degree, Strathmore University Law School, 2017

33 Paul Gubbins & Edoardo Totolo 'Digital Credit In Kenya: Evidence from demand-side surveys'

34 Mutua, J., Digital lenders form lobby group ahead of new rules, Business Daily Thursday, June 6, 2019 20:44 https://www.businessdailyafrica.com/economy/Digital-lenders-form-lobby-group-ahead-of-new-rules/3946234-5147736-daomrz/index.html> accessed 27th June 2019

lobbying by various stakeholders to have regulation is needed to explicitly provide for an interest rate cap for microcredit.[35]

There are calls for Safaricom, Airtel and Telkom Kenya to split their telecommunications business from their mobile money transfer and lending units if the Kenya Information and Communications (Amendment) Bill 2019 is enacted into law.[36] The Bill seeks to compel mobile phone companies to form separate arms to manage any other business they engage in outside telecommunications services and shall require the service providers to apply for separate licensing from the respective regulators of any industry or sector ventured into, as well as splitting the telecommunications business from such other business.

4.6 Regulating Sports betting and gambling

Mobile money had an influence on sports betting[37] in Kenya and is termed as an enabler of sports betting,[38] as all that is required is for one to be registered to one of the several betting outfits, be registered on mobile money by a mobile network provider and have money in the virtual wallet.[39]

The seamless integration between mobile money and sports betting is enhanced due to the ease of access to mobile money, the cost effectiveness and efficiency of mobile money, transparency, consistency, reliability and privacy of mobile money wallets.[40] Other factors include the easy availability of information, promotion of sports betting, ease of access to payment, commitment to

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[35] Jason G, Blechman 'Mobile credit in Kenya and Tanzania: Emerging regulatory challenges in consumer protection, credit reporting and use of customer transactional data.'

[36] Mbugua, N., 'M-Pesa, Airtel Money set for split in new Bill' https://www.businessdailyafrica.com/news/MPesa-Airtel-Money-set-for-split/539546-5165930-bbwvsfz/index.html> accessed 28th June 2019

[37] All forms of betting are governed by the Betting and Gaming Control Act in Kenya under the supervision of the Betting and Licensing Control Board (BCLB). Sports betting as an industry falls under this domain. There are several players that include and not limited to Sportpesa, mCheza, Betway, Elitebet Kenya, Betyetu, Justbet, Bet365, Betin, and Kenya sportsbet. Competition and aggressive pursuance of customers is clearly visible within the industry.

[38] Betting Control and Licensing Board (BCLB) under the Betting, Lotteries and Gaming Act of 1966.

[39] Pannis, Stathis et. al, 'Mobile Commerce Service Scenarios And Related Business Models' EURESCOM project P1102 eMporio

[40] Gemba, A., 'Implications Of Sports Betting In Kenya: Impact Of Robust Growth Of The Sports Betting Industry' Dissertation Project Report Submitted To The Chandaria School Of Business In Partial Fulfillment Of The Requirement For The Degree Of Global Executive Of Masters In Business Administration (Gemba), United States International University, 2017

payments and after sales services were instrumental in informing the relationship between betting and electronic commerce.[41]

All this is notwithstanding the adverse effects of sports betting, which is a form of gambling.[42] Presently, the government seems focused only in maximizing its revenues through taxation of sports betting companies, and is disinterested in managing the protection policies of individuals engaging in sports betting and did not control the exposure, advertisement and promotion of sports betting.[43]

There is a direct impact of banking on gambling to the extent that banks have been linked to lottery deposit accounts and the provision of deposit accounts that had a direct link to the interest earnings of a lottery.[44] Further, the introduction, growth and acceptance of mobile money and electronic cash and payment systems has greatly enhanced the adoption and use of gambling around the world. This is such that the emergence of technological innovations in payments had enhanced ease of access and settlement of lottery winnings as well as the ease of access to playing resources.

The multi-billion industry in Kenya is regulated by the Betting Control and Licensing Board (BCLB) under the Betting, Lotteries and Gaming Act of 1966.[45] However, the law has been playing catch up with technology as it was enacted before the era of mobile phones and the internet. Glaring loopholes and omissions define the current law and hence the challenge faced within and outside the industry and its span of impact. Additionally, betting and gambling in Kenya has taken on the technological aspect and hence posed new challenges to regulation and legislation.[46]

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[41] Yawe, B. L., & Ssengooba, K. (2014). Gambling and Mobile Money Payments: A Case Study of Sports Betting in Uganda, (37), 1–14.

[42] Ibid

[43] [43] Pannis, Stathis et. Al, 'Mobile Commerce Service Scenarios And Related Business Models' EURESCOM project P1102 eMporio

[44] Mwadime, A, 'Implications of Sports Betting In Kenya: Impact Of Robust Growth Of The Betting Industry' A Project Report Submitted to the Chandaria School of Business in Partial Fulfillment of the Requirement for the Degree of Global Executive of Masters in Business Administration at United States International University Africa, Spring 2017

[45] Betting, Lotteries and Gaming Act Chapter 139 Laws of Kenya

[46] Jack, W., & Suri, T. (2011). Mobile Money: The Economics of M-PESA 1. *Group*, 1–30. http://doi.org/10.3386/w16721> accessed 10 August 2018

Mobile technology has changed the face of gambling in Kenya and the interlink between gambling and mobile money transactions must be founded through sound regulation, which should focus on surveillance, auditing and monitoring of gambling activities in a compliant environment.[47]

4.7 Consumer Protection

Although Kenya has enacted the Consumer Protection Act, there seems to be continuous challenges affecting mobile money service customers. This is largely due to the fragmentation of the regulations in different pieces of legislation and more often than not, the consumer is left to figure out things themselves.[48]

Another concern that touches on consumer protection is the transparency especially of the transaction costs. Section 56 (3)[49] requires that a consumer shall be entitled to be informed by a service provider of all the charges and fees intended to be imposed for the provision of a service. Although there is transparency of mobile money transfer costs in Kenya, as agents display tariff boards where point of cashing in and cashing out, MNOs do not disclose the transaction costs for person-to person payments either before or after the transaction is completed. There is also poor disclosure of the cost of accessing Value Added Services, such as bill pay and bank to wallet/wallet to bank transfers, via USSD.[50]

Transparency of terms and conditions continues to be a challenge as markets develop and move gradually from simple payments conducted via mobile phones, towards products like merchant payments, credit, savings and insurance.[51] For instance, in cases of micro-loans and interest paying savings accounts consumers are not informed of the interest rates and rollover charges of the loan directly, but is instead directed to review the Terms and Conditions to third party websites. In some

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47 Mulwa, M., & Ndati, N. (2013). Integrated marketing communication (IMC) and technology adoption: A case of Safaricom's M-PESA mobile money transfer services in Kenya. *African Journal of Science, Technology, Innovation and Development*, *5*(5), 363–371. http://doi.org/10.1080/20421338.2013.829297> accessed 10 December 2016

48Blechman J., 'Mobile Credit in Kenya and Tanzania: Emerging Regulatory Challenges in Consumer Protection, Credit Reporting and Use of Customer Transactional Data.' http://www.macmillankeck.pro/media/pdf/AJIC_Issue_17_2016_Blechman.pdf> accessed 20 May 2019

49 Competition Act No. 12 of 2010

50 Jason G, Blechman 'Mobile credit in Kenya and Tanzania: Emerging regulatory challenges in consumer protection, credit reporting and use of customer transactional data.'

51 I Mas & O. Morawczynski 'Designing Mobile Money Services: Lessons from M-PESA' available at http://www.afminetwork.org> accessed 9 February 2017

cases, customers may not understand the complexity of the contract signed, making it possible for them to face additional fees/services without being aware.[52]

Kenya's inherent problem is that there is a lack of coherence in consumer protection and market oversight. The split in responsibility has made it difficult for regulators to take a strategic view of priorities across the entire retail financial services sector.[53] Decisions are driven by different legal duties and powers of individual regulators such as the Communications Authority of Kenya and the Central Bank of Kenya. Having two regulatory regimes for what is often from the consumer's perspective a single product or service can result in different rights and a divergence in protection for personal and small business consumers.[54] Mobile money service users may not fully understand which regulations apply to a payment transaction and how these may differ depending on the payment method and platform used, the parties involved in the payment transaction, and the nature of the product purchased.[55]

The lack of understanding stems from the fact that the different bodies including banks, MNOs and agents whose operations are often overseen by different regulatory bodies also operate under different sets of regulations.[56] Consumers are therefore unclear over what redress rights they have which entity to turn to if there is a payment-related problem.[57]

4.8 Emerging Issues

E-money models are still in their infancy. As these models gain traction and expand, other regulatory challenges will arise, including; whether to treat e-money as savings products, rather than as simply funds transfer and how to level the playing field among different kinds of entities offering similar

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52 Malala, J,' Kenya Bankers Association Consumer Protection for Mobile Payments In Kenya

53 Blechman J., 'Mobile credit in Kenya and Tanzania: Emerging regulatory challenges in consumer protection, credit reporting and use of customer transactional data.'

54 Ibid

55 Mulwa, M., & Ndati, N. (2013). Integrated marketing communication (IMC) and technology adoption: A case of Safaricom's M-PESA mobile money transfer services in Kenya. *African Journal of Science, Technology, Innovation and Development*, *5*(5), 363–371. http://doi.org/10.1080/20421338.2013.829297> accessed 14 July 2018

56 Mitheu, J' The Regulation of Digital Credit In Kenya: The Case for Consumer Protection' Thesis submitted in partial fulfillment of the requirements of the Bachelor of Laws Degree, Strathmore University Law School. March 2018

57 Nzomo, V, 'E-Commerce and the Law in Kenya: Consumer Protection' https://blog.cipit.org/2018/02/15/e-commerce-and-the-law-in-kenya-consumer-protection/> accessed 5th May 2019

services.[58] Consequently, regulators may soon confront questions about whether e-money accounts should enjoy the same benefits and protections as bank accounts.[59]

Most regulatory authorities consider the payment of interest a feature of a bank deposit and consequently ban interest payments on e-money in an effort to clearly delineate between banking activity and payment services.[60] However, this distinction between payments and banking activity is of questionable legal merit. Because deposit taking is often an activity reserved for prudentially regulated and licensed banks, regulators and nonbank e-money issuers have embraced the argument that non-bank e-money issuance is simply a payment mechanism and not a bank deposit.[61] However, collecting repayable funds from the general public is arguably a "deposit" regardless of whether it is collected by a bank or payment services provider.[62] As e-money is increasingly used as a savings vehicle, and as there is evidence that customers desire to earn interest, there is no clear guidelines to capture this emerging trend.[63] In the future, regulators may be forced to reevaluate perceived risks and reconsider permitting nonbank e-money issuers to pay interest earned on pooled accounts.[64]

In most developing country frameworks, e-money is not considered a deposit and, thus, is not covered by deposit insurance.[65] However, as discussed, to the extent underlying customer funds are kept in bank accounts, such funds are exposed to the risk of bank failure. Even in circumstances where deposit insurance exists, the value of pooled accounts is often much higher than the

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58Malala J, 'Consumer Protection for Mobile Payments in Kenya: An Examination Of The Fragmented Legislation and The Complexities It Presents For Mobile Payments,' WPS/02/14 KBA Centre for research on financial markets and policy working paper series, 3

59 Gutierrez E & Singh S., '*What Regulatory Frameworks Are More Conducive to Mobile Banking? Empirical Evidence from Findex Data Policy* Research Working Paper 6652 (October 2013) World Bank: Finance and Private Sector Development, Latin America and the Caribbean Region.

60 Maore K & Mutembei C., 'Critical Literature Review on Mobile Banking Regulatory Overlap and Gap in Kenya' Research paper Submitted to the 2011 Operation Research Society of Eastern Africa (ORSEA) Conference, Nairobi: University of Nairobi. Available at www.orsea.com (accessed 9 February 2018)

61 Nzomo, V, 'E-Commerce and the Law in Kenya: Consumer Protection' https://blog.cipit.org/2018/02/15/e-commerce-and-the-law-in-kenya-consumer-protection/> accessed 5th May 2019

62 Ibid

63 Ngugi, B et. al 'M-PESA: A Case Study of the Critical Early Adopters' role in the Rapid Adoption of Mobile Money Banking in Kenya. '*The Electronic Journal on Information Systems in Developing Countries.'* (2010)

64 Carlos, J & Jenkin, I., "Risk Based Supervision in the Digital Financial Inclusion Era" CGAP, 26 April 2016, http://www.cgap.org/blog/risk-based-supervision-digital-financial-inclusion-era> accessed 21 December 2017.

65 Gutierrez E & Singh S., '*What Regulatory Frameworks Are More Conducive to Mobile Banking? Empirical Evidence from Findex Data Policy* Research Working Paper 6652 (October 2013) World Bank: Finance and Private Sector Development, Latin America and the Caribbean Region.

applicable deposit insurance coverage limits.[66] As electronic value offerings grow in volume and popularity, and as evidence mounts that e-money schemes are increasingly being used as savings vehicles, regulators may want to consider extending deposit insurance protection at the level of individual customer mobile money balances or alternatively raise the ceiling for pooled accounts.[67] Many developed countries already provide such deposit protection.

4.9 Conclusion

This Chapter has looked at some of the salient risk factors and shortcomings of the existing regulatory framework. It argues that the current hybrid system of regulation has resulted to most of the challenges and thus makes a case for an overhaul into a customized regulatory framework. It also specifically draws attention to some of the resultant challenges that have marred the sector, which it advocates that the same must be addressed because the mobile money market has significantly grown and continues to grow at a high rate. There is thus likelihood that any risks which are not addressed have the potential to destabilize the system, and thus there is need for the government to urgently derive measures to create a tailor made regulatory model.

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66 Ibid

67 Triki T and Faye I, 'Financial inclusion in Africa' African Development Bank 2013, 25 https://www.afdb.org/fileadmin/uploads/afdb/Documents/ProjectandOperations/Financial_Inclusion_in_Africa.pdf > accessed on 22 January 2019.

CHAPTER FIVE: CREATING AN IDEAL LEGAL AND REGULATORY FRAMEWORK

5.1 Introduction

The mobile money market in Kenya continues to grow each day and this growth is proliferated by the numerous technological advancements. It is therefore necessary that the government considers means of establishing an enhanced regulatory framework to govern this sector. In the preceding chapter, the study looked at the current existing challenges ranging from operational risks to emerging technological developments. These, the study identified as the main challenges that have continued to affect the legal and regulatory space in Kenya, and by extension, likely to nip the potential of the sector for the growth of the economy in the country.

While this research does not come close to providing a definitive solution for the regulation of the mobile money environment in Kenya, it affirms the need for custom made regulation for the mobile money services sector in Kenya and proceeds to make several recommendations to be considered when establishing a fitting regulatory system for mobile money market in Kenya.

This chapter therefore justifies the need for a tailor made regulatory framework for mobile money services in Kenya. It also attempts to identify some of the requirements which should be met in order to achieve a viable legal and regulatory framework that would facilitate an efficient mobile money services sector in Kenya.

5.2 Proposition for custom made regulation

The primary motivation for this study has been the lag of law in the regulation of mobile money transfer and payment services in Kenya. In its analysis of the existing mobile money market regulatory framework, the study reviewed and considered the context surrounding mobile money market in Kenya, as well as the regulatory options that are available to policy makers and regulators.

In identifying an ideal regulatory framework to govern mobile money services sector in Kenya today, it is prudent to consider as paramount the need to maintain regulatory efficiency and consumer needs. Further, in making this determination, two salient aspects must be considered. First, is the structure and operation of the mobile money market itself as distinct from the transactions taking place in the market and, second, the legal framework governing transactions in the mobile money market.

This research thus comes to the conclusion that custom-made regulation would be a more suitable regulatory model for mobile money market in Kenya. It is therefore prudent for the government to consider formulating policies geared towards the establishment of custom made regulation to govern the sector. This in turn, will provide a more flexible, efficient, and effective regulatory framework for mobile money services in Kenya.

The customized regulatory framework must also look at ways of resolving some of the existing gaps in order to enhance the operating space for the stakeholders as well as providing efficiency for the consumers. To this regard, the following section makes some of the main recommendations, which should be considered when developing the customized regulatory framework.

5.3 Enhanced regulation of risks

An ideal regulatory framework for any mobile money market should be able to address some of the following risks including systemic risk, operational risk, competition and anti-trust.

5.3.1 Systemic Risk

Despite the increased importance of mobile money in many countries, the overall impact is considered negligible, even if usage were to expand significantly. The Central Bank of Kenya should devise ways of controlling the balance between mobile money and central bank money and regulate short-term rates.

Mobile money systems currently pose a far smaller risk to the financial sector than banks and other financial institutions. However, this is greatly dependent on the transaction amounts remaining as small as they do and this is further tied to the transaction limits imposed by the Central Bank. The current maximum amount transferable per transaction is 70,000 shillings, the total amount one may transfer in a day is 140,000 and the maximum amount that may be held in a customer's account at any time is 100,000 shillings.

Although keeping these limits low simplifies the regulation of systemic risk, it fails to take into consideration customers' interests to access of more funds. As a payment system, however, it would be desirable for it to be able to handle more significant transfers. This would necessitate the formulation of new regulations to deal with the systemic risk that would undoubtedly arise when mobile money is responsible for a large number of transactions, including some large volume transactions.

A number of regulations can be introduced to reduce systemic risk for instance, by requiring the money held within the system to be held in multiple banks, or by requiring the money to be held in banks of a certain standing. These measures would eliminate the current concern whereby MNOs have liberty to elect where their funds shall be deposited.

5.3.2 Operational risks

The law should also address operational risks such as privacy concerns and security issues. There are privacy concerns around the basic operation of mobile money systems, which the law should eliminate. This includes mandatory presentation of identification documents and signatures, when transacting through an agent. While this may be important for record keeping purposes, it will also eliminate significant risk that arises from anonymous transactions.

The mobile payment systems should continue to be maintained as a mere conduit to secure customers' funds. In any case, it is highly unlikely that the MNOs would be willing to go into banking business as this would put them under extra regulations as financial institutions. That being said, however, security of the customers' funds should receive an extra layer of security given the fact that they are, at the moment, individually unprotected by deposit insurance.

It has been implied that there is virtually no credit risk posed by the mobile money transfers and payment systems given the fact that the service providers do not, at any point, have any legal ownership of the money. However, given the basic banking operations, the money does not belong to the clients either, once it has been deposited by the service providers into a bank account. This exposes the clients, through the trust, to credit risk. As a result, the clients should be protected from the risks on their deposits or at the very least, compensated to justify the risk their money is placed under.

The compensation should come in the form of interest paid to the customers on their deposits and the protection should come in the form of deposit insurance to individual customers' deposits. The current regulations do not allow non-bank mobile money issuers to pay interest on the mobile money to their customers. Interest here is to be understood to include interest equivalents which are basically any benefits such as, free airtime given to the customer. Currently, there is no justification from the regulators, who only insist that paying interest is a banking activity.[68]

Intermediation places the customers' money at risk, which risk is compensated by the interest offered by the institutions carrying out the banking business. The intermediation gives rise to systemic risk, which is what prudential regulations attempt to mitigate. While the mobile money issuers, such as mobile payment service providers do take deposits from their customers, the deposits are not held by them, but rather, they are held in totality by commercial banks, which then intermediate on the funds and pay interest to the trust account. As such, it is not entirely out of the question to share this interest with the customers, as the service providers are not allowed, under any circumstances, to benefit from this interest.

5.4 Deposit Insurance

The biggest shortcoming to the implementation of deposit insurance with respect to mobile money services is the definition under the Deposit Insurance Act.[69] The Act provides that an institution is under a lawful obligation to repay monies to a depositor who is acting as a trustee for another or as joint owner with another, and the trusteeship or joint ownership is disclosed on the records of the institution. This can be done under three circumstances: where the deposit is deemed to be a deposit separate from any deposit of that depositor acting in his own behalf or acting in another trust with the same institution; or where the deposit held in trust is deemed to be a separate deposit for each beneficiary where the depositor is a trustee for multiple beneficiaries; and where the deposit held in trust is deemed to be separate from other deposits with the institution on his own behalf or by another trustee with him as the beneficiary.

68 As Ehrbeck and Tarazi observed, there is little reason given by regulators for this. However, Ehrbeck and Tarazi go on to explain that the definition of banking activity focuses especially on the deposit taking and the intermediation of the funds by the institutions, and not the interest alone.

69 Deposit Insurance Act

As matters stand, however, it is still unclear whether mobile payment systems are required by the law to be members of the fund because none of them is. As such, the deposit insurance extends to the bank accounts held in trust as individual bank accounts. In the event of a collapse of the bank, the entire mobile payment system ecosystems would receive a maximum of 100,000 shillings to be shared among the millions of registered users.

The Act still fails to define deposits generally but defines the deposits that may be insured under the Fund. As such, whether a deposit shall be protected depends solely on whether the insured party is a member of the Fund. Given the criteria for compulsory membership under section 24 of the Act, it cannot be guaranteed that every mobile money provider shall have their funds insured.

The mobile payment service providers should, at the very least, be required to be members of the Deposit Insurance Fund. The money that is held within the systems is placed at risk, which can hardly be mitigated by insuring the individual trust accounts alone. The law expressly caps the maximum amount that can be repaid by the Fund at 100,000. Considering the number of registered mobile money users and the amount of money held within the mobile payment systems, the compensation by the fund obviously negligible.

5.5 Privacy Concerns

In line with the minimalistic approach that underpinned the original implementation of mobile payments service in Kenya, unnecessary procedures such as keeping a physical log of transactions when transacting through agents should be eliminated. It is a matter of fact that mobile money users can make withdrawals through an ATM without providing any information other than their PINs that are attached to their mobile money accounts.

This would go a long way in eliminating the risk of misuse of personal information such as signatures and ID numbers. There has been no satisfactory reason justifying the presentation of identification documents and signing off on each transaction. In fact, some agents do not really enforce the requirement for signing for each transaction one performs. As such, it can simply be eliminated with no serious repercussions in terms of a security leak.

5.6 Balance of interests

Firstly, the cost of introducing new regulations must be justifiable from the perspective of the regulator, the service provider, and the consumer. The eventual burden of most of the existing regulations ends up being shouldered by the consumer because of the service provider increasing their prices in order to meet the cost of conforming to the new regulation. As such, the regulations should only be limited to those whose benefits outweigh the cost of implementation.

Second, the regulator must be able to have the perfect balance of regulation. Overregulation has been considered by many to be the cause of the slow uptake of mobile money in many jurisdictions. While regulations are not the only factor at play here, it has been argued by many to be a key contributor. MPESA, the pioneering mobile payments service in Kenya, launched in 2007 into a regulatory vacuum that allowed it to grow with minimal supervision.

To ensure effective regulation that does not undermine innovations, the regulator must own responsibility to ensure that any intervention aimed at breaking a monopoly or abusive dominant position does not harm the industry, create an unequal playing field for current market players, or negatively impact customers.[70]

To this end, the development of cooperation frameworks among MNOs should be continuously developed and reviewed. This should also have clear action plans which are continuously reviewed. This should also incorporate the various regulators such as the Competition Authority of Kenya, the Central Bank of Kenya and the Communications Authority of Kenya, in order to enhance mutual collaboration and information sharing on matters that have both competition and communication dimensions.

Finally, the legislature must be willing to enact new legislation to fit new innovations rather than trying to squeeze new products into the traditional definitions in the law. Regulation of mobile money has taken the country such a long time mostly due to the fact that the regulators were trying to regulate a service that the law could not even describe.

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70 Dinenko, A. " Regulatory Challenges underlying FinTech in Kenya and South Africa" https://www.biicl.org/documents/1814_regulation_of_fintech_in_kenya_and_south_africa_v_1.pdf?showdocument=1 > accessed 4th May 2019

5.7 Consumer protection

The current consumer protection regulation in Kenya, which has grown largely in response to expanded use of financial products, has led to the fragmentation of the current regime. Consequently, the gaps that it presents as a result of its fragmentation support the case for consolidation of the legislative instruments for consumer protection of financial services.[71]

Some of the continued interventions to protect consumers such as use of clear contracts that fully disclose all fees to be charged, tailored for various customer situations, including different languages and illiteracy should be enhanced. Similarly, all requisite disclosures should be reasonably comprehendible to all customer groups.[72]

The need to harmonize and extend consumer protections for mobile money markets should include the regulators to enhance the enforcement and awareness creation of consumer rights and the need for consumer protection. Secondly, MNOs should include in their contracts the full consumer rights provided under existing law. Thirdly, the Central Bank of Kenya, through its supervisory and oversight role, should ensure that it does what it can under existing statutory authority to ensure that existing consumer protections are applied to new payment methods. Kenya should have a reform legislation that would provide authority for the Consumer Protection Act to have mandate over financial services and products.

5.8 Financial Services Authority

This is the Authority that has been proposed to consolidate all the markets in the financial services sector, including banking, insurance, cooperatives, saccos and other financial service providers. Once established, through the relevant legislation the Regulator should also be mandated to oversee all maters in regard to financial payments.

The proposed Financial Services Authority would be the most ideal regulator for a number of reasons. First, it would isolate regulation of mobile money from CBK and CAK, and this would give the mobile money sector the due regulatory attention it currently deserves. In support of this

[71] Malala, J,' Kenya Bankers Association Consumer Protection for Mobile Payments In Kenya (2014)
[72] Andiva B.

argument, the CBK and CAK have found it extremely difficult to keep up with the pace of mobile money hence the lag in regulations.

Second, being an independent regulator, it would draw experts from banking, ICT, telecommunications, and mobile money sectors. The existing command-and-control regulation, the overlap of functions and lack of coordination amongst the regulators, CBK and CAK evidenced in the framework are indeed red flags that the regulators are at pains in determining what to do. They find themselves in an unenviable position where they have to balance the interests of those involved in the mobile money market on the one hand, and promotion of emerging innovations on the other. It is indeed a herculean task that can only be achieved with the right expertise in the area of mobile money of which they are lacking.

The lack of expertise amongst the regulators is compounded by the rapid development in the mobile money markets such that regulations formulated today might be inappropriate a few months from now. Gradually mobile money is becoming more complex and with each passing day boundaries between sectors are becoming blurred, therefore supervision and regulation will become more complex. This challenge may ultimately be cured by the proposed Financial Services Authority.

5.9 RECOMMENDATIONS

The current regulatory framework has been marred by amendments, due to the pressure from the emerging developments. Overtime, this has proven to be ineffective, hence the existing framework is still unsuitable for the mobile money market in Kenya. It is thus obvious that piecemeal regulation has failed to guarantee suitability in terms of regulating mobile money and payment services in Kenya. Instead, the same has been used as a stop gap measure which will never be adequate to regulate the existing services.

This study thus proposes that custom-made regulation would be the most appropriate model, if the benefits of mobile money transfer and payment services in Kenya are to be truly achieved. The study thus recommends that the regulation of mobile money sector in Kenya should be isolated from the existing regulators, mainly the Central Bank of Kenya and the Communications Authority of Kenya. In the stead, the government should set up an independent regulatory body, with experts drawn from banking, ICT, telecommunications, and mobile money sectors.

Having made proposals for the unified Financial Services Regulator in Kenya, it is envisioned that there would be three main reasons why this model should succeed. First, mobile money being a peculiar innovation requires an out-of-the-box approach to regulate it through an independent unified regulator. Second, the industry is a rapidly evolving in comparison to the banking industry which continues to be governed by archaic established regulatory models. Third, the existing regulators, CBK and CAK have found it extremely difficult to keep up with the pace, leading to a lag in regulations. Lastly, since we cannot predict the direction that mobile money innovations such as M-PESA are taking, we ought to create an appropriate regulatory framework for them, which is long overdue.

5.8 CONCLUSION

This study sought to evaluate the suitability of the existing legal and regulatory framework in the regulation of mobile money transfer and payment services in Kenya. This goal was broken down into a set of specific objectives that included analyzing the evolution of the existing legal and regulatory framework, identifying its shortcomings and testing its suitability in terms of adapting to frequent technological changes and facilitating smooth operations in the mobile money industry.

In fulfilling the study's objectives, this thesis found that the existing regulatory framework is unsuitable to regulate mobile money transfer and payment services in Kenya. The framework is comprised of inflexible and over inclusive rules that are tailor made from the banking and ICTs sectors and transferred into the mobile money industry thus negating its peculiar nature. Needless to say, the fact that mobile money by its operational nature incorporates both banking and ICT does not justify formulation of regulation in this manner. This is the main reason why the study concludes that the current framework is at a disadvantage when it comes to regulating MMTs and payment services in Kenya.

This study has attempted to evaluate the history of mobile money transfers and payment services in Kenya. It opines that mobile money services have revolutionized the way of doing business across the world. Additionally, it is linked to various sectors in the world and the market continues to grow at an alarming rate. In Chapter one, the discourse focused on laying the base for the study. It explained the three pertinent questions which the study sought to address, which includes first, how the existing legal and regulatory framework has evolved and developed in Kenya; second, what challenges do the existing legal and regulatory framework pose; and third, what is the most appropriate legal and regulatory model that should be adopted to facilitate the efficient operations of mobile money services in Kenya.

The first chapter also examined the theoretical framework on regulation. This is important because it lays the foundation of the study and more so to raise pertinent questions to support the need for regulation in the mobile money services sector in Kenya today. The theorists supported the need for codification on the sole argument that codification the entire regulatory domain is man-made and thus easily manipulated by private or public actors.[73]

Under Chapter Two, the study sought to analyze the origins and development of mobile money transactions and payment services. It recognizes that in Kenya, the sector developed in an unregulated market, having evolved as a result of sporadic combination of both banking and telecommunications. Being a hybrid system, it continues to suffer from various challenges which include the overlap of functions amongst regulators and coordination failure among others.

Chapter Two also examines the different regulatory models that may be employed, while also taking into consideration ideal regulatory techniques. It reviewed the pros and cons of both self-regulation and statutory regulation. It thus recommended a hybrid system in the meantime, which should be enhanced through proper oversight and enforcement mechanisms if it is to be successful as a regulatory model.

Chapter Three focused on analyzing Kenya's existing regulatory framework. It discusses mainly the National Payment Systems Act, which seems to be the principal legislation governing mobile money markets. This is in conjunction with the E Money Regulations, 2013 and the Retail Transfers Regulations, 2013. An analysis of these laws, however, lays bare the many current shortcomings of the same such as, inadequate dispute settlement mechanisms, the regulators wide discretion and unlimited access to information, overlapping functions, inadequate consumer protection measures among others.

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[73] ibid

Chapter Four makes an argument for the need for effective regulation, in its current hybrid system. These include but are not limited to: fair competition, enhanced insurance and credit facilities that a vital for a thriving business environment. Finally, this Chapter attempts to give recommendations to some of the existing challenges, which if considered, may improve the current regulatory framework. The main recommendation it makes is for custom-made regulation which would be a more suitable regulatory model for mobile money transfer and payment services in Kenya. Although there are not many best practices in the area of mobile money for Kenya to rely on, practices and research across a range of other fields are likely to provide considerably greater understanding of how custom made regulation might be formulated to provide a more flexible, efficient, and effective regulatory framework for MMTs and payment services in Kenya.

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