

**AN EXAMINATION OF THE ADEQUACY OF THE CONSUMER PROTECTION ACT
IN PROTECTING BANKING BORROWERS IN KENYA.**

**A CASE STUDY OF THE NATIONAL BANK OF KENYA TERMS AND CONDITIONS
FOR AN UNSECURED LOAN.**

BY

NICHOLAS AMUTI

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ABSTRACT

The passage of the Consumer Protection Act 2012 (*CPA 2012*) has been heralded as a new dawn for borrowers in the Kenyan banking sector. Until its passage in December 2012, the regulatory framework dealing with the protection of borrowers lacked a cohesive policy and regulatory framework because it had been scattered in various private and public law measures.

Secondly, existing legislations such as the Banking Act and the Central Bank of Kenya Act did not offer sufficient protection to borrowers as compared to banks. This inequality in protection was largely attributable to the fact that, majority of the laws dealing with borrowers in the banking sector focused on safeguarding the interests of the banks first, at the expense of the borrower.

Thirdly, in some instances, where such legislation contained checks and controls to protect the borrower, only the Central Bank, being the enforcing authority could implement them against the banks and therefore the borrower had to rely on a third party to enforce his rights on his behalf.

This paper therefore seeks to examine to what extent protection of the borrower has been strengthened by the passage of the Consumer Protection Act. In order to achieve this goal, I shall first identify banking practices in the “*National Bank terms and conditions for unsecured loan,*” which I deem to be unfair to the banking borrower. Having done that, I shall then examine the CPA 2012 to identify whether it has any form of protection for the borrower against the identified unfair practice. The adequacy of the CPA 2012 in protecting the borrower will therefore be determined by whether or not it offers a solution to the identified unfair practice.

In that regard, an unfair practice in this paper shall be considered to be any act or omission by the bank or its agents whose consequence may result in the banking borrower suffering a detriment or resulting in a disadvantage to the borrowers' interests.

The fundamental argument in this paper is therefore twofold. First is the assertion that a comprehensive legislative framework is crucial for adequate protection of the borrower. Consequently, the quest for protection of the borrower must welcome into this discussion the intricacies of a contractual relationship, the unequal bargaining power between the lender and the borrower, the different capacities of borrowers especially the vulnerable ones and the capacity to monitor lender-borrower behaviour and enforce penalties and remedies in order to be adequate.

The second part of the fold entails recognition of the fact that a comprehensive legal framework with adequate protection clauses for the borrower is only as good as its implementation. It is therefore important to establish an institution to enforce the legislation and to set up a criterion for enforcement.

DECLARATION

I hereby declare that this thesis is my original work and has not been presented for a degree in any other University.

Name: *NICHOLAS AMUTI MOMBO*

Date:

Signature:

This thesis has been submitted for examination with my approval as the University Supervisor.

Name: *DR. DAVID GACHUKI*

Date:

Signature:

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ABBREVIATIONS

APR	Annual Percentage Rate
ATM	Automated Teller Machine
All ER	All England Law Reports
BPLR	Benchmark Prime Lending Rate
CBA	Commercial Bank of Africa
CBK	Central Bank of Kenya
CPA	Consumer Protection Act
EWCA	European Writing Centres Association
FSD	Financial Sector Deepening
IMF	International Monetary Fund
KBRR	Kenya Bankers Reference Rate
KCB	Kenya Commercial Bank
KLR	Kenya Law Reports
NBK	National Bank of Kenya
SFC	Standard Form Contract
UTCCR	Unfair Terms in Consumer Contract Regulations
WLR	Weekly Law Reports

LIST OF STATUTES

Kenya

The Constitution of Kenya

The Banking Act of Kenya, Cap 488

The Central Bank of Kenya Act, Cap 491

The Competition Act 2010

The Consumer Protection Act 2012

South Africa

National Credit Act 2005

United Kingdom

Consumer Rights Act 2015

The Unfair Terms in Consumer Contracts Regulations 1999

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3. Captain JN Wafubwa v Housing Finance Company of Kenya [2011] HCCC 385, [2012] eKLR
4. Francis Joseph Kamau Ichatha v Housing Finance Company of Kenya Limited [2004] HCCC 414, [2015] eKLR
5. Kyangavo v Kenya Commercial Bank Limited and another [2001] CA 428, [2004] eKLR
6. Margaret Njeri Muiruri v Bank of Baroda (Kenya) Limited [2004] CA 282, [2012] eKLR
7. Rose Florence Wanjiru v Standard Chartered Bank of Kenya Limited and two others [2003] HCCC 433, [2014] Eklr
8. Trust Bank Limited v Eros Chemists Limited and another [1999] HCCC 133, [2000] eKLR

United Kingdom

1. Garnac Grain Company Incorporation v HMF Faure and Fair Dough Limited [1967] 2 All ER 353
2. Hedley Byrne and Company Limited v Heller and Partners Limited [1963] 2 All ER 575
3. HSBC Bank PLC v Patrick [2011] EWCA Civ 67
4. L'Estrange v F Graucob Limited [1934] 2 KB 394
5. Paragon Finance PLC v Nash [2001] EWCA Civ 1466, [2002] All ER 248

6. Photo Production Limited v Securicor Transport Limited [1980] UKHL 2, [1980] 1 All ER 556
7. Plevin v Paragon Personal Finance Limited and another [2014] UKSC 61
8. Socimer Bank v Standard Bank [2008] EWCA Civ 116
9. Springwell Navigation Corporation v JP Morgan Chase Bank [2010] EWCA Civ 1221
10. Spurling v Bradshaw [1956] EWCA Civ 3, [1956] 1 WLR 461
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CHAPTER ONE

1.0 INTRODUCTION: A GENERAL OVERVIEW AND OUTLINE

1.1 INTRODUCTION

All over the world there has been a long tradition for protection of consumers/borrowers either from unscrupulous lenders, usury laws or highly excessive charges. Over the years an awakening period specifically for financial consumer protection has been taking place. From the year 2010 to the year 2012, the World Consumer Rights days were dedicated to strengthening the financial consumer rights. On 15th March 2010, the theme was titled Our Money, Our Rights; in 2011 it was titled, Consumer for Fair Financial Services and in 2012 the theme was titled, Our Money, Our Rights -Campaigning for Real Choice in Financial Services.

In Kenya, banks are major players in the money market. According to the Banking Survey 2015 report,¹ the total aggregate balance sheet of the sector expanded from two trillion seven hundred billion Kenya shillings in December 2013 to three trillion two hundred billion Kenya shillings in December 2014 indicating a continued year-on-year growth. In fact, nearly four in every one hundred people with a bank account currently take loans from a commercial bank, having more than doubled from the two out of every one hundred who borrowed from banks in 2006, hence the need for protection.²

¹ Nation Team, 'Banking Survey 2015 Report' *Daily Nation* (Nairobi, 21 May 2015) Advertising Feature I.

² The Central Bank of Kenya and Financial Sector Deepening (F.S.D), 'Profiling Developments in Financial Access and Usage in Kenya' (Fin Access 2013 Report) < http://fsdkenya.org/wp-content/uploads/2015/08/13-10-31_Fin_Access_2013_Report.pdf > accessed 19 October 2014.

1.2 BACKGROUND

The need to protect the banking borrower first emanates from the contractual nature of the banker-customer/borrower relationship.³ This contractual relationship creates an assumption that both the borrower and the bank have equal bargaining power and that both voluntarily enter into this agreement upon proper consultation. Indeed in the case of *Captain JN Wafubwa v Housing Finance Company of Kenya*,⁴ Ogola J notes in his obiter dicta that ‘...Banks cannot just hide behind the contracts they make; regardless of how unjust they are, to literally destroy their customers...’ He further states that, ‘a time has come for banks in Kenya to look into the eyes of their customers and answer the question: Are banks Kenyans? Or have they just entered Kenya for business?’

Secondly, consumer protection laws and regulations are also based on a presumption that private law measures (which include contract law) fail to supply consumers with adequate information for them to make efficient choices among products and therefore protect themselves from unscrupulous lenders.⁵ In fact even when a bank decides to disclose the information to the borrower, it is often buried in so much legalese. Consequently, in the absence of information, borrowers would not be expected to be able to weigh the benefits and costs of such banking services and products and make meaningful choices.⁶ Consumer protection therefore takes the form of a public law measure concerned with enhancing equity and fairness, in order to

³ MW Hesselink, ‘Unconscionability, Unfair Exploitation and the Nature of Contract Theory, Comments on Melvin’s Eisberg’s Foundational Principles of Contract Law’ (2013) Amsterdam Law School of Legal Studies Research Paper 7/2013 <<http://hdl.handle.net/11245/1.487132>> accessed 22 October 2016.

⁴ [2011] HCCC 385, [2012] eKLR.

⁵ G Howells and S Weatherrill, *Markets and the Law: Consumer Protection Law* (2nd edn, Ashgate Publishing Ltd 2009) 32, see also Consumer International, ‘A-Guide-to-Developing-Consumer-Protection-Law’ (2011) <<http://www.consumersinternational.org/media/715456/a-guide-to-developing-consumer-protection-law.pdf>> accessed 22 October 2016.

⁶ F Akinbami, ‘Financial Services and Consumer Protection after the Crisis’ (2011) 29(2) International Journal of Bank Marketing 3.

overcome any imbalance of power between the lender (bank) and the borrower.⁷ The state through consumer protection legislation is therefore tasked with ensuring that both parties' interests are protected.

Thirdly, protection of borrowers is also borne by the realisation that the quest to protect the interests of borrowers often pits borrower interests against bank interests. A good example to highlight this point can be demonstrated during financial turbulences in which case Banks tend to become risk averse, in an effort to protect and safeguard their interest. It therefore forces banks, for example to call loans earlier than they would usually do in more prosperous times. This is detrimental to the borrower since, the requirement to repay loans is often to begin *effective immediately expecting* borrowers to get additional money to give the banks overnight. The resultant effect is usually borrowers losing their assets due to inability to service their loans as per the new requirements.

Fourthly, borrower protection also arises due to a mistrust of banks by Kenyan borrowers. A good example is the ongoing case of *Rose Florence Wanjiru v Standard Chartered Bank of Kenya Limited and two others*⁸ in which the plaintiff accused the defendant of increasing its rate of banking without obtaining the approval from the minister of finance to levy the charges as required under the Banking Act. The plaintiff therefore sought for orders compelling the defendant and to return all monies they had levied their customers without the approval of the finance minister as required by the Banking Act 1989.

⁷ International Financial Consumer Protection Organisation, 'Review of Supervisory Tools for Suitable Consumer Lending Practices' (FinCoNet Report on Responsible Lending 2014) < <http://www.finconet.org/FinCoNet-Responsible-Lending-2014.pdf> > accessed 28 August 2015.

⁸ [2003] HCCC 433, [2014] eKLR.

A further mistrust of banks is illustrated in the case of *Al-Jalal Enterprises Limited v Gulf African Bank Limited*.⁹ In this case, the plaintiff had sought for injunction orders to protect its property from auction by the defendant. Despite the fact that the court noted that the plaintiff had defaulted in repaying the loan and failed to obey court orders, Ogola J. stopped Gulf African Bank Ltd from recovering two hundred and twenty million Kenya shillings it had advanced to Al-Jalal Enterprises Limited, as he decided to extend a “hand of mercy” to the plaintiff and issued an injunction ordering Al-Jalal Enterprises to “to pay the defendant thirty million Kenya shillings within ten days from the date of the ruling and pay ‘a further thirty million Kenyan shillings within ninety days from the date of the ruling’. According to his obiter dicta, Ogola J. was concerned with the ruthless manner in which Kenyan banks acted against their customers as he equated banks to a robber who after killing his victim, insists on not only attending the funeral, but also carrying the casket to the grave in order to confirm that the victim is dead and buried.

Fifthly, the volatile combination of profit seeking companies, and ill-informed, ill-educated borrowers has also opened up dangerous potential for exploitation of borrowers.¹⁰ In addition, other factors that may make borrowers vulnerable to predatory lending include financial vulnerability, injury, sickness or unemployment.¹¹ It is however important to note that vulnerability does not always lead to abuse, but it increases the risk.

⁹ [2014] HCCC 161, [2014] eKLR.

¹⁰ A Karnani, ‘Regulate Micro-credit to Protect Borrowers’ (2009) Ross School of Business Working Paper 1133 <<http://ssrn.com/abstract=1476957>> accessed 24 October 2016

¹¹ J. Malbon, ‘Predatory Lending’ in Pelma Rajapakse (eds), *Impact of the Regulatory Regime on Promoting the Housing Finance Market in Australia* (2005) 5(4) Law and Financial Markets Review 10.

Protection of borrowers is also heightened by technological financial innovation resulting in the evolution of banking to electronic banking¹² and diversification encompassing the evolution of banks to provision of services outside their traditional roles.¹³ For instance banks are now offering multi-functional banking like bancassurance programs which are new products that borrowers may not really understand thus creating an avenue for exploitation of those borrowers.

In that regard, the quest to protect borrowers must be aimed at ensuring that borrowers receive sufficient information to allow them to advance their economic interest, and that they are not subject to unfair or deceptive practices by banks.

1.3 STATEMENT OF THE PROBLEM

An adequate consumer protection framework ought to transform the lives of borrowers to better living standards.¹⁴ In order to do so, the Constitution of Kenya provides for the inclusion of three key elements whose implementation would hopefully foster the goal of protection of borrowers. Firstly, article 46 (1) (c) of the Constitution, provides that, protection of consumers/borrowers must be concerned with protecting the consumers/borrowers economic interest. The term economic interest can only be interpreted to mean the financial wellbeing of borrowers which is often affected by a high cost of credit and the abuse of the profit motive by banks to the detriment of borrowers. Unfortunately, despite the passage of the CPA 2012, borrowers'

¹²The East African Team, 'One out of Four Accounts 'Dormant' As Mobile Money Takes Over Banking' *The East African* (Nairobi, 23-29 May 2015) 40; see also Peter Kiragu, 'Mobile Money Business nears Kshs. Two Trillion Mark as "Digital Cash" Culture Grows' *Daily Standard*, (Nairobi, 10 September 2014) 41.

¹³ FR Edwards and FS Mishkin, 'The Decline of Traditional Banking: Implications for Financial Stability and Regulatory Policy' (1995) 1(2) FRBNY Economic Policy Review 42.

¹⁴ JR Barth and G Caprio and R Levine, *Rethinking Bank Regulation: Till Angels Govern* (Cambridge University Press 2005) 1.

continue to suffer from exorbitant bank charges and high interest rates. In 2015 for example, in a span of about four months, the average lending rates had moved from an average of 16.49 percent in May 2015 to 30 percent which was too expensive for ordinary Kenyans.¹⁵

Secondly, article 46 (1) (b) provides that consumers must have the right to the information necessary for them to gain the full benefit from services they consume. This therefore calls for sufficient disclosure of information by banks to borrowers to assist borrowers in decision making. This is information which is accurate; full and complete with no ambiguity and also understandable to the borrower¹⁶. However, despite the existence of disclosure provisions in the CPA 2012, meant to ensure that borrowers receive sufficient information, banks are still accused of failure to disclose sufficient information to borrowers. For example, as of May, 2015 not all banks had effected the new Annual percentage rate (APR) pricing system for bank loans which is a standardised rate which takes into account all compulsory fees associated with a loan together with the interest and finance charges, thus expressing the real cost of borrowing.¹⁷

Thirdly, article 46 (1) (a) also provides that borrowers must have a right to services of a reasonable quality. In this regard, “reasonable quality” must be concerned with identifying contract terms that are unfair to the borrower such as those that limit a borrower’s legal rights. Unfortunately, unfair practices continue to be witnessed in the banking sector thus enabling

¹⁵ Brian Ngugi, ‘Borrowers Feel the Pinch as Loan Rates Rise’ *Daily Nation* (Nairobi, 23 October 2015) 5.

¹⁶ JM Lacko and JK Pappalardo, ‘Federal Trade Commission Bureau of Economics, Staff Report, Improving Consumer Mortgage Disclosures: An Empirical Assessment of Current and Prototype Mortgage Disclosure Forms’ (2007) AT ES-6, <http://www.ftc.gov/os/2007/06fpo25505_mortgage_disclosure_report.pdf> accessed 15 August 2015.

¹⁷ Infotrace and Solutions, ‘Financial Markets, Trends and Policies’ (Infotrace Solutions 2015 Report) <www.infotracesolutions.com> accessed 09 December 2014.

banks to exploit borrowers.¹⁸ For instance during the month of September/October 2015, when the CBK moved to stabilise the shilling, it sparked abnormal interest rates hikes by commercial banks to as much as thirty percent on average.¹⁹

In view of the fact that banking borrowers in Kenya are still complaining of exploitation by banks yet the CPA 2012 has enacted and realised the protection provisions recommended in the constitution; there is need to determine how adequate these provisions are in protecting the banking borrower's interest. This is crucial in order to identify any "missing ingredients" that may hamper the enhancement of the protection of the Kenyan banking borrower.

1.4 SCOPE OF THE STUDY

This study has focussed on three key issues which affect the protection of banking borrowers. Firstly, it has dealt with how interest rates affect the economic interest of the borrower and hence the protection of the borrower. Secondly, it has dealt with the weaknesses and strength of disclosure provisions in protecting borrowers in the banking sector in Kenya. The key concern here is the effectiveness of these provisions in protecting borrowers. Lastly, it has dealt with unfair banking practices which are practised by banks and which affect the protection of borrowers in the banking sector.

1.5 JUSTIFICATION OF THE STUDY

In Kenya, there is lack of expansive literature both on the subject of consumer protection in general and borrower protection in the banking industry. This study seeks to analyse the

¹⁸ Joshua Masinde, 'Attempts to Cap Interest Rates Keep Drawing Blanks' *Daily Nation*. (Nairobi, 12 November 2013) <<http://www.nation.co.ke/kenya50/finance/Attempts-to-cap-interest-rates/-/2032892/2069016/-/91wqpr/-/index.html>> accessed 24 August 2015.

¹⁹ Joshua Masinde, 'Central Bank Spares Loan Seekers from an Increase in Interest Rates' *Daily Nation*, (Nairobi, 18 November 2015) 33.

contribution of an adequate legal framework towards the protection of borrowers in the banking sector, where the interests of borrowers takes first priority to that of bankers. This is important in the case of Kenya since, several other laws including the Banking Act and the Central Bank of Kenya Act existed before the enactment of the CPA 2012 but did not provide adequate protection for the borrower.

This study will also assist in identifying the different ways a bank may take advantage of the borrower. This will be achieved by identifying unfair practices in the National bank terms and conditions for an unsecured loan. The CPA 2012 will then be analysed to determine how it has attempted to resolve those unfair practices and therefore protect the borrower.

1.6 RESEARCH OBJECTIVES

1.6.1 PRIMARY OBJECTIVE

The primary objective of this research is to determine the adequacy of the CPA 2012 in protecting borrowers from unfair banking practices identified in the National Bank terms and conditions for an unsecured loan and then make recommendations where necessary.

1.6.2 SECONDARY OBJECTIVES

1. To investigate the effectiveness of provisions dealing with interest rates charges under the CPA 2012.
2. To establish the effectiveness of disclosure provisions provided in the CPA 2012 in protecting borrowers in the banking sector.
3. To identify banking practices which inhibit the effective protection of borrowers in the Kenyan banking industry.

1.7 RESEARCH QUESTIONS

This research seeks to answer the following questions:

1. How adequate is the CPA 2012 in protecting borrowers from unfair banking practices identified in the National bank terms and conditions for an unsecured loan?
2. How effective are the interest rate provisions under the CPA 2012 in protecting borrowers in the banking sector?
3. How effective are the disclosure provisions provided in the CPA 2012 in protecting borrowers?
4. What banking practices contribute towards inhibiting effective protection of borrowers in the banking sector?

1.8 HYPOTHESES

This research will test the following hypotheses:

1. Banking borrowers are not adequately protected in the Kenyan banking industry.
2. An adequate consumer protection framework will enhance the protection of the banking borrower in the banking sector.

1.9 THEORETICAL FRAMEWORK

This research is founded on the conflict theory by Karl Marx. According to Marx, private ownership of the means of production results in irreconcilable contradictions, between the

economic interests of the exploiters and those of the exploited.²⁰ Since only the capitalists own the means that others need to engage in productive activity and which the others can only get under the capitalists own terms, Marx views this relationship as one which is based on exploitation of the weaker party by the stronger party. Conflict theory is therefore used in this research in order to explain the relationship between the weaker party (the borrower) and the stronger party (the bank) and therefore justify the need for protection of the weaker party.

In analysing this relationship, Marx conceptualises society as one where economic interests are the profound cause of class struggle.²¹ According to him, power is gained through economics, which is characterised by a struggle between those who have (the rich) and those who do not have (the poor).²² Those with power, usually device ways to keep themselves in control by exploiting, the less powerful thus resulting in inequality.²³

Marx therefore divided society into a two class system; the bourgeoisie who are the owners of the means of production and the proletariat who work for the former. The bourgeoisie exploit the proletariat in an effort to ensure that status quo is maintained- the poor remain poor and the

²⁰ D Homes and K Hughes and R Julian, *Australian Sociology: A Changing Society* (2nd edn, Pearson Education 2007); see also K Krawford, 'Power in Society – Marx and Conflict Theory: An Analysis of Power in Society' (2009) <www.academia.edu/.../Marx_and_Conflict_Theory> accessed 14 September 2014.

²¹ K Marx and F Engels, L Trotsky, *The Communist Manifesto and its Relevance for Today* (Chippendale NSW, Resistance Books 1998) 7.

²² E Lepird and S Canny and M Saldana, 'Conflict Theory v Marxism Conflict Theory' (2013) Iowa State University <<http://www.soc.iastate.edu/sapp/Conflict.ppt>> accessed 22 October 2016.

²³ Credo, 'Conflict Theory' in C. Forsyth & H. Copes (eds), *Encyclopaedia of Social Deviance* (Sage Publications, 2014) <http://search.credoreference.com/content/entry/sagesdeviane/conflict_theory/0> accessed 24 October 2016.

rich continue to get rich.²⁴ This selfish and materialistic interest aimed at solely maximising one's own income is what leads to conflict.²⁵

In the Kenyan banking industry, a tug of war culminates in the power struggle between the borrower and the credit provider- the bank. However, borrowers are not able to match the financial muscle in the hands of banks.²⁶ The bargaining advantage being in their favour, the banks are able to levy terms upon their borrowers which promote their profits to the detriment of the borrower.²⁷ A conflict then emerges as the borrower feels exploited by the banks.

The conflict theory is also important in this research as it provides some ideas on how to protect the borrower in the banking sector. In principle, it recognises the fact that conflict will always exist between a stronger and a weaker party. In fact Lewis Coser, a strong proponent of conflict theory considers conflict to be a natural and necessary part of society since it is through conflict that humans are able to reach their goals. In cognisance of this fact, it becomes obvious that any solution aimed at protecting the borrower must always start with the realisation that the bank already has a stronger bargaining power than the borrower.

However, Marx's Conflict theory has been criticised on several grounds. Randal Collins argues that it fails to recognise "symbolic goods and emotional solidarity which are among the main

²⁴ PA Samuelson, 'Understanding the Marxian Notion of Exploitation: A Summary of the So-called Transformation Problem between Marxian Values and Competitive Prices' (1971) 9(2) *Journal of Economic Literature* 4.

²⁵ J Hirshleifer, *In the Dark Side of the Force: Economic Foundations of Conflict Theory* (Cambridge University Press 2001) 27.

²⁶ X Vives, 'The Prudential Regulation of Banks by Mathias Dewatripont and Jean Tirole' (1996) 34(3) *Journal of Economic Literature* 1-2.

²⁷ OP Ardic and JA Ibrahim and N Mylenko, 'Consumer Protection Laws and Regulations in Deposit and Loan Services: The World Bank Financial and Private Sector Development Consultative Group to Assist the Poor.' (2011) Policy Research Working Paper 5536/2011 < <http://www.cgap.org/financialindicators> > accessed 24 October 2016.

weapons used in conflict.”²⁸ This assertion is relevant to this research since banks have been accused of being able to use certain features completely unrelated to the loan-such as a picture of a pleasant, smiling person on the offer letter-to exploit vulnerable borrowers to take up loans.²⁹ This is because while borrowers are often unaware of their blind spots, lenders usually are and may actively seek to exploit those tendencies.³⁰ Indeed, since lenders are more experienced they can easily appreciate what a consumer can afford to purchase and therefore have the advantage to be able to assess an appropriate level of borrowing for the borrower.³¹

Secondly, Marx’s conflict theory has been criticised for its proposition of a conflict which is physical in nature-whereby the proletariat wage a war against the bourgeoisie. This criticism of the conflict theory is particularly evident in the banking sector whereby the nature of the conflict is a ‘mind battle’ to have terms and conditions that favour the interest of either the borrower or the bank.

1.10 LITERATURE REVIEW

1.10.1 INTEREST RATES

The effect of interest rate regulation to consumers/borrowers has always remained controversial as different scholars provide for divergent views on this subject. Ng’etich and Wanjau³² in their paper examine how interest rates affect borrowers hence resulting in non-performing assets. Their main argument is that high interest rates charged by banks is detrimental to borrowers’

²⁸ R Collins, ‘Conflict Sociology’ (1974) New York Academic Press 56-61 < <http://media.pfeiffer.edu/lridener/courses/COLLINR1.HTML>> accessed 24 October 2016; see also A Kenneth, *The Social Lens: An Invitation to Social And Sociological Theory* (3rd edn, Pine Forges Press 2010) 234.

²⁹ D Porteous, ‘Consumer Protection in Credit Markets. Financial Access Initiative Framing Note’ (2009) Policy Focus Note 1<www.financialaccess.org.> accessed 09 December 2014.

³⁰ R Tooth, ‘Behavioural Economics and the Regulation of Consumer Credit’ (2012) The Law Foundation of New Zealand’ <<http://www.srgexpert.com/wp-content/uploads/2015/08/Consumer-Credit-Behavioural-Economics-Case-Study-2012-Final.pdf>> accessed 24 October 2016.

³¹ *ibid.*

³² JC Ng’etich and K Wanjau, ‘The Effects of Interest Rate Spread on the Level of Non-Performing Assets: A Case of Commercial Banks in Kenya’ (2011) 1(1) *International Journal of Business and Public Management* 1-2.

economic interest since it increases the cost of loans charged on the borrowers. Their arguments are invaluable to this discourse since it gives limelight to the plight of the borrower, an aspect which is often ignored in many discourses. It therefore helps tilt the whole discourse to empathise with the borrower first rather than safety and soundness of banks.

However, while their arguments are valid they are deficient since they are only one sided and fail to consider the effect that low interest rates would have on borrowers. This study therefore furthers his arguments by asserting that a balance between the highest and lowest interest rate ought to be achieved, thus advocating for Adam Smith's suggestion of 'a rate which is somewhat above the lowest market price or a price which is commonly paid for the use of money by those who can give the most undoubted security.'³³

Rosenberg, Gonzalez and Narain³⁴ in their article examine the effect of high interest rates charged on borrowers. In as much as their study is focussed on micro-credit loans the crux of the study is on the effect of "high interest rates" which is a common factor even in the banking sector.

They argue against charging high interest rates since to them an interest charge represents money taken out of a borrowers' pockets, and it is unreasonable if it not only covers the costs of lending but also deposits "excessive" profits into the pockets of [lenders]. In essence their argument is that however minute; any increase in profit affects the borrowers' consumable disposable income as the borrower ends up paying much more than he had initially anticipated. This is dangerous

³³ JM Madlow, 'Adam Smith on Usury Laws' (1977) 32(4) The Journal of Finance 1195-1200.

³⁴ R Rosenberg, A Gonzalez and S Narain, 'The New Moneylenders: Are the Poor Being Exploited by High Microcredit Interest Rates?' (2009) Occasional Paper 15/2009 CGAP <<https://www.cgap.org/sites/default/files/CGAP-Occasional-Paper-The-New-Moneylenders-Are-the-Poor-Being-Exploited-by-High-Microcredit-Interest-Rates-Feb-2009.pdf>> accessed 24 October 2016.

for borrowers since savings represent the first line of defence for borrowers from getting into debt through borrowing.³⁵

However, they fail to consider in their study the effect of other bank charges on the borrower, in the event that interest rates would be reduced. This paper attempts to create an interlink between interest charges and other bank charges by asserting that by merely capping lending rates and leaving all other factors unchanged, there is risk of reversing gains made to the borrower. Firstly, banks may increase the transaction cost for other fees in order to cover up for the lowering of interest rates. Secondly, financial inclusion may be reduced since lower interest rates would result in banks unwillingness to lend to high risk borrowers whose category generally includes vulnerable borrowers.

Steven Schwarcz³⁶ in his article seeks to analyse the inadequacy of focussing on banks solely in a quest to find solutions to protecting borrowers. He argues that an exclusive bank focussed approach concerned with capping interest rates ignores the bulk of the financial system which banks comprise of.

Schwarcz's arguments are useful in bringing out the challenge that capping interest rates in the banking sector faces in isolation of the rest of the entire financial system. Indeed, interest rates are a facet of the entire financial system both locally and internationally and cannot just be analysed in isolation. More importantly however is the fact that it is useful in assessing the possibility of having an integrated financial system in Kenya which can be regulated under one body for purposes of ease of implementation.

³⁵ Financial Conduct Authority, 'Consumer Credit and Consumers in Vulnerable Circumstances' (2014) Optimisa < www.fca.org.uk/news/consumers/consumer-credit-research > accessed 24 October 2016.

³⁶ SL Schwarcz, 'Protecting Financial Markets: Lessons from the Subprime Mortgage Meltdown' (2008) 93(2) Minnesota Law Review.

Secondly, he also gives an opportunity to reflect on the effectiveness of other mechanisms for protecting borrowers. He argues that it is time to assess the effectiveness of old methods used to regulate the financial markets. He argues that more attention should be focussed on tackling the question of conflict of interest between institutions and financial markets, complacency to enforce the law and complexity that is experienced by less educated customers. However, he only offers a solution to the first two issues by asserting that a higher level of liability should be placed on the individual tasked with these responsibilities.

This paper attempts to aid him out on the question of complexity that is experienced by less educated borrowers by suggesting a greater responsibility be placed on bankers to educate borrowers through financial awareness programmes inducted under the banner of corporate social responsibility.

1.10.2 DISCLOSURE REQUIREMENTS

Joseph Stiglitz,³⁷ in his article argues that disclosure provisions are supposed to promote economic efficiency where one party to a transaction has more or better information than the other.³⁸ R Grady endorses his views by providing that disclosure provision achieve that purpose by creating a level playing field through provision of standardised and comparable information for both parties.³⁹ This is important to this study since according to a report by the Financial Sector Deepening, consumer welfare in Kenya is compromised by lack of effective disclosure of

³⁷ C Musanga , ‘Publishing Cost of Loans has Lifted the Lid on Commercial Banks’ Hypocrisy’ *Daily Nation* (Nairobi, 15 February 2016) 16.

³⁸ J E Stiglitz, ‘Information and the Change in the Paradigm in Economics’ (2002) 92 *The American Economic Review*.

³⁹ R Grady, ‘Consumer Protection in the Financial Sector: Recent Regulatory Developments’ (2012) 2 *The Finsia Journal of Applied Finance* 4.

prices and key terms.⁴⁰ This study therefore intends to highlight that one the best ways to protect a borrower is by having effective disclosure provisions under the consumer protection legislation.

Brix and McKee,⁴¹ argue that for credit products, evidence suggests that disclosing loan terms to customers can help reduce borrowing costs. They state that it does this by providing the borrowers with an opportunity to compare different rates that are being offered by other banks and then choose the one that is suitable to them. This is important to this study since banks have been accused in the past of advertising themselves as the cheapest alternative by exploiting the borrower's inability to compare the cost of loans from their different competitors due to many hidden costs.

Bucks and Pence, in their paper argue that borrowers that are most financially vulnerable to an increase in interest rates by banks are those with the least understanding of their contract terms.⁴² Their assertion is important since it challenges the notion that disclosure provision forms an adequate protection for banking borrowers. They seem to suggest that disclosure provisions would be useless if borrowers did not understand those terms and conditions.

Secondly they allude to the fact that disclosure provisions would be effective only to the extent that it is in a form that the borrower understands.⁴³ This is important because even if a borrower

⁴⁰ Financial Sector Deepening, 'Consumer Protection Diagnostic Study in Kenya' (A Report Submitted to the Ministry of Finance 2011) <http://www.fsdkenya.org/insights/11-02-28_FSD_insights_consumer_protection_issue_03.pdf> accessed 24 October 2016.

⁴¹ Brix and McKee, 'Consumer Protection Regulation in Low-Access Environments: Opportunities to Promote Responsible Finance' (2010) 60 Focus Note 8.

⁴² BK Bucks and KM Pence, 'Do Borrowers Know Their Mortgage Terms?' (2008) 2663 Journal of Urban Economics 2.

⁴³ Ernst and Young, 'Disclosure Effectiveness: What Investors, Company Executives and Other Stakeholders Are Saying' Disclosure Effectiveness CC0404 <[http://www.ey.com/Publication/vwLUAssets/EY-disclosure-effectiveness-november-2014/\\$FILE/EY-disclosure-effectiveness-november-2014.pdf](http://www.ey.com/Publication/vwLUAssets/EY-disclosure-effectiveness-november-2014/$FILE/EY-disclosure-effectiveness-november-2014.pdf)> accessed 24 October 2016.

was financially literate, an ambiguous disclosure provision would result in more cost for the borrower in an attempt to understand the clauses, hence defeating the objective of borrower protection concerned with protecting the economic interest of the borrower. An adequate financial borrower legislation should therefore make sure that plain language is used and that the use of complex formulas and calculations is avoided.⁴⁴ In the end, disclosures should be clear, concise, accurate, reliable, comparable, easily accessible and timely.⁴⁵ Further, it should focus on key features of the service being offered including the costs, penalties, surrender charges, risks and termination fees.⁴⁶

Lee and Cho,⁴⁷ in their paper state that adequate disclosure should also not overload the borrower with information so as not to confuse borrowers. This position is supported by Biza-Khupe⁴⁸ who alleges that too much information for the borrower may actually be self-defeating towards the goal of protecting the borrower. Indeed poor and illiterate borrowers often find various financial jargons and terms confusing.⁴⁹ This is important in the case of Kenya since, a finding by Genesis Analytics,⁵⁰ indicated that Kenyan banks increasingly focussed on low-end consumers whose level of financial knowledge awareness was poor, and hence a mathematical

⁴⁴Financial Sector Deepening Kenya, 'Financial Inclusion' (2009) <http://fsdkenya.org/wp-content/uploads/2015/08/11-06-27_finaccess_09_results_analysis.pdf> accessed 23 October 2016.

⁴⁵ Consumers International, 'In Search of Good Practices in Financial Consumer Protection' (2013) <<http://www.consumersinternational.org/media/1135359/in%20search%20of%20good%20practices%20in%20financial%20consumer%20protection.pdf>> accessed 24 October 2016.

⁴⁶ *ibid.*

⁴⁷ J Lee and J Cho, 'Consumers Use of Information Intermediaries and the Impact on Information Search Behaviour in the Financial Market' (2005) 39(1) *The Journal of Consumer Affairs* 5.

⁴⁸ S Biza-Khupe, 'Information Regulation in Consumer Credit Markets-Determinants of Financial Information Oversupply' (2011) 16(3) *International Research Journal of Finance and Economics* 3, 11.

⁴⁹ CS Mcrae, 'Understanding Financial Covenants by Banks' (2004) 44(5) *Contract Management* 34.

⁵⁰ A South African firm contracted by the Central Bank of Kenya and the Financial Sector Deepening in 2009.

tool like the Annual Percentage Rate (APR) which is currently used to calculate the total interest rate was found to be too complex for such borrowers to understand.⁵¹

Hadfield, Howe and Trebilcock⁵² in their paper warn against ‘the cost of becoming informed’ on the part of the borrower by virtue of disclosure provisions. They argue that too much information in the hands of the borrower may be viewed as a threat by the lender who may scale up the cost in an effort to re-establish the strategic informational advantage.⁵³ They also argue that the cost of the borrower getting informed may be too much relative to the gain to be achieved from the information and result in more harm.⁵⁴ According to them, this harm results from the disadvantage that the borrower will suffer, when the bank decides to scale up costs in order to ensure that the bank meets the requirement or obligation for adequate disclosure provisions.

This study is important because it looks at the subject of disclosure provisions from the perspective of the bank. In essence therefore, it cautions against a disclosure provision that may hamper the competitive advantage to the party in possession of that information. Secondly it is important because it seeks to analyse the cost-benefit analysis of disclosure provisions towards the goal of protecting the banking borrower.

⁵¹ *ibid* 44.

⁵² GK Hadfield and R Howe and MJ Trebilcock, ‘Information Based Principles for Rethinking Consumer Protection Policy’ (1998) 21 *Journal Consumer Policy* 12.

⁵³ *ibid*.

⁵⁴ *ibid*.

1.10.3 UNFAIR BANKING INDUSTRY PRACTICES

Hill and Kozup,⁵⁵ in their article argue that industry practices are usually designed to the detriment of the “vulnerable” such as the elderly and the impoverished. It specifically identifies a friendly approach and an aggressive response as some of the tools used to exploit the vulnerable. Despite alluding to provisions on unconscionable conduct as a solution against an aggressive approach such as coercion and undue influence they fail to provide any solution with regards to a friendly approach where a bank takes advantage of a borrower’s desperation, by acting in a friendly manner.

This is especially important for this study as the current consumer protection framework does not distinguish between a vulnerable borrower and one with equal bargaining power with the banks. This study will therefore aim to show that there is need to have specific legislation that covers the interests of the vulnerable borrowers in the banking sector.

Giesela Ruhl,⁵⁶ in his paper argues that consumer contracts can lead to the lowest consumer protections standards, resulting in practices which are unfair to the borrower. Despite the fact that his paper is contextualised on cross-border consumer transaction and the disadvantage inherent to such a borrower, it still focuses on the question of how consumer protection should work from an economic perspective. He highlights the need to protect the borrower due to the disadvantage he suffers from informational asymmetry. He castigates the economic theory suggestion that ‘the self healing powers of the market’ can help in protecting the borrower without the need for regulatory intervention. He asserts that screening mechanism which is an economic theory solution for protecting borrowers is insufficient because it relies entirely on the

⁵⁵ RP Hill and JC Kozup, ‘Consumer Experiences with Predatory Lending Practices’ 41(1) The Journal of Consumer Affairs, Vol. 41, Issue 1, 29-46.

⁵⁶ G Ruhl, ‘Consumer Protection in Choice of Law’ (2011) 44 Cornell International Law Journal 9.

‘consumer/borrower’s ability and willingness to gather the relevant information’ yet such a borrower lacks that capacity.

He also castigates the signalling mechanism where the party with the information is supposed to relay the information to the other party. He argues that this economic theory principle does not guarantee any protection because the weaker party is at the mercies of the stronger party. In such a case he has to wait until the information is released and he cannot be sure of the veracity of that information and just how much of it has been released to enable him make an informed decision. Despite arguing for a direct regulation to protect borrowers from inadequacies of contract law which in turn lead to unfair practices against the borrower, he fails to give examples of any such unfair practises.

Nguyen and Pontell,⁵⁷ in their paper argue that ‘a thin line exists between practices used by lenders which are deemed “unethical or risky” and those considered to be white collar “crimes.” This paper is particularly important to this research as it recognises the fact that some practices by banks despite not being criminal in nature result in unfairness to the borrower. For instance banks are able to deplete their borrowers account faster, making it easier to charge for unnecessary or exorbitant penalties by processing charges from the largest transactions first.⁵⁸

Moreover, banks are also able to lure vulnerable borrowers who are in default on existing loans by cancelling an existing debt and replacing it with a new agreement, a practice called novation.⁵⁹ Alternatively, such lenders consolidate the borrowers existing debt by giving them

⁵⁷ TH Nguyen and HN Pontell, ‘Mortgage Origination, Fraud and the Global Economic Crisis’ (2010) 9(3) *Criminology and Public Policy* 5.

⁵⁸ See appendix I and II.

⁵⁹ M De Waal, ‘African Bank: No Rescue Plan for Borrowers’ 2015 *The M&G Online* (Limpopo, 12 May 2015) <<http://mg.co.za/article/2015-05-12-african-bank-no-rescue-plan-for-borrowers/>> accessed 24 October 2016.

additional disbursement despite their previous debt. It therefore becomes necessary for any comprehensive legal framework to protect borrowers from unconscionable practices but also unethical ones whose effect results in the detriment of the borrower's interest.

Nguyen and Pontells' views are also supported by other scholars. For instance, David Slawson⁶⁰ writes about "deceptive contracting" whereby banks induce borrowers to take loans with promises and representations that they eventually nullify or contradict against standard form contracts. Lynn Nottage,⁶¹ also talks of use of fine prints as another form of abusive practice. He asserts that it is used by banks, to hide (in smaller than average font) intricate and binding legal details of the agreement from the borrower. This practice is disadvantageous to the borrower especially where a term is not conspicuous to the borrower or a term is used which a borrower would not have reasonably understood to be part of that contract. Billet, Flannery and Garfinkel,⁶² also write about the practice of banks using a litany of exclusions, exceptions, and legal jargon as another form of predatory practice. He contends that by this practice banks are able to safeguard the informational advantage they possess over borrowers, since many borrowers may not easily understand such terms.

However, all these scholars fail to recognise the role that financial literacy plays in the proliferation of abusive practices upon banking borrowers and how banks take advantage of this situation. This research therefore seeks to have borrowers obliged to partake in a bigger role in ensuring that borrowers are equipped in terms of financial literacy through compulsory

⁶⁰ D W Slawson, 'Contractual Discretionary Power: A Law to Prevent Deceptive Contracting by Standard Form' (2006) 4 Michigan State Law Review 2.

⁶¹ LR Nottage, 'Form and Substance in US, English, New Zealand and Japanese Law: A Framework for Better Comparisons of Developments in the Law of Unfair Contracts' (2005) *SSRN Scholarly Paper*, <<http://papers.ssrn.com/abstract=842684>> accessed 15 August 2015.

⁶² MT Billet and MJ Flannery and JA Garfinkel, 'Are Banks Loans Special? Evidence on the Post-Announcement Performance of Bank Borrowers' (2006) 41(04) *Journal of Financial and Quantitative Analysis* 17.

workshops and public awareness forums for borrowers under the banner of corporate social responsibility.

Sheila Bair⁶³ in her paper also examines the danger of easily available credit to the protection of the borrower's economic interest. She argues that despite the fact that this credit promotes financial development in the short-run by providing for affordable credit for vulnerable borrowers who would otherwise not have afforded it, it results in over-indebtedness for borrowers in the long-run.⁶⁴ This is because they are designed to get borrowers to borrow and spend more rather than to build and establish their financial security.⁶⁵ This paper is particularly important to this research as it gives an example of a practice which is legal and which may look beneficial to borrowers but which may be considered unethical and hence detrimental to borrowers' interests.⁶⁶

1.11 RESEARCH METHODOLOGY

This research is entirely a qualitative research method. The justification for choosing this method is borne on the fact that qualitative research mainly involves an analysis of primary and secondary sources of data - which forms the data to be analysed in this research.⁶⁷

This research will be conducted through a *case study* of the National Bank of Kenya, terms and conditions for an unsecured loan. A case study design was chosen because it narrows down the

⁶³S Bair, 'Protection of borrowers' (United States Systemic Risk Council, Washington, July 2011) <www.bankrate.com/finance/.../sheila-bair-q-a-protect-borrowers-banks-1> accessed 09 December 2014.

⁶⁴See South Africa's Consumer Credit Act 2005, S 79 (1) that "A consumer is over-indebted if the preponderance of available information indicates that the particular consumer is or will be unable to satisfy in a timely manner all the obligations under all the credit agreements to which the consumer is a party."

⁶⁵J Yam, 'Consumer Protection and the Banking Industry' (Association of Banks' Half- Yearly Dinner, Hong Kong, June 2001), <www.bis.org/review/r010620b.pdf> accessed 09 December 2014.

⁶⁶ See LM Delgadillo and LV Erickson and KW Piercy, 'Disentangling the Differences between Abusive and Predatory Lending: Professionals' Perspectives' 2008 42(3) Journal of Consumer Affairs 1.

⁶⁷ K.J Devers and R M Frankel, 'Study Design In Qualitative Research-2: Sampling And Data Collection Strategies' (2000) 13(2) Education for Health 263-271.

study and allows for an in-depth analysis of a specific sector. In this case the National Bank of Kenya rather than the entire banking sector is the focus of this research. This narrow outlook enables the study to concentrate on specific issues identified in the case of National bank, which in this case is “unfair practices” identified in the terms and conditions. This is especially important in this study since a study of the entire banking industry in Kenya would not be possible due to the limited time period of 12 months provided for this study. The choice of National Bank of Kenya is borne by the fact that it is a national bank and would therefore be representative of all borrowers in Kenya including vulnerable borrowers who are focus of this study.

The main method used to collect data involved a desk-based review of the existing scholarly literature and relevant primary and secondary sources which included the Constitution of Kenya, the Banking Act, the “terms and conditions” of the National Bank of Kenya and the Consumer Protection Act. Special Attention will also be given to the Central Bank reports and Financial Sector Deepening (F.S.D) reports in order to get actual statistical facts.⁶⁸

Content analysis will then be used to analyse the data. This will firstly involve perusing through the “terms and conditions” of National Bank of Kenya in order to identify banking practices which are not favourable to the borrower. An analysis of the CPA 2012 will then be conducted to determine whether it has had the intended effect of protecting borrowers from the unfair banking practices identified above.

⁶⁸ This is important since the reports by the F.S.D are highly accredited research findings and policy recommendations that draw their credibility from the support of International Organisations like the World Bank will provide up-to-date information on the state of financial borrowers in Kenya.

1.12 LIMITATIONS

This research is mainly a qualitative study which relies exclusively on secondary data and desk top research. This has the tendency to provide information that is not up to date with the fast changing world in the banking industry.

Secondly, this study has only been conducted on the basis of a case study of one bank only. It is therefore not a sufficient sample for which conclusive generalisation of the failure or success of the CPA 2012 in protecting borrowers can be made. A more conclusive generalisation of the entire banking industry can be made if a study of a bigger sample of banks in Kenya is conducted.

1.13 CHAPTER BREAKDOWN

Chapter one: Introduction: A general overview and outline.

This chapter contains a background to the study, statement of the research problem, research objectives, research questions, hypothesis, justification of the study, literature review, research methodology to be used, limitations and the chapter breakdown.

Chapter two: Legal Regime governing borrower protection in Kenyan banking industry.

This chapter seeks to assess the relevant laws that govern protection of borrowers in the banking sector in as far as they deal with some of the issues affecting borrowers such as interest rates, disclosure provisions and unfair banking practices.

Chapter three: A description of the rationale for borrower protection in the banking industry.

This chapter helps to clarify why borrowers ought to be protected against unfair bank practices by banks. In short it advances the justification for protection of borrowers in the banking sector.

Chapter four: An examination of the protection of borrowers under the consumer protection Act.

This chapter is aimed first at identifying, from the National Bank's Terms and conditions, certain banking practices which are unfair to the borrower. The next step will involve an analysis of the CPA 2012 to see whether it provides any adequate protective measures against the "unfair bank practices" identified above.

Chapter five: Conclusion and recommendations.

This chapter gives a conclusion of the results reached from the research questions, research objectives and the hypothesis. It then provides recommendations where appropriate.

CHAPTER TWO

2.0 LEGAL REGIME GOVERNING BORROWER PROTECTION IN KENYA

2.1 INTRODUCTION

Despite the enactment of the Consumer Protection Act 2012 as the main statute responsible for the protection of consumers including borrowers; a strong interlink between various statutes touching on aspects of borrower protection issues still persists. This interdependence of these statutes is closely linked to the existing fragmentation of the financial sector in Kenya. Consequently, different aspects relating to the protection of the banking borrower can therefore be identified in several statutes.

However, this chapter is merely concerned with regulatory gaps in relation to the protection of banking borrowers and specifically with aspects of the law covering interest rates, disclosure provisions and unfair banking practices. The assumption is that; an attempt at analysing this regulatory flaws and weaknesses will help to highlight the importance of having an adequate consumer protection framework and it will also act as a measuring yardstick for determining how adequate the CPA 2012 has been in attempting to resolve those gaps.

2.2 PRIVATE LAW MEASURES

2.2.1 CONTRACT LAW

In essence private law measures are grounded on a belief that parties to a contract always have equal bargaining power and that they are well informed before getting into the contract. Its greatest weakness is the assumption that parties to a contract have equal bargaining power and the proclamation that an ascent of signature means a party has complied with the reading the contract. It fails to take into consideration how much reliance a borrower may have on the lender,

his ability to comprehend what he is reading, and his desperation for the money at the time of taking a loan.

2.2.2 TORT LAW

The weakest point for the protection of the borrower under the law of torts is the fact that the borrower-banker relationship is essentially contractual in nature. In essence therefore, the banker does not owe the borrower any duty of care other than the rights and obligations provided in the contract. However, the law of torts in consumer protection will apply in situations where for instance a banker upon receiving a request for information or advice in circumstances that show that his skill or judgment is being relied upon, gives that information or advice without clear disclaimer of responsibility. In such a case the banker has a legal duty to exercise proper care in doing so even though he is not under any contractual or fiduciary obligation to the inquirer and if he is negligent an action for damages will lie.⁶⁹

Secondly, in situations where a bank assumes a fiduciary role or is aware of circumstances which have induced a customer to regard it as having assumed such a role; such a banker owes the borrower a duty of care. For instance, it has been held that where a bank agrees to act as a financial advisor with a person and fails to disclose material information which has come to its attention, which is critical to the performance of the customers' business; the bank assumes a fiduciary obligation towards the customer when it agreed to act as the customer's financial advisor and will be held liable.⁷⁰ However, it remains to be seen whether the circumstances discussed above include situations where borrowers are vulnerable- elderly, unable to comprehend and/or in desperate need of the loan making them vulnerable to exploitation.

⁶⁹ *Hedley Byrne and Company Limited v Heller and Partners limited* [1963] 2 All ER 575.

⁷⁰ *Woods v Martins Bank* [1959] 1 QB 55.

2.3 PUBLIC LAW MEASURES

2.3.1 CONSTITUTION

By virtue of the enactment of consumer protection rights in the constitution, the quest to protect the borrower/consumer assumes a higher status than any ordinary statute. Consequently, consumer/borrower protection rights as provided under article 46 of the Constitution assume the status of constitutional entitlements to which the borrower has constitutional rights to invoke.⁷¹

In essence this is made possible by virtue of article 2 (4) of the constitution which proclaims the supremacy of the constitution against any other law and article 2 (4) which invalidates any law that is inconsistent or in contravention with the constitution up to the extent of that inconsistency.

Secondly, it is arguable that by referring to the provisions of article 46 as “rights” they acquire an equal standing under the bill of rights. The resultant effect of this provision is that providers of services and goods now have a constitutional obligation to ensure that they meet the standards provided for under article 46.

Thirdly, by virtue of article 46 (1), the constitution not only spells out consumers’ rights and obligations but it also provides for liability from the providers of such services and products. Article 46 (1) of the constitution therefore gives consumers, the rights to goods and services of reasonable quality; information necessary to gain full benefit from goods and services; protection of their health, safety, and economic interests; and compensation for the loss or injury arising from defects in goods or services. This way the borrower are empowered to seek redress for

⁷¹ D Mutunga, ‘Consumer Protection With Regard To the Financial Services Provision: A Case Study of Kenya’ <http://www.academia.edu/4994754/consumer_protection_with_regard_to_the_financial_services_provision_a_case_study_of_Kenya> accessed 24 October 2016.

infringement of their rights directly as consumers and they no longer have to rely on a third party like the Central Bank of Kenya to enforce their rights.

Article 10 of the constitution also provides for national values and principles such as good governance, integrity, transparency and accountability to which providers of services including banks are required to observe and implement. These principles prescribe for minimum acceptable standards required while conducting a business hence setting standards for protection of borrowers. The only disadvantage for the borrower is that since they are “only minimum standards” those tasked with observing them may merely observe the minimum threshold for purposes of compliance.

2.3.2 CONSUMER PROTECTION ACT, 2012⁷²

The greatest protection mechanism under this Act is that it empowers consumer/borrowers to sue the offender to get redress, including compensation, where the said breach affects him or her adversely. A significant way of protection of the borrower is through prohibition of unfair practices under Part III of the CPA 2012. The act provides that it is an unfair practice for a person [including a lender] to make a false, misleading or deceptive representation to a [borrower].⁷³ This means that the CPA 2012 imposes a legal liability on lenders for unfair business conduct. This way it echoes a key tenet of good practice in financial consumer protection: “responsible business conduct of financial service providers and authorized agents⁷⁴”. It is a call for the goal of profit-maximization by lenders (banks) in Kenya to be interfered with,

⁷² Act No. 46 of 2012 of the Laws of Kenya.

⁷³ Consumer Protection Act 2012, S 12.

⁷⁴ Consumers International, ‘In Search of Good Practices in Financial Consumer Protection’ (2013) <<http://www.consumersinternational.org/media/1135359/in%20search%20of%20good%20practices%20in%20financial%20consumer%20protection.pdf>> accessed 24 October 2016.

if not pursued along with, the best interests of the borrower⁷⁵. This means that contract terms and conditions should be fair to both the borrower and the bank. The effect of this statement is that, a term ought to be considered as unfair if, contrary to good faith, it causes a significant imbalance in the parties' rights and obligations under the contract to the detriment of the borrower. This is important because it is not expected that a vulnerable borrower will usually walk into a bank with a lawyer to break down the legalese in loan agreements for him or her, before entering into the contract.

The second form of protection is the empowerment of the borrower to rescind any agreement where the defaulting party engages in an unfair practice⁷⁶. This right of rescission offers wide protection to the borrower. Firstly, the effect of rescission is the restitution of the parties to their pre-contractual positions⁷⁷. However, the borrower is entitled to recover the amount by which any payment made exceeds the value that the service generated to the borrower⁷⁸. Secondly, the agreement need not be written, it can be oral or implied as well. This is especially important for the borrower since *section 34 of the CPA 2012* requires a credit agreement to be in writing. The right of rescission however, protects the borrower even if the contract is not in writing. Thirdly, the “unfair event” can either have taken place after or during the signing of the agreement. The bank therefore has no defence in arguing that the unfair event is one that took place after the signing of the agreement. A breach of any regulation made by the CPA, will make a person liable to a fine not exceeding five hundred thousand shillings or imprisonment for a term not exceeding two years or both such fine and imprisonment.

⁷⁵ibid 7.

⁷⁶ Consumer Protection Act 2012, S 16 (1).

⁷⁷ Consumer Protection Act 2012, S 16 (12).

⁷⁸ Consumer Protection Act S 16 (2).

2.3.3 COMPETITION ACT, 2010⁷⁹

The main form of protection for banking borrowers under the Competition Act is protection from unfair and misleading market conduct. In particular, the borrower is protected with regards to false or misleading representations where banks lure borrowers by misleading advertisements⁸⁰ and from charges and fees which had not been brought to the attention of the borrower prior to their imposition or prior to the provision of the service.⁸¹ This Act also provides for hefty penalties in case of contravention of consumer rights which may attract fines of up to 10 million Kenya shillings and/or imprisonment of up to five years.

However, the greatest protection for the banking borrower is provided under the provision dealing with unconscionable conduct.⁸² This Act has broadened the definition of what constitutes unconscionable conduct beyond the general ambit of coercion, undue influence and duress and in the processes created a list of practices by a lender such as a bank that may result in unfairness to the banking borrower. The protection of the banking borrower has therefore been enhanced as follows:

Firstly, by including the relative strengths of the bargaining positions of parties involved in a transaction, this Act has recognised the problem of a borrower with a weaker bargaining power relative to the bank.⁸³ Secondly, it puts emphasis on protecting the economic interest of the borrower by assessing whether a consumer/borrower was required to comply with conditions that would not protect his/ her legitimate interests.⁸⁴ Thirdly, it addresses the question of whether the consumer was able to understand the documents in relation to the services provided.⁸⁵ This is

⁷⁹ Act No. 12 of 2010 of the Laws of Kenya.

⁸⁰ *ibid*, S 55.

⁸¹ *ibid*, S 56 (3).

⁸² *ibid*, S 56.

⁸³ *ibid*, S 56 (2) (a).

⁸⁴ *ibid*, S 56 (2) (b).

⁸⁵ *ibid*, S 56 (2) (c).

important because often borrowers are presented with documents in a form that is illegible, ambiguous or in small print which obscures their understanding. However, it fails to define what is meant by ‘understandable’ and therefore the question of whether language barrier can fit into this description remains debatable. It also fails to address how the “level of understanding” of the borrower can be measured to determine if he has a level of understanding of a reasonable man. Fourthly, it seeks to protect the borrower from banks that exploit vulnerable borrowers desperation by considering both the amount and the circumstances under which, such a borrower could have acquired the same services from a different supplier.⁸⁶ Its weakness however is the fact that it fails to define what circumstances can be considered as desperate for the sake of the borrower and criterion to be used in measuring it.

2.3.4 BANKING ACT⁸⁷

The protection provisions under this act are primarily concerned with safeguarding the interest of the depositor as opposed to those of the borrower. In fact the single most protection provision for the borrower is the fact that before anyone can provide banking services they must be licensed.⁸⁸ This provision gives the Central Bank the opportunity to conduct an assessment of any institution before giving/denying approval therefore protecting borrowers from unscrupulous lenders seeking to operate as banks. All the other licensing requirements with the exception of the one dealing with the convenience and needs of the area to be served such as those pertaining to the adequacy of an institutions capital structure, its financial condition and history, the character of

⁸⁶ *ibid* S 56 (2) (e).

⁸⁷ Cap 488 of the Laws of Kenya.

⁸⁸ Banking Act of Kenya, S 3 (1).

its management, the professional and moral suitability of its proposed managers are primarily concerned with the protection of the depositor.⁸⁹

Unfortunately the penalty of a fine not exceeding one hundred thousand shillings or imprisonment for a term not exceeding three years with regard to licensing malpractices is too small to act as a deterrent.⁹⁰ Moreover, there is a possibility that this penalty may be too small compared to the gain achieved from the malpractice.

It also fails to deal with the question of interest rates effectively. Section 44A for instance provides for limitations on the maximum interest recoverable from debtors by banks and other financial institutions with respect to *defaulted or non-performing loans*. Undeniably this is a great step in protection of borrowers. Nevertheless it only protects borrowers after they have negotiated the contract at the point of default. More protection can be afforded to borrowers, if they can also be protected before entering the contract, at their time of need/desperation. This would ensure that borrowers are also protected from exploitation at the time when they are most vulnerable.

2.3.5 CENTRAL BANK OF KENYA ACT⁹¹

The Central Bank's role with regard to protection of borrowers can first be seen in its core mandate of formulating monetary policy, promoting price stability.⁹² Unfortunately this mandate is directly linked with primarily the "safety and soundness" of the banks and not consumer protection.

⁸⁹ Banking Act of Kenya, S 4 (5).

⁹⁰ Banking Act of Kenya, S3 (2).

⁹¹ Cap 491 of the Laws of Kenya.

⁹² The Constitution of Kenya, art 231 (1).

In fact, its role in licensing and supervising authorised dealers contributes to the greatest protection of borrowers. This way it plays a hand in determining whether an entity has the ability to act as a bank and therefore those that do not meet the criteria are denied license.

The greatest weakness for this Act has been the fact that the borrower must rely on the action of a third party/ the regulator which is the Central Bank in order to ensure his rights are protected. The resultant effect is that the borrower has to wait until the Central Bank of Kenya acts because he has no locus-standi. This issue speaks loudly to the question of implementation and enforcement of the law. In fact it cannot be argued that this Act requires any further amendment since the standards of the provisions provided for are in par with other prudential regulations around the world. However an inefficient, weak or corrupt Central Bank will result in poor implementation and enforcement, which in turn leads to inadequate protection of banking borrowers.

2.3.6 PRUDENTIAL GUIDELINES BY THE CENTRAL BANK OF KENYA

These Guidelines are issued by virtue of section 33(4) of the Banking Act, which empowers the Central Bank of Kenya to issue guidelines to be adhered to by institutions in order to maintain a stable and efficient banking and financial system. They derive their power by virtue of section 55 (1) and (2) of the Banking Act which empowers the Central Bank to make regulations for carrying out the provisions of the Banking Act and to prescribe penalties for those institutions that fail to comply. However, it is arguable that these guidelines are firstly concerned with protection of the interests of the depositors and not the interests of borrowers.

2.3.7 CIVIL PROCEDURE ACT⁹³

Banking borrowers are offered protection under this Act in cases where banks have failed to stipulate the rate of interest in lending agreements. Section 26 of the Civil Procedure Act empowers courts to exercise their discretion in awarding interest in situations where a bank has failed to expressly indicate it.⁹⁴ However, this provision means that borrowers will have to rely on the courts of law to find a reasonable interest rate, a decision which may not be favourable to the borrower.

2.3.8 CREDIT REFERENCE BUREAU REGULATIONS, 2013

The history of this regulations points towards the protection of interest of banks/depositors rather than borrowers. On the question of disclosure, the biggest injustice to the borrower is that by virtue of agreeing to be a customer of a bank, information about the customer can be disclosed to the credit reference bureau. It however does not provide a measuring yardstick of how much information is necessary to be released and what is to be used to measure the adequacy of such information.

2.4 JUDGE MADE LAW/ PRECEDENTS

Despite the discretion that courts of law have in deciding cases, the contractual nature of a borrower lender relationship has made it an uphill task for borrowers to get favourable rulings. On several occasions courts have held that ‘their role in such disputes is to construe contract terms made between parties to a contract and not to negotiate such terms or conditions.’⁹⁵ The reasoning by such courts has been based on a false assumption that parties to a transaction have

⁹³ Cap 21 of the Laws of Kenya.

⁹⁴ See *Ajay Indravadan Shah v Guilders International Bank Ltd* [2001] CA 135, [2003] eKLR.

⁹⁵ See *Trust Bank Limited v Eros Chemists Limited and another* [1999] HCCC 133, [2000] eKLR; *Kyangavo v Kenya Commercial Bank Limited and another* [2001] CA 428, [2004] eKLR

equal bargaining power and that a party always has the choice of walking out of an unfavourable contract. This reasoning however fails to take into consideration the individual position of the borrower such as desperation for the money or their inability to act rationally.

2.5 INDUSTRY PRACTICES AND REGULATIONS

The greatest obstacle against adequate protection of borrowers' results from the fact that the Kenya Bankers Association which is the institution tasked with formulating guidelines and regulations for the banking industry has no enforcing authority. It only makes the regulations but the banks have no obligation to adhere by them.

Secondly, since the Kenya Bankers Association is an institution aimed at protecting the interests of bankers it is not expected that the rules and regulations they formulate will be in the interest of the borrowers. This issue dwells with the question of failure of self-regulation in the protection of borrowers in the banking sector. The main obstacle here being conflicting interests between the "safety and soundness" of banks which is the prime objective of the Kenya Bankers Organisation versus "borrowers interests."

CHAPTER THREE

3.0 A DESCRIPTION OF THE RATIONALE FOR BORROWER PROTECTION IN THE BANKING INDUSTRY

3.1 INTRODUCTION

Several explanations have been advanced in an attempt to give a justification for borrower protection in the banking sector. Majority of scholars adhere to the legal perspective rationale tailored behind a borrower with a weaker bargaining power relative to the banker.⁹⁶ A second argument resonates around the fact that borrowers have less information compared to professionals like bankers while the third one asserts that consumers do not always act rationally. I also advance a rationale for protection based on the self-interest nature of the banks to the detriment of borrowers.

3.2 BARGAINING POWER

The personal borrower generally has a weaker bargaining power relative to the bank⁹⁷. The ‘Corporate Goliath’ [banker] therefore has a higher chance of getting what it wants from the borrower.⁹⁸ This advantage results from the fact that banks have at their disposal the financial wealth and legal knowledge of the best skilled experts in the world, posted in every department, while the vulnerable borrower is generally left to the mercies of individual skills or knowledge.⁹⁹ This therefore creates uncertainty with regard to the ability of an unregulated market to adequately defend the borrower’s interest.¹⁰⁰ This is because borrowers with low levels of education, or those not properly informed of their rights face the risk of exploitation by

⁹⁶ *ibid* 52.

⁹⁷ *Ibid*.

⁹⁸ DD Barnhizer, ‘Inequality of Bargaining Power’ (2005) 139(76) *University of Columbia Law Review* 9.

⁹⁹ DC Moss, ‘Borrowers fight back with lender liability’ (1987) 73(03) *American Bar Association Journal* 64-68, 70, 72; *ibid*.

¹⁰⁰ *ibid* 5.

unscrupulous lenders.¹⁰¹ This risk is especially true for first time borrowers and low-income borrowers as they lack the awareness, knowledge and skills to assess product's appropriateness, costs and risks.¹⁰²

The need to protect such borrowers becomes even more crucial since it is a principle of law that a person who signs a document knowing it is intended to have a legal effect is generally bound by its terms. In the United Kingdom's Appeal case of *Springwell Navigation Corporation v JP Morgan Chase Bank*,¹⁰³ the appellant made two claims against the respondent in respect of losses it had incurred, alleging that the respondent had breached a general advisory duty to the appellant and that the respondent had misrepresented the risks relating to the investments. The appeal court upheld the principle of contractual estoppels and held that by signing the contractual documentation, the appellant must be taken to have read and understood them and was therefore contractually bound by its acknowledgement that no representation or warranty had been made by the respondent. It is therefore important that such borrowers are empowered and educated on the importance of not committing to any signing of documents whose effects they do not understand.

In the case of *L'Estrange v Graucob*,¹⁰⁴ the claimant purchased a cigarette vending machine for use in her cafe. She signed an order form which stated in *small print* "Any express or implied, condition, statement of warranty, statutory or otherwise is expressly excluded." The vending machine did not work and the claimant sought to reject it under the Sale of Goods Act for not

¹⁰¹ *ibid* 29.

¹⁰² J Malala, 'Consumer Protection for Mobile Payments in Kenya: An Examination of the Fragmented Legislation and the Complexities it presents for Mobile Payments' (2014) KBA Centre for Research on Financial Markets and Policy Working Paper Series 02/2014, <www.kba.co.ke/img/pdf/Working%20Paper%20WPS-07-13> accessed 12 November 2014.

¹⁰³ [2010] EWCA Civ 1221.

¹⁰⁴ [1934] 2 K.B. 394.

being of merchantable quality. The court of Appeal held that in signing the document the appellant was bound by all the terms contained in it irrespective of whether or not she read the form.

The problem with these decisions is that they assume that both parties are equally informed about the transaction. In the latter case for example, little attention is paid to the fact that this information was provided to the borrower in small print form which might have obscured his ability to obtain full information from the documents and therefore have less bargaining power than the bank.

Nevertheless, the need for borrower protection is not to punish the lender because of the inherent advantage it possess over and above the borrower or curtail the way it operates by virtue of this advantage.¹⁰⁵ Protection of the borrower is concerned with ensuring that the bank discloses information to the borrower that will enable him to make a meaningful decision.¹⁰⁶ Informed consumers harness the power of information as they gain the knowledge which enables them to stand up for their rights and make choices from various options available. Indeed ‘a sufficiently inequality of knowledge and understanding is a classic source of unfairness in a debtor-creditor relationship.’¹⁰⁷ In short unchecked disparity in bargaining power undermines the legitimacy of a bargain by creating an unfair imbalance which vitiates the concept of consent and volition in a contractual agreement, especially on the part of the weaker party.¹⁰⁸

¹⁰⁵ J Levin and B McDowell, ‘Balance Theory of Contracts: Seeking Justice in Voluntary Obligations’ (1983) 29 The McGill Law Journal 24.

¹⁰⁶ Consumer Regulation, ‘The State of the Kenyan Consumer Report’ (Workshop on State of Kenyan Consumer Report 2012) <[www.consumerforum.co.ke/.../DISSEMINATION%20REPORT%](http://www.consumerforum.co.ke/.../DISSEMINATION%20REPORT%20)> accessed 09 December 2014.

¹⁰⁷ *ibid* 156.

¹⁰⁸ *ibid* 98.

3.3 INFORMATION ASSYMETRY

The point of contention is not the fact that one party has more information than the other. Information asymmetry only becomes relevant if one party abuses that information to gain undue advantage over the other; if the weaker party is denied the ability to acquire the relevant information or if the acquisition is too costly for the borrower.¹⁰⁹ This is especially important for loan transactions which are classified as credence goods. A borrower is not in a position to ascertain the quality of the products before conclusion of the contract or even after performance of the contract.

Munene¹¹⁰ in his paper gives a contrary opinion on who benefits from this information. He asserts that, the borrower will always have a better understanding of the prospective returns and risks than the lender despite due diligence on the part of the lender. However this does not consider the fact that view that through the machinery of well oiled lawyers, financial support and knowledge, the bank has the capacity to quickly be on the same wavelength of information with the borrower.

Secondly, the trajectory of the argument by Munene relies heavily on the financial literacy of borrowers; that their knowledge will equip them with skills to be able to distinguish the quality of the products and services. But statistics in Kenya already pin point to a majority of borrowers who are not financially literate.¹¹¹

¹⁰⁹ *ibid* 52; see also KC Engel and PA McCoy, 'A Tale of Three Markets: The Law and Economics of Predatory Lending' (2002) 80(6) *Texas Law Review* 5.

¹¹⁰ L Munene, 'Asymmetric Information in the Banking Sector: How Adverse Selection & Moral Hazard Affect Our Banking System' (2012) <<https://laiboni.wordpress.com/2012/04/09/asymmetric-information-in-the-banking-sector-how-adverse-selection-moral-hazard-affect-our-banking-system/>> accessed 22 November 2015.

¹¹¹ C Nelson and A Wambugu, 'Financial Education in Kenya: Scoping Exercise Report' Financial Sector Deepening (2008) <<http://fsdkenya.org/publication/financial-education-in-kenya-scoping-exercise-report/>> accessed 24 October 2016.

A third factor is that through screening of borrowers banks can reduce the information asymmetry in the advantage of borrowers, if any.¹¹² On the part of the borrower, screening might not be equally fruitful because it is a very costly expedition which an individual borrower may not be able to afford.¹¹³ I acknowledge that the internet may offer the borrower infinite access to information but once again the prohibitively high cost of accessing this information may act as a hindrance to the borrower.¹¹⁴

3.4 IRRATIONAL CONSUMERS

Behavioural economics point to the fact that consumers may not always make rational decisions about borrowing due to behavioural biases in their decision making.¹¹⁵ Indeed a study by the Capital Markets Authority of Kenya has shown that individuals make buying decisions based on emotions unlike institutions that are guided by rigid risk management strategies.¹¹⁶ This fact is crucial since predatory lenders may first ensure that a borrower is psychologically committed to the loan before disclosing all information, or they can use their skill and training to convince borrowers of the improbability of a “worst-case scenario” where the borrower is unable to pay the loan.¹¹⁷

The ability of borrowers to process and make use of information is also hindered by financial illiteracy. A financial illiterate borrower is less likely to meaningfully comprehend legal

¹¹² *ibid* 62.

¹¹³ *ibid* 52.

¹¹⁴ *ibid.* 52

¹¹⁵ S Agarwal and others, ‘Do Consumers Choose the Right Credit Contracts?’ (2006) Working Paper 119/2006 <http://finance.wharton.upenn.edu/~souleles/research/papers/ContractChoice_1207s.pdf> accessed 24 October 2016.

¹¹⁶ R Mwanjasi, ‘Equity Funds are Best for Retail Investors’ *The Business Daily* (Nairobi 22 July 2015) 32.

¹¹⁷ J Sovern, ‘Preventing Future Economic Crises through Consumer Protection Law or How the Truth in Lending Act Failed the Subprime Borrowers’ (2010) 71 *Ohio State Law Journal* 59.

documents including contractual obligations and therefore the law must protect him from exploitation by unscrupulous lenders.¹¹⁸

3.5 SELF INTEREST INHERENT IN BANKS

Consumer protection initiatives tend to face obstacles because they are usually viewed as an invasion into the arena of [banking industry].¹¹⁹ The main problem is that the form of protection envisaged in the banking industry is primarily concerned with safety and soundness of banks first¹²⁰ (which translates to profitability of the banks), while borrower protection legislation is concerned with the protection of the borrower's interest first.¹²¹ Since banks have the bargaining power the banks interest usually prevails against the borrowers' interest as consumer protection is inevitably subordinated to "safety and soundness" by banking regulators.¹²²

Loan terms also suggest a negative relation between lenders and borrowers protection mechanisms.¹²³ Banks will therefore shield themselves from default losses and as long as they are protected, they will not be overly concerned with the inability of borrowers to meet their obligations. Subsequently a conflict emerges between "safety and soundness" and borrower protection since the former benefits the bank while the latter benefits the borrower.¹²⁴

¹¹⁸ *ibid* 45.

¹¹⁹ FA Schurr, 'The Relevance of the European Consumer Protection Law for the Development of the European Contract Law' (2007) 38 *Victoria University of Wellington Law Review* 8.

¹²⁰ T Derrick, "'Safety and Soundness" v Consumer Protection' *The Atlantic* (New York, 2 March 2010) <<http://www.theatlantic.com/business/archive/2010/03/safety-and-soundness-vs-consumer-protection/36941/>> accessed 20 October 2016.

¹²¹ S Ligeti, 'Banking Supervision' (2001) 23 (1/2) *Journal of the Budapest University of Economic Sciences and Public Administration* 2.

¹²² AJ Levitin 'Consumer Financial Protection Bureau: An introduction' (2012) 32 *Review of Banking and Financial Law* 1.

¹²³ *ibid* 62.

¹²⁴ *ibid* 14.

CHAPTER FOUR

4.0 AN EXAMINATION OF THE PROTECTION OF BORROWERS UNDER THE CONSUMER PROTECTION ACT

4.1 INTRODUCTION

In order to examine the adequacy of the CPA in protecting banking borrowers, aspects of the National bank terms and conditions which were deemed unfair to the borrower were identified. The scope of this discussion was however limited to issues dealing with interest rate, disclosure provisions and unfair banking practices. Having identified those specific issues, the next step involves explaining why they are considered to be unfair to the borrower. The last step involves examining the CPA to identify whether it has any solution to the “unfair aspect” which has been identified. The absence or presence of a solution forms the basis for determining the adequacy of the CPA.

4.2 INTEREST RATE

The first issue dealing with interest rate is found in clause 2.1 of the National Bank Terms and Conditions which provides that “The borrower will pay (and authorises the bank to debit his account with) interest (as well after as before any demand or judgement or the bankruptcy of the borrower) on the facility at the annual rate which is specified in this agreement *and at such other rate as determined by the bank of its sole discretion...*”

This clause is deemed to be unfair to the borrower since it purports to give absolute discretionary powers to the bank, without any limitations or control.¹²⁵ This unfairness arises from the fact

¹²⁵ This paper takes cognisance of *Section 44 of the Banking Act* which makes, it incumbent upon the bank to seek approval from the Minister before it raises any interest to be charged, however the CPA 2012 fails to provide for

that, the bank is enabled to unilaterally alter the terms in the agreement and set new rates, without even consulting with the borrower. By giving the bank, the power to set interest rate at their own discretion, the bank may charge a rate which may be exorbitant to the borrower. In the case *Francis Joseph Kamau Ichatha v Housing Finance Company*,¹²⁶ the plaintiff took a mortgage from the defendant to be charged an interest rate of 18 per cent for 15 years. Despite the fact that, one of the terms in the contract was that the plaintiff be given a month's notice by the bank if the interest rate is increased, the bank increased the interest rate to 26 per cent without consulting the plaintiff. In declaring the variation illegal, Odunga J. stated that the basis of a notice in this case was to enable the borrower to have an opportunity to decide whether or not based on the new interest terms to continue with the contract or bring it to an end if there is no agreement.

In the case of *Socimer Bank v Standard Bank*,¹²⁷ the Court of Appeal considered a clause requiring one party, in the event of the other's default, to determine the value of certain assets on the date of termination. The court held that, while the discretion had to be exercised in good faith and with rationality this did not oblige the party to take reasonable care to arrive at the true market value or to not imply a term obliging the party to find, on solely objective criteria, the true market value of the assets.

From the *Socimer* and *Ichatha* cases it can be inferred that any variation of interest by the bank done in bad faith, without consulting the borrower and which would be to the detriment of the borrower would not be enforceable against the borrower. In determining what constitutes good

equal measure of protection for the borrowers' consent to be sought by the bank, when it seeks to adjust interest rates.

¹²⁶ [2004] HCCC 414, [2015] eKLR.

¹²⁷ [2008] EWCA Civ116.

faith, the case of *Margaret Njeri Muiruri v Bank of Baroda (Kenya) Limited*¹²⁸ stated that an action done without good faith is one which results in prejudicial change to another party and one which significantly alters the rights of another party. In this case therefore the banks action to unilaterally increase interest rate from 14 % to 45% without even informing the appellant was held to be an action done without good faith.

Further, the criterion to be followed in adjusting interest rates is left to the sole discretion of the bank thus giving the bank discretion to manipulate it. This power is too wide as it may imply that interest rate can be changed from time to time for whatever reasons. This may be subject to abuse and manipulation since the bank may unilaterally vary interest rates, and may not be required to account for such a decision to the borrower. In the case of *Paragon Finance PLC v Nash*¹²⁹ where rate of interest was variable at Paragon's discretion, the court of appeal held that this power had to be exercised in a rational and honest way. This therefore means that the banks must take into consideration the expectations of both parties; so that the rate that is set is not grossly exorbitant to the borrower. Unfortunately, the CPA 2012 does not have any specific provision to protect the borrower from such unilateral decisions by the bank.

Despite the detrimental effect of this provision to the borrower- that the bank is empowered to act at its sole discretion- it is not brought to the attention of the borrower. This can therefore 'be interpreted as indicia of unfairness since terms are expected to be reasonably transparent and should not be operated to defeat the reasonable expectations of the [borrower].'¹³⁰ Moreover,

¹²⁸ [2004] CA 282, [2012] eKLR.

¹²⁹ [2001] EWCA Civ 1466 [2002] ALL ER 248.

¹³⁰ *ibid.*

since the effect of this clause is that the borrower allows the bank to unilaterally set the rate of interest which rate may favour the bank alone. Such a clause ought to be brought to the attention of the borrower by being made conspicuous. This can be done by making the clause appear more prominent than the other clauses, either by having it highlighted or in bold print.

In the case of *Spurling v Bradshaw*,¹³¹ the defendant used the services of the plaintiff to store goods on several occasions and signed an invoice which contained an exclusion clause. On one occasion, upon being dissatisfied with the state of the goods, the defendant refused to pay, asserting that the clause had not been incorporated into the contract when he signed the document. While relying on the exclusion clause to demonstrate that they were not liable for the damage the claimant brought an action for the agreed price of storage.

The court unanimously held that the defendant would have been aware of the term from the previous contracts and therefore it did form part of the contract. This then would have resulted in sufficient notice to the defendant. However, Lord Denning, was categorical that in normal circumstances a party would not be bound by terms of a contract of which he has not received reasonable notice. He further asserted that some clauses carried much more weight than the others and needed to be printed in red ink on the face of the document with a red hand pointing to it before it could be said that the notice was sufficient.

The protection provision provided by the CPA 2012 which may protect the borrower in this case is under section 13 (2) (f) which imposes a liability on the bank to ensure that the terms of the transaction are not so adverse to the consumer as to be inequitable. However, this clause might

¹³¹ [1956] EWCA Civ 3, [1956] 1 WLR 461.

not protect the borrower since the threshold to be met under this provision might be too high. This is because the term “so” when used with the term “adverse” denotes a greater extent of hostility that might not be expected of humans.¹³² Secondly, the act does not define what it means to be inequitable and what criterion is to be used to measure it.

The second issue dealing with interest rate is found in clause 2.3 of the National Bank terms and conditions which provides that “If at any time during the continuance of the facilities, the amount drawn by the borrower from the bank is in excess of the facilities committed by the bank ...whether demand has been made or not on the borrower to repay the same and whether notice has been given or not to the borrower to repay the same, the borrower shall pay *additional interest* (after as well as before any demand made or judgment obtained or the liquidation or administration of the borrower) at the rate of..... per cent per annum for the Kenya shillings denominated facilities andper cent per annum for the foreign currency denominated facilities... This clause further states that “*The borrower acknowledges and agrees that the aforesaid additional rate of interest represents a reasonable pre-estimate of the loss to be suffered by the bank in funding the default on the borrower’s part.*”

This clause is unfair to the borrower as it has the effect of binding a borrower to terms which they did not have real opportunity of becoming acquainted with before the conclusion of the contract. This is because this clause provides that the borrower does not have to be notified yet without such notification, the borrower cannot reasonably be expected to be aware of the issue at hand. Borrowers ought to have an opportunity to read and understand contractual terms, and

¹³² W Collins, *Collins English Dictionary*, (6th edn, Harper Collins Publishers Limited 2006) 21, 1541.

then be able to make a choice whether to accept or to reject to be bound by those terms of the contract. According to the office of fair trading, in the United Kingdom, this provision is essential because long and complex contracts terms present special problems to consumers and therefore they need to be given more opportunity to read and understand them.¹³³ The CPA 2012 however does not provide for such protection.

Secondly, *additional interest* without outlining the procedure used to calculate the figures allows the bank to charge at a level it determines itself. This is a form of penalty against the borrower and therefore the borrower ought to be informed of the exact amount of interest rate to be charged for overdrawing their account. This is necessary in order to ensure that borrowers do not end up paying more compensation than is really needed to cover the damage they have caused. Otherwise the resultant effect is that borrowers will end up paying excessive or disproportionately high penalties. This clause is essential because despite the fact that banks are expected to disclose the total costs associated with loans, the loan repayment schedule and the Annual Percentage Rate, which takes into account the interest rate component, bank charges and fees, and third-party costs, including legal fees, insurance costs, valuation fees and government levies, the central bank has indicated that not all banks are compliant. By providing such an obligation in the CPA 2012, it becomes an obligation for banks to observe rather than a mere optional “good practice” that is expected of banks.

This provision also forces the borrower to make a disadvantageous declaration that *“the borrower acknowledges and agrees that the aforesaid additional rate of interest represents a*

¹³³ United Kingdom Office of Fair Trading, ‘Guidelines on Use of Unfair Terms in Consumer Contracts’ (2008) 4 OFT UTCCR Bulletin 16 < www.oft.gov.uk/advice_and_resources/publications/guidance/unfair-terms-consumer/> accessed 25 August 2015.

reasonable pre-estimate of the loss to be suffered by the bank in funding the default on the borrower's part." The unfairness arises from the fact that once a declaration has been written into a contract, borrowers are forced to make it even if it is not true or despite its being disadvantageous to the borrower. The effect of such a declaration is that, the borrower "signs away their right" to argue that the facts were not as indicated in the declaration. The CPA 2012 also does not provide any protection in such a situation.

The third aspect dealing with interest rate issue is found in clause 3.2 which provides that "The signature and delivery of this application by the *borrower* is deemed *conclusive evidence* of the borrower's agreement to be bound by the terms of the facility as to the amounts of the facility *and interest as approved and determined by the bank.*"

This provision deems consumers' signatures on standard form contracts (S.F.C'S) to be objective manifestations of assent regardless of whether the borrower ever read or understood the terms and conditions.¹³⁴ Indeed, this is no fault of the bank, but the concern here is how to protect the borrower from being exploited by banks. Specifically since the borrowers signature represents his assent and understanding of the contract, the law must equally ensure that what is provided in the contract by the bank meets the standard and form that a reasonable person would be expected to understand.

In the case of *HSBC Bank PLC v Patrick*,¹³⁵ the respondent/HFC Bank Ltd sent to the appellant/Mr. Patrick a form which invited him to provide various personal details as part of an application for a credit card to be issued by the Bank. At the end of the form a notice provided

¹³⁴ *ibid.*

¹³⁵ [2011] EWCA Civ 67.

that the appellant should '*sign it only if you want to be legally bound by its terms.*' The appellant sued against the decision of the lower court to make him liable for payment arguing that inter-alia the form which he signed and returned to the Bank was no more than an invitation to treat. The court of Appeal unanimously held that by signing the application form and returning it to the Bank the appellant had applied for credit and offered to be bound by the terms and conditions set out in the form.

However, this presumption should not suffice in the case where a banker *is aware yet oblivious* of the fact that a borrower does not have the capacity to comprehend a contract, and the ensuing obligations that arise. Caution should therefore be exercised in the case of the very old, the illiterate and young persons whose level of understanding of complex contracts may be poor in order to ensure that the bank did not take advantage of their inability to understand the contract in order to make them sign a contract. Indeed, it is arguable that since an enforceable contract consists of actual representations, promises, and mutuality of obligations; and since mutuality of obligations requires "*meeting of the minds*" of the parties then those parts of a contract that the lender should not reasonably expect the borrower to read and understand should be voidable as against the bank.

Secondly, it must be clear that a bank has only a legal duty to provide information to the borrower in an understandable *form* but it has no obligation to ensure that the borrower understands that information.¹³⁶ An understandable form would then require for instance that the bank provides information in a legible font; fine print is made conspicuous to the reader/borrower and the information is not ambiguous. Once the bank has discharged this duty

¹³⁶ *ibid* 45.

then the presumption that signature signifies understanding and assent of the contract cannot be used indiscriminately against the borrower. This is because a higher level of compliance by banks would be required before they can rely on this principle of law.

Further, most of these terms and conditions are written in the English and Kiswahili language which are the official languages of Kenya.¹³⁷ However, in the case of illiterate borrowers the language used can be a barrier to justice if the information cannot be understood by the borrower. I appreciate the fact that a borrower can ask the bank for translation and explanation. Nevertheless, if a lender is aware of the inability of the borrower to understand any information and takes advantage of that fact, the lender must be held liable for that is exploitation. This is because a crucial element in determining whether a borrower can meet their loan obligations is the borrower himself.¹³⁸ Therefore, if a borrower lacks the ability to understand the loans terms; *and the lender is aware of that fact*, then that first line of defence for the borrower against exploitation disappears. This is because that borrower cannot be expected to reasonably measure against their knowledge whether or not the loan facility will be beneficial to their interest.¹³⁹ In that regard if the borrower provides information that is not in an understandable form or takes advantage of the inability of the borrower to understand the information to the borrowers' detriment, the bank cannot argue that it has discharged its burden of providing information which the borrower can make meaningful use of.

¹³⁷ The Constitution of Kenya, art 7 (2).

¹³⁸ PN Stoop and C Chürr, 'Unpacking the Right to Plain and Understandable Language in the South African Consumer Protection Act 2008' (2013) 16(5) Potchefstroom Electronic Law Journal 5.

¹³⁹ *ibid.*

4.3 DISCLOSURE PROVISIONS

The first issue dealing with disclosure provisions is found in clause 3.1. This clause provides that “The bank may approve the full facility applied for or a lesser sum or decline the application in its sole discretion *without giving any reasons*, such decision of the bank may be by endorsement to that effect in the relevant part of this agreement, or by a separate letter and in either case it *shall be effective to bind the parties without any further act by the borrower.*”

This provision is subject to abuse in the case of an unscrupulous lender, since the bank has no obligation to give a reason for such disapproval. Failure to give reasons for the rejection of the facility is tantamount to denying the borrower information to enable him make a meaningful decision as is guaranteed under article 35(1) (b) of the constitution. In the interest of protecting the borrower, from such unscrupulous lenders it would only be fair to the borrower that all banks should provide reasons to the borrower for rejecting his application for a loan. For example a bank may indicate that “taking into consideration your salary, your loan is rejected because the bank is of the opinion that you will not be able to meet the payment obligation”. Such a borrower will then be able to appreciate the criteria for rejection and

On the other hand if a bank for instance indicates that, “your application for the loan is rejected because you do not fit the criteria of clients we serve”, the borrower then has a right to go to court and sue the bank if he feels his right to be served by the bank has been interfered with. Provision of information regarding the rationale for rejection protects the borrowers from abuse by enabling him to seek justice in court where his right has been abused. This cause becomes difficult if there is no evidence of the reasoning in written form, even though a court of law may still summon the bank to appear in court and give its testimony.

This provision is also unfair to the borrower as it does not provide the borrower with freedom to exercise his/her choice. In fact, the only option for the borrower is to decide between not buying a service and/or paying the high price. For instance it dictates specific product terms, without an option to choose something different. Essentially it is like being “boxed in a corner” by the bank, since the borrower is deemed to accept the terms and conditions in clause 3.1, without any further action on his part.

In this clause, if the bank rejects the original facility by the borrower, unless the borrower takes further action, the assumption is that *the borrower has agreed to be bound by this clause*. Yet this clause fails to take into consideration the fact that a desperate borrower, is likely to take up any offer, when in desperation. It would only be fair that an opt-in provision is adopted, in which case the borrower gets to acknowledge whether or not he wishes to be bound or not, by the new terms.

The second clause dealing with disclosure provision is found in clause 2.1 of the national bank terms and conditions. This clause provides that “The borrower will pay (and authorises the bank to debit his account with) interest (as well after as before any demand or judgement or the bankruptcy of the borrower) on the facility at the annual rate which is specified in this agreement and at such other rate as determined by the bank of *its sole discretion...*”

The sole discretion suggests that the lender can vary interest to its benefit, without any recourse to or notification to the borrower which is unfair to the borrower. This is especially detrimental to the borrower where such interest rises to exorbitant levels. In the case of *Margaret Njeri*

Muiruri v Bank of Baroda (Kenya) Limited,¹⁴⁰ the banks action to unilaterally increase interest rate from 14 % to 45% without even informing the appellant was found to have been a radical and prejudicial change which significantly altered the rights of the appellant and which was done without good faith in failing to inform the borrower and therefore unenforceable. Indeed good faith principle is based on a principle of “fair and open dealing” where terms are expressed fully, clearly and legibly, and with respect for the consumer’s interest.¹⁴¹

The CPA 2012 does not put an obligation on the lender to give notice to the borrower, in case of any adverse changes to the contract, yet it requires the borrower to give notice to the lender in several circumstances including when rescinding an agreement.¹⁴² The effect is that the lender is protected from sudden and unexpected changes in the contract but the borrower is not.

The bank ought to notify the borrower of the change in the interest rate and the borrower is given an opportunity to reject the contract since, a new contract introduces new terms which the borrower might not be privy to in the first place. Such provision of information to the borrower allows him to make an informed decision based on his or her circumstances and the consequences that are likely to arise due to the variation undertaken. It affords the borrower an opportunity to assess his relationship with the lender, and the right to terminate the contract may even be exercised if provided for.¹⁴³

Notification is also important as it helps identify at what point in time when an interest rate starts to be calculated. In the *Margaret Njeri case*,¹⁴⁴ it was noted that failure to give notice meant that “there was no indication at what point, or what time the rate of interest increased as there was no

¹⁴⁰ [2004] CA 282, [2012] eKLR.

¹⁴¹ J Chitty, *Chitty on Contracts: General Principles*, vol 1 (31st edn, Sweet & Maxwell 2012) 1160; see also E McKendrick, *Contract law* (9th edn, Palgrave Macmillan 2013) 220.

¹⁴² Consumer Protection Act 2012, S 16 (3).

¹⁴³ *ibid* 23.

¹⁴⁴ *ibid* 128.

notice.” This could be detrimental to the borrower, especially where he disputes the aggregate amount resulting from the interest charged.

Failing to provide borrowers with pertinent information that allows them to make informed decisions creates an imbalance between rights of the bank and the borrower, to the detriment of the borrower. Section 6 of the CPA 2012 may become handy here. A borrower who finds an unexplained abnormality in his/her charges in a credit agreement – in particular, an overstatement by the lender – can rely on this right to pursue justice. Unfortunately, this right assumes that the borrower is able to detect abnormalities in such estimation which might not be the case for a vulnerable borrower.

4.4 UNFAIR BANKING PRACTICES

The first aspect dealing with unfair banking practices is found in clause 12.10. This clause states that “*The bank shall not be liable for the acts or omissions of its advocates, valuers or other professional advisers.*”

The effect of this provision is to limit the liability of the bank from its (third party) agents. This provision is unfair to the borrower if it seeks to absolve and/ or limit the bank from liability from its agents, without taking into consideration the relationship between the bank and its agents or taking into consideration the role or and/or contribution played by the bank, by virtue of its relationship with its agents. For instance if these “third parties” are acting as agents of the bank, then the exclusion of the bank’s liability should only be based on the rules of principal-agent relationship. In such a case generally the principal (bank) is liable for all acts of the agent within the scope of the agent’s actual and apparent authority, hence it is possible for the bank to be held liable for the acts of its agents.

In order to determine whether a principal-agent relationship exists “...one party must expressly or impliedly consent that the other party should act on his behalf so as to affect his relations with third parties, and the other also similarly consents so to act or so acts.”¹⁴⁵ In the case of *Garnac Grain Company Incorporation v HM Faure and Fair Dough Limited and Bunge Corporation*,¹⁴⁶ Lord Pearson, stated that “The relationship of the principal-agent can only be established by the consent of the principal and agent. Moreover, they will be held to have consented if they have agreed to what amounts in law to such a relationship, even if they do not recognize it themselves and even if they have professed to disclaim it...”

Nevertheless, if the third parties are not agents of the bank or if they provide additional independent services; the contract must clarify whether these acts or omissions are incidental to the service being provided to the borrower or are merely optional services. In such a case, the borrower ought to be given the option to decline such additional services especially if there is a cost/fee to be charged. In such a case it is fair for the bank, not to be held liable for an action by the third party, if the borrower has been properly informed of the fact that it is an optional service which the borrower undertakes to enter with directly with the third party.

There is no clear provision in the CPA 2012 that offers protection to the borrower, in a situation where the bank attempts to extinguish/reduce its liability from the action of its agents or third parties. A protection clause could therefore be provided in the CPA 2012 and qualified to specify that the bank will not be *liable for the acts or omissions of its advocates, valuers or other professional advisers, which the borrower **independently undertakes** with the agents or which are not incidental to the service offered to the borrower.* The effect of this provision therefore

¹⁴⁵ F Bowstead and PW Reynolds and Reynolds, *Agency* (17th edn, Sweet & Maxwell 2006) 1-001.

¹⁴⁶ [1967] 2 All ER 353.

would be to make the borrower liable for all the acts of third party agents provided by the bank, but not the ones which the borrower independently procures. Similarly, a clause could be added to the CPA 2012 to provide that “*a term may also be unfair if it inappropriately excludes or limits the legal rights of the borrower or another party, in the event of total or partial non-performance of its agents as per instructions.*”

If indeed it can be established that there exists a relationship between the bank and its advocates, valuers or professional advisers, this clause may also be unfair to the borrower since it does not provide to *what extent* the bank is excluded from liability from the action of these agents. In the absence of a provision in the CPA 2012 on “unfair contract terms” then the assumption would be that even if these agents are negligent in their duties the exclusion clause would still prevail to protect the lender from liability. In the case of *Photo Production Limited v Securicor Transport Limited*,¹⁴⁷ the plaintiff sued the defendant/Securicor Transport Ltd after Securicor's employee, started a fire at Photo Production's factory to warm himself while at work and accidentally burnt it down, costing £648,000. The defendant argued that an exclusion clause in its contract meant they were not liable, as it said “*under no circumstances would it be responsible for any injurious act or default by any employee... unless such act or default could have been foreseen and avoided by the exercise of due diligence on the part of [Securicor].*”

In finding for the plaintiff in an appeal against the decision of the trial court, the court of appeal held that the breach of contract went to the root of the contract and invalidated the whole agreement, and extinguished the exclusion clause. In particular, Lord Denning stated that a competent court would not allow a party to rely on an exemption or limitation clause in circumstances in which it would not be fair or reasonable to allow reliance on it. He further stated that in considering whether a provision is fair and reasonable, a court of law would

¹⁴⁷ [1980] UKHL 2.

consider inter-alia whether it was in a *standard form*, whether there was *equality of bargaining power, the nature of the breach*. However this decision of the court of appeal was unanimously overturned by the House of Lords, holding that *on the facts of the case*, the exclusion clause could be relied upon by the defendant. Lord Wilberforce, writing for the House of Lords, explicitly rejected Denning's reasoning and found that the exclusion clause precluded all liability even when harm was caused intentionally.

Taking into consideration the fact that this decision is not binding but only persuasive in Kenya, I beg to disagree with the reasoning of the House of Lords and support Lord Denning's reasoning in the court of Appeal. Firstly at the time of making this decision by the House of Lord's in 1980, the unfair contract terms 1977 had just been passed. This court might therefore have been influenced by the fact that the unfair contract terms did not consider it unfair at that time, to provide absolute exclusion to a party. It is therefore arguable that the 1977 act was not as extensive in coverage as to protect a borrower/consumer. With the passage of the "United Kingdom Unfair Terms in Consumer contracts Act 2015" the scope of exclusion for liability has been further reduced for instance the Act provides that there shall be no exclusion or limitation for liability for death or personal injury arising from negligence. Absolute exclusion is no longer tenable.

Secondly, Lord Denning raises a very important issue that cannot just be disregarded. In particular he is concerned with the extent an exclusion clause can exclude one from liability. He asserts that if the court can say that "*the parties as reasonable men cannot have intended that there should be exemption or limitation in the case of such a breach*" then such an exclusion cannot be absolute. In effect his argument is that there are certain situations in which despite the existence of an exclusion clause, the court can interfere with that decision and say that an

unfairness and prejudice would result to a party and therefore the court as the representative of fair and reasonable man, as Lord Radcliffe put it cannot just stand and witness this unfairness.

CHAPTER FIVE

5.0 CONCLUSION AND RECOMMENDATIONS

5.1 CONCLUSION

The enactment of any consumer protection legislation is mainly aimed at identifying the weakness of the weaker party- in this case the borrower-; and then protect them from exploitation by the stronger party- the bank. Protection of banking borrowers is especially necessary where; 'a contract defeats all sense of right and wrong, where a contract is grossly inequitable or if a contract is such that no reasonable person would willingly enter into it'.¹⁴⁸ However the CPA 2012 does not have adequate provisions to protect the borrower from unfair interest rates, lack of disclosure and unfair banking practices. In fact for any adequate protection of the banking borrower, such a borrower must rely on several other statutes including the Banking Act, Competition Act and the Central Bank of Kenya Act.

Firstly, the borrower remains unprotected against certain unfair banking practices identified in the National bank terms and conditions which have the effect of exploiting the borrower. These practices include: excluding or limiting the legal liability of the bank; failure to provide sufficient notice to the borrower before imposing any new charges; enabling the bank to unilaterally alter the terms of the contract without a valid reason; irrevocably binding a borrower to terms which he had no real opportunity of becoming acquainted with; giving the bank exclusive rights to interpret the terms of the contract.

¹⁴⁸A Kiunuhe, 'Consumer Protection Laws to Curb Rising Exploitation' *Business Daily* (Nairobi, 15 June 2010) <<http://www.businessdailyafrica.com/Opinion-and-Analysis/Consumer-protection-laws-to-curb-rising-exploitation/-/539548/938592/-/vw0urj/-/index.html>> accessed 5 September 2015.

Nevertheless, the major factors that affect the protection of the borrower are exorbitant bank charges and high interest rates.¹⁴⁹ High interest rates and high bank charges result in the borrower paying exorbitant cost. The result is that the borrower is unable to be financially stable. Further, these high cost, act as an impediment to access to affordable banking services for borrowers. Nevertheless, very low interest rates and bank charges can still result in the borrower paying high indirect costs due to increase in transaction cost by the lender. For instance in an effort by the banker, to ensure that there is compliance with the law and that borrowers, are not excessively charged, he may increase cost to cover for the cost of ensuring that there is compliance with the law.

The main disadvantage for the borrower is that he has a weaker bargaining power relative to the bank and therefore cannot bargain on an equal footing with the bank.¹⁵⁰ Therefore private law measures which encompass self regulation and contract rights and obligations cannot offer sufficient protection to the borrower since the borrower plays a minimal role in the formulation of this rules and rights.¹⁵¹ Consequently the need for a comprehensive legal framework to enhance the protection of the borrower is critical since an independent party (The state) formulates the rules and regulations that govern the relationship of the borrower and the lender. In that regard government intervention is aimed at ensuring the interest of the borrower achieve some form of protection.

Secondly, the CPA 2012 only provides for general provisions that affect all borrowers dealing with both the service and goods industry. It therefore fails to specifically deal with credit issues

¹⁴⁹Ibid 15; see also G Ngigi, 'Big Banks Cartel Hurting Economy with Expensive Loans, says World Bank' *Business Daily* (Nairobi, 11-13 March 2016) 1-2.

¹⁵⁰ ibid 77; see also ibid 106.

¹⁵¹ S Bright, 'Winning the Battle against Unfair Contract Terms' (2000) 20(3) *Legal Studies* 3.

which affect borrowers. Indeed, financial services contracts – under which borrowers fall – are more complex than other consumer relationships, and therefore require special regulatory treatment.¹⁵² This is because the problems encountered by the financial consumer are unique to this industry and can only be tackled when those specific issues affecting borrowers are integrated into the law. Kenya could borrow a leaf from the South African approach of legislation which has a separate and independent statute to deal with credit agreements. This way, South Africa’s National Credit Act, 2005 is able to deal with specific issues relating to the borrower like “improved standards of consumer information, prohibition of unfair credit and credit-marketing practices, reckless credit granting and debt re-organisation in case of over-indebtedness.

Thirdly, disclosure provisions in the CPA 2012 are also not effective. This ineffectiveness speaks directly to the challenge of information asymmetry, in Kenya. The main weakness is that disclosure requirements under the CPA 2012, assume that information is disclosed in a useable manner, yet it could be in legalese, barely understandable by the borrower. Further, it assumes that there is infrastructure that will help the borrower use the information, such as the presence of a lawyer. It also assumes that the borrowers have the capacity to synthesize the disclosed information. There is therefore a need to emphasize not only disclosure but understandable disclosure for the borrower since borrowers who understand their payment obligations well enough are able to decline unwise loans.¹⁵³

¹⁵² Association of Supervisors of Banks of the Americas, ‘Best Practices and Recommendations on Financial Consumer Protection’ (2012) <http://www.asbaweb.org/E-News/enews-32/INC%20FNAN/2%20INC%20FNAN.pdf> accessed 25 October 2016; see also International Bank for Reconstruction and Development: The World Bank, ‘Good Practices for Financial Consumer Protection’ (2012) <http://siteresources.worldbank.org/EXTFINANCIALSECTOR/Resources/Good_Practices_for_Financial_CP.pdf>accessed 25 August 2015.

¹⁵³ *ibid* 117.

Fourthly, the CPA 2012 fails to make a distinction between different defaulting borrowers. The resultant effect is that all borrowers are treated equally and the consequence of default is the same. Indeed, a borrower may default on a loan because he is unable (accidental default) or because, though potentially solvent, he is unwilling to repay (strategic default).¹⁵⁴ It is only fair, that a strategic defaulter should get severe punishment than the accidental defaulter, because the former is a repeat defaulter.

Fifthly, the CPA 2012 is not supported by an equally adequate institutional framework for successful enforcement and implementation. The Kenya Consumer Protection Advisory Committee which is an institution created in the CPA 2012 is a mere advisory committee that does not have corporate powers to sue on its own name on behalf of the borrower.¹⁵⁵ The effect therefore is that the borrower must rely on their own means to sue or enforce its legal rights, which might be costly for individual borrowers who do not have the financial means to institute a suit in court.

Sixthly, the CPA 2012 also seems to be lagging behind the developments and jurisprudence advanced in case law. In particular it pays too much attention to the technicalities of a contract and therefore remains deficient in recognising the handicapped nature of a borrower relative to a party with more resources. Indeed, in the case of *Plevin v Paragon Personal Finance Limited and another*,¹⁵⁶ the United Kingdom Supreme Court held that in determining whether a debtor-creditor relationship is fair a wide range of considerations may be taken into consideration such as; *the sophistication or vulnerability of the borrower; the choices available to the borrower;*

¹⁵⁴ T Jappelli et al, 'Effects of Judicial enforcement on Credit Markets' (2005) 37(2) Journal of Money, Credit and Banking 5.

¹⁵⁵ Consumer Protection Act 2012, S 89 (1).

¹⁵⁶ [2014] UKSC 61.

what the borrower could reasonably be expected to know or assume; and the degree to which the creditor is aware of these matters.

5.2 RECOMMENDATIONS.

5.2.1 ECONOMIC INTEREST

Firstly, it is necessary to cap/limit the extent beyond which banks should not be allowed to set lending rates so as to ensure that the cost is not unreasonable for the borrower.¹⁵⁷ There is need to have a maximum rate beyond which interest rate cannot be set by banks.

Secondly, the borrower should have a chance to reject a loan where interest rates drastically changes before the borrower has gotten the chance to utilise the loan effectively. For instance, a period of less than one week should be set, for which a borrower can reject a loan, subject to reasonable penalties, if the rates increase drastically and he is able to demonstrate that the loan will therefore not help in advancing his interest.

5.2.2 DISCLOSURE

The borrower must always be given the option to reject any hidden charges that may arise after signing up for the loan, and the opportunity to return part of the loan they have borrowed during what is termed as a cooling-off period without interest in case they find out that they cannot use all the money they have borrowed.¹⁵⁸

In cases of fine prints which are used to absolve the borrower from liability, the law can protect the borrower by stating that any fine print (that is illegible) that is to the detriment of the

¹⁵⁷ See Central Bank of Kenya (Amendment) Bill 2015.

¹⁵⁸ LM Oketch, 'Clients Welcome Policy on Hidden Bank Charges' *Daily Monitor* (Kampala, 2 April 2015) <<http://www.monitor.co.ug/Business/Clients-policy-hidden-bank-charges/-/688322/2673148/-/fiq8qf/-/index>> accessed on August 24 2015.

borrower must be disregarded unless if the bank can prove that it was sufficiently brought to the attention of the borrower.

Banks must disclose to borrowers “worst case scenario” indicating what payment would be if the interest rates went to the highest amount permitted. This way a borrower can make an informed decision having taken into consideration their ability to meet their loans obligations in the “worst case scenario”.

5.2.3 UNFAIR BANKING PRACTICES

In order to protect the borrower from unfair overdraft charges by banks, the law should make it mandatory for banks to process charges based on the date of the transaction and not based on the largest transactions first.¹⁵⁹ This way the likelihood of having several overdrafts charges for the borrower is reduced, especially in cases where an unscrupulous bank may take advantage of desperate borrowers. (*See Appendix I and II for explanation and page 23*).

Secondly, there is need to limit the total amount of fees that may be imposed on a borrower who uses overdraft facility or to put a limit to the number of times a borrower can utilise an overdraft. Both of these recommendations can help prevent a cascade of overdraft fees for the vulnerable borrowers.

Thirdly, the law ought to make it mandatory for banks to inform borrowers that the order in which transactions are processed can affect the total amount of fees incurred in the case of

¹⁵⁹ United States Federal Deposit Insurance Corporation, ‘Guidance on Overdraft Payment Supervisory Guidance’ (2011) < <https://www.fdic.gov/news/news/financial/2010/fil10081b.pdf> > accessed 24 October 2016.

overdraft. This way borrowers will take caution to ensure that their transaction are calculated in the order they took place, in order to prevent predatory banks from unfairly maximising on overdraft related fees.

Lastly, the law also ought to make it mandatory for lenders to give a warning to borrowers that the final cost of the loan may vary from what is initially presented. This will protect borrowers from scrupulous lenders who are able to exploit vulnerable borrowers by presenting loans as affordable to the borrowers.

5.2.3 GENERAL RECOMMENDATIONS

First, an independent third party ought to review and approve loan contracts on behalf of borrowers.¹⁶⁰ This is necessary because certain borrowers may not have the financial ability to hire a private party to review the contract on their behalf.¹⁶¹ This will ensure that minimum substantive standards (fairness, efficiency) and procedural standards (a font size that is visible, language that the borrower understands, and use of different colours for contract terms that need to be made prominent due to their adverse effect to the contract) are met.

Secondly, the CPA 2012 could also be bolstered to better protect the borrower by providing for a list of terms which might be deemed unfair if they are included in a borrower contract.¹⁶²

Lastly, since financial literacy is critical to effective understanding of disclosed information¹⁶³ and in recognition of the difficulty that borrowers face in understanding banks contracts, the

¹⁶⁰ *ibid* 41.

¹⁶¹ S I Becher, 'Asymmetric Information in Consumer Contracts: The challenge that is yet to be met' (2008) 45 *American Business Law Review* 4.

¹⁶² See United Kingdom's Unfair Terms in Consumer Contracts 2015, Sch 2 which has identified a (non-exhaustive) list of more than 20 terms which can be deemed to be unfair if included in a consumer contract.

CPA 2012 ought to emphasize a compulsory corporate social responsibility by banks to educate borrowers on financial covenants and what they need to pay special attention to when analysing a contract.¹⁶⁴ This way, lenders will have an obligation to ensure that borrowers understand their payment obligations well enough, to enable them to decline unwise loans.¹⁶⁵ This is especially important in developing countries like Kenya, where financial literacy is low among borrowers.¹⁶⁶

¹⁶³M Miller and others, 'The Case for Financial Literacy in Developing Countries: Promoting Access to Finance by Empowering Consumers' (2009) World Bank, DFID, OECD, and CGAP joint note, Washington, DC: World Bank <[http://brigaders.wdfiles.com/local-files/professional%3Abusiness-project-resources/Financial % 20 Literacy.pdf](http://brigaders.wdfiles.com/local-files/professional%3Abusiness-project-resources/Financial%20Literacy.pdf)> accessed on 26 October 2016.

¹⁶⁴ *ibid* 45.

¹⁶⁵ *ibid* 117.

¹⁶⁶IW Mwangi and EN Kihui, 'Impact of Financial Literacy on Access to Financial Services in Kenya' 3(19) *International Journal of Business and Social Science* 1-4.

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7.0 APPENDICES

APPENDIX I

Date	Item	Debit (Kshs.)	Overdraft Fees (Kshs.)	Balance (Kshs.)
				190
11/1	toothbrush	5		185
11/2	petrol	29		156
11/3	tea	8		148
11/4	internet	90		58
11/5	Books	105	20	-47

APPENDIX II

Date	Item	Debit (Kshs.)	Overdraft Fees (Kshs.)	Balance (Kshs.)
				190
11/5	Books	105		85
11/4	internet	90	20	-5
11/2	petrol	29	20	-34
11/1	toothbrush	5	20	-39
11/3	Tea	8	20	-47

HOW BANKS OVER-CHARGE OVERDRAFT FEES.

In **Appendix I**, the customer would expect that the transactions would be computed based on the date of the transaction. This in turn would result in the borrower having only one overdraft for which he will pay a fixed sum of Kshs. 20.

In **Appendix II**, the bank starts with the largest transaction resulting in a quicker depletion of the customer's account. This results in four overdrafts, resulting in a total charge of Kshs. 80.

Appendix III

A copy of the National Bank terms and conditions for an unsecured loan.