UNIVERSITY OF NAIROBI

COLLEGE OF HUMANITIES AND SOCIAL SCIENCES

SCHOOL OF LAW

A THESIS SUBMITTED IN PARTIAL FULFILLMENT OF THE REQUIREMENTS FOR THE AWARD OF THE DEGREE OF MASTER OF LAWS (LL.M) DEGREE

COURSE: GPR 699-PROJECT PAPER

CORPORATE GOVERNANCE IN THE KENYAN BANKING SECTOR: A CRITICAL REVIEW OF THE CREDIT INFORMATION SHARING MECHANISM AND ITS IMPACT ON BORROWERS

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DECLARATION

I, **BONIFACE MACHUKI** do hereby declare that this thesis submitted in partial fulfillment of the Master of Laws (LL.M) requirement of the University of Nairobi, School of Law is my original work and has not been, is not, nor is it pending submission for any award of Diploma nor Degree in any other institution in Kenya nor worldwide. The references used hereinafter, are for academic purposes whose sources to the best of my ability and knowledge has been acknowledged fully.

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DEDICATION

To my wife Sarah Ongeri, the absences are forgiven, I hope. To my little king Keragia and my princess Nyanchama, you little angels, I love you!

To my dearest mum Nyanchama, because of your dedication; your name shall forever be etched in history books. Alice auntie, thank you.

To my siblings Alfie, Erastus, Kahj and my only sister Kwamboka, be blessed.

ACKNOWLEDGEMENT

I would like to sincerely thank my supervisor, Mr Tim Mweseli, for the able support, guidance and directions during the course of writing this research. You were always available on a call's notice freely dispensed with advice that enabled me complete this task. To Mr Leonard Obura Aloo for his meticulous guidance that has tremendously improved this final draft and to Dr Evelyne Asala for ably chairing the defence panel. All errors are my sole responsibility.

My warmest gratefulness to my dad Samuel Okwoyo and my dearest mum Florence Nyanchama Keragia; you taught me that wisdom is better than wealth and the best education is the one learnt for its own sake. You taught me to fear God.

My friends Ratemo (Rats), Gera (Barongo), Erac, Dr Kerubo and Kui; I had the shoulders of giants to lean on.

Eric Naibei advocate, thanks for your contributions onto this work.

May you all be richly blessed.

LIST OF ACRONYMS AND ABBREVIATIONS

ACPK	Association of Credit Providers of Kenya
AMFI	Association for Micro Finance Institutions
CAK	Competition Authority of Kenya
CAP	Chapter
CBK	Central Bank of Kenya
CBR	Central Bank Rate
CIS KENYA	Credit Information Sharing Association of Kenya
CIS	Credit Information Sharing
CMA	Capital Markets Authority
COFEK	Consumer Federation of Kenya
CRB	Credit Reference Bureau
DFI	Development Financial Institutions
DLAK	Digital Lenders Association of Kenya
FINTECH	Financial Technology Company
IRA	Insurance Regulatory Authority
KBA	Kenya Bankers Association
KDIC	Kenya Deposit Insurance Corporation
KEPSS	Kenya Electronic Payment and Settlement System
MFI	Micro Finance Institution
MPC	Monetary Policy Committee

NPL	Non-Performing Loan
NSE	Nairobi Stock Exchange
OECD	Organisation for Economic Co-operation and Development
RBA	Retirements Benefit Authority
SACCO	Savings and Credit Co-operative Society
SASRA	Sacco Societies Regulatory Authority

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Companies Act No. 17 of 2015

Central Bank of Kenya Act Cap 491

Insurance Act Cap 487

Finance Act 2019

Kenya Deposit Insurance Act No. 10 of 2012

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

Kenya Communications (Amendment) Act, 2009 Laws of Kenya

Kenya Post Office Savings Bank Act Cap 493B

Competition Act, Cap 504

Co-operative Societies Act Cap 490

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ABSTRACT

This thesis seeks to look at the interplay between principles of corporate governance in general and in particular as elucidated by Central Bank of Kenya in the Prudential Guidelines 2013, how they are practiced by the banks to the benefit of or detriment of the key stakeholders who are borrower.

In order to form a view, the writer has used the Credit Information Sharing mechanism touted by the Central Bank and the Kenya Bankers Association as a solution to eliminating information asymmetry in the financial sector and thus enabling the borrowers enjoy better interest rates and possibly lead to a reduced NPL book in the banking industry.

The writer has interrogated the conduct of the Central Bank of Kenya in trying to achieve the above, the response by the banks and Micro Finance institutions, the legislature and case law. The end result is that, though the CIS mechanism has lofty visions, the financial sector need to do more in order to pass on the benefits of the CIS mechanism to the borrowers.

The required interventions may be regulatory review, closer supervision by the regulator, better self-regulation for example through peer reviews and a host of other urgings that may include incentives to financial institutions that comply voluntarily or lead in this area. Further, this thesis posits that direct legislative regulation by the National Assembly is undesirable in a fully liberalised financial sector.

Review of the existing regulations and implementation may very well be what is needed. For example a fully thought out Alternative Dispute Resolution (ADR) under the CIS mechanism would give hope to the stakeholders. Review regulations to give more frequent updates, holding consumer directors responsible for failure in the CIS process within an organisation occasioning loss to the of timelines for example to update customer data, accuracy of the data are some of the interventions that can be taken to ensure benefit to the borrowers and the financial sector at large.

CHAPTER ONE

INTRODUCTION AND CONCEPTUAL ISSUES

1.0 Background to the study

The financial services industry expanded tremendously in the recent past. The expansion has included the introduction of the Micro Finance sub-sector and the Sacco sub-sector in the mainstream financial services sector vide various legislations.[1] Further, there are pension schemes, securities market, and insurance among others in the financial sector. This expansion has blurred the line between what a bank and a financial institution does. Banks have become conglomerates offering a bouquet of financial products and services[2] while the regulatory regime has remained segmented for example, whereas banks would offer insurance products they are not regulated under Insurance Regulatory Authority (IRA).[3]

The expansion of financial services has crossed the traditional banking model and perhaps the celebrated definition of a bank as an institution that ‘‘should one, accept money and collect cheques from customers and placing them to their customers' accounts, two, honor cheques or orders drawn on them by their customers when presented for payment and three, keep current accounts and record debits and credits in them’’[4] has expanded considerably. This is more so in the integrated financial offerings by banks and the advent of internet and mobile banking.[5] The expansion also necessitates re-looking at the definition of a bank customer from a more traditional one of an account holder towards accepting the definition which includes non-account holders.[6] This is significant since mobile banking and lending by banks is on the increase and often this is

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[1] See the Microfinance Act, No 19 of 2006, Sacco Societies Act, No 14 of 2008 and the expanded regulatory framework.

[2] It is possible to find a bank offering insurance services, financial advisory services, asset finance and stock broking services. Most accounts now come with life insurance cover of one nature or another.

[3] For example the Retirement Benefits Authority regulates Pension, the Sacco Societies Regulatory Authority regulates Saccos, Central Bank of Kenya regulates Banks. IRA is established under the Insurance (Amendment Act) 2006 Cap 487

[4] United Dominions Trust v Kirkwood (1966) 2QB 431 (CA)

[5] Mwenda K Kenneth, Legal Aspects of Banking Regulation, Pretoria University Law Press, 2010 at p.8 where he posits that the definition as given in UDT v Kirkwood is no longer sufficient.

[6] Woods v Martins Bank (1959) where it was held that an non-account holder is a customer

available to bank account holders and non-bank account holders and mostly does not include any paperwork, a traditional basis for establishing banker-customer relationship.

These individual regulatory regimes[7] established under their own legislations have had weaknesses and efforts have been on going to have a unified regulatory framework.[8] The effort is geared towards regulation of the institutions which is outside the scope of this study. The impact of such regulation is however noted in passing in this research and further notes that the regulation efforts will continue as the line between the traditional financial institutions and new financing models emerge.[9] Although, the research focuses on the traditional banking model in relation to the benefits customers are accruing from such, the expanded roles and services the banks are offering the borrowers have created the need for greater efficiency in lending decisions. One way to increase efficiency in lending decisions is thought to be through the reduction of information asymmetry in those lending decisions.

Central Banks play an important role in regulation of customer-banker relationships; in Kenya the Central Bank of Kenya does this through the Banking Act,[10] where it can issue regulations and directions through circulars. CBK in the effort to reduce the information asymmetry in the financial sector promulgated Credit Reference Bureaus Regulations 2008.[11] This was followed by the establishment of a self-regulating organization called the Credit Information Sharing Association of Kenya (CIS Kenya).[12] The main purpose of the CIS Kenya is to bring credit providers together and enabling them to share borrowers' financial information safely. The use of the word 'safely' here means the institutions can share customer financial transactions data without breaching customer banker confidentiality which is implied in a contract between a banker

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[7] Jacob Gakeri, 'Financial Services Regulatory Modernisation in East Africa: The search for a New Paradigm Shift' (2011) Vol 1(16) *International Journal of Humanities and Social Science*

[8] See for example the 1999 Capital Markets Authority's Chief Executive Report "Strategy Towards a Consolidated Financial Services Regularity Framework" There is a draft Financial Markets Conduct Bill, 2018 in this regard t which CBK has raised concern over clashing roles, it remains to be seen whether such unified regulatory regime shall be achieved in future.

[9] It is noted that there is now new ways of establishing banker-Customer relationship without paper filling; these include mobile banking, mobile lending and internet banking among others. These will pose significant regulatory challenges, for example where loan interest caps are introduced, banks have steered away from traditional loan lending methods to mobile lending which charges higher interest rate on annualised basis. See for example Timiza by Barclays and KCB-MPesa by KCB and Loop by NIC now NCBA.

[10] Cap 488 Laws of Kenya

[11] Supra Note 10 Section 31(3) and (4), section 55(1)

[12] www.Ciskenya.co.ke

and a customer.[13] CBK also prohibits disclosure of customer details and dealings except as authorized under law and or the Prudential Guidelines.[14] A borrower's financial transaction information is critical to him and can be used to adversely select against him in a financial transaction.[15]

The Kenyan banking sector has undergone tremendous challenges in the recent past. Most of these challenges have mainly affected bank customers or stakeholders in the broader sense. Banks have also been affected by these challenges, leading to retrenchments and even closures. Several factors such as poor corporate governance, the declining economy in the whole country and a poor regulatory regime[16] have contributed to these challenges.

To remedy some of the challenges, there have been legal or regulatory interventions, that is, through the publishing of various rules and regulations by the regulators such as the Central Bank of Kenya and the Capital Markets Authority, as well as the passing of relevant laws by Parliament.

These efforts come at a time when traditional banking is on the decline owing to technological advancement. For example today a bank customer can transfer funds in real time from his account to another customer in another bank using the Real Time Gross Settlement System (RTGS).[17] The banks have gone all out to embrace technology. Today there is active encouragement by banks to their customers to use Cash Deposit Machines, take loans through the banks' mobile platforms, and for customers to rely entirely on use of mobile and internet banking channels, video banking and telephony banking to carry out their transactions.[18]

Whereas the above technological advances are welcomed and encouraged, they are sometimes outside the scope of regulations and the lacuna allows the financial institutions to exploit the

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[13] Tournier v. National Provincial and Union Bank of England (1924) 1KB 461

[14] Prudential Guidelines, 2013 issued under Section 31(3) and (4), section 55(1)of the Banking Act Cap 488

[15] Ibid

[16] As is often the case, law is behind the fact. An example is the mobile banking phenomenon where regulations came after the mobile money was already in the mainstream market.

[17] The system went live on 29th July 2005 and since them more and more electronic banking offerings are being introduced.

[18] See Timiza by Barclays, Eazzy Pay by Equity Bank and Video and Telephony banking by Standard Chartered Bank Kenya Limited.

customer.[19] For example traditional personal loans and term loans including mortgages come under the interest rates regulation that was passed in 2016.[20] However, the resultant credit unavailability led to innovative banks introducing mobile lending which is not captured in the regulations. The Mobile loan facility may have an interest rate of up to 75% per annum contrary to the cap of 14% per annum set by the current legal regime.

This is the opposite of what is expected in a market with supposed reduced banking information asymmetry due to the presence of Credit Information Sharing (CIS) initiatives and regulations. The mobile and internet banking lending platforms are also supposed to be cheaper and with lower interest rates due to reduced requirement of manpower, paperwork, time and resources. This is currently not the case. Thus, by banks pushing customers to alternative transactional platforms, they are invariably sidestepping the regulations and consequently depriving the consumer of the very intended benefit. The research seeks to establish if this is a failure of corporate governance by looking at the corporate actions when faced with decisions under the CIS mechanism.

The CIS mechanism is about gathering borrowers' information, processing that information and storing that information in a manner that is usefulto any person that may be interested in the collected information. The advent of multiple channels through which borrowers' financial information could be accessed and gathered for example internet banking, online banking and mobile banking meant that there is now available more information that banks could use in their lending decisions.. By simply tracking a customer's expenditure for example places where the customer uses his debit card ('swiped'), online payments and mobile payments, a financial institution through analysis of this trend, can draw an accurate conclusion on whether to lend to that particular customer and if so what amount to lend.[21] It is the contention of this research paper that now more than ever; the spotlight must be shone on corporate governance practices within the

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[19] See generally Njaramba Gichuki *Law of Financial Institutions in Kenya*, (2013) (Second Edition) Law Africa Publishing Ltd, Nairobi.

[20] See sec 33 B, the Banking (Amendment) Act, 2016. See also Wambua, Eric (2017) "*The effect of interest rates capping on the levels of personal loans granted by commercial Banks in Kenya*," Masters of Business Administration (MBA) Thesis, School of Business, University of Nairobi.

[21] Traditionally this analysis was done through banking statements however, there is rising concern that customer data is being gathered in addition to following the trail of expenditure, also through social forum like Facebook. Some mobile money applications (mobile apps) check number of contacts and status to determine your credit score.

financial sector especially since they now have more information within their grasp with which they can use in their lending decisions. Banks as corporates are concerned with return on shareholder investments, left on their own and armed with borrowers' information they would adversely select out customers they perceive as risky who nevertheless have ability to repay loans.

The CIS mechanism was thus created to uniformly collect data, process the same, store the same and make the same available to subscribers or lenders with uniform borrowers' score as a means of entrenching a sustainable beneficial financial sector to both the banks and the borrowers. The regulatory regimes need to be more proactive to ensure that financial institutions are held to account to disclose whether they are applying the CIS mechanisms in their lending decisions. This disclosure should not only be to the regulators but also to the key stakeholders such as borrowers.[22] Leaving this group out is akin to allowing financial institutions unfettered access to gather and use personal financial information from all and sundry sources to the benefit of the financial institutions whereas the borrowers do not have corresponding rights to know how their financial information have been used in reaching favourable or unfavourable lending decisions and what remedies the borrowers may have against such decisions.[23]

It must be remembered that use of private information or data may change the way a society feels about an individual and even about how individuals feel about themselves.[24] It is now widely accepted that "organizations ranging from businesses…can easily retrieve information about a person's finances…sites visited on the internet and recent purchases to name just but a few."[25] With this realization comes the greatest responsibility of financial institutions need to exercise good corporate governance to ensure their departments to not overreach in the use of customer's data and also where such use is required promptly inform the customer of such use or intended use. This will ensure customers benefit from information about them held by these financial

[22] For example it would be important for a financial institution to disclose in its mobile lending whether it considered the CRB status, it accessed the customers' social profiles, cross-checked with other institutions for example mobile telephony companies.

[23] The argument here is that any information for credit decision including mobile lending by a financial institution should of necessity be regulated in the manner it is collected and used. The 'switch' to mobile lending due in part to interest rate capping of 2016 lays credence to this assertion since the depriving a borrower traditional lending will invariably push him to the mobile lending where limits are small and interest very high.

[24] Creech C Kenneth, Electronic Media Law and Regulation, 5th edition, Focal Press 2007 at page 288

[25] Ibid

institutions. That 'invasion' of privacy can "subject an individual to mental pain and distress, far greater than could be inflicted by mere bodily injury."[26]

The technological advancement made as expressed above has made it easy to collect personal data and sometimes use the same to evaluate or screen customer. The application of computers in data processing permits instantaneous access to large amounts of information about a customer or prospective customer.[27] It is desirable from a corporate governance perspective that the banks and financial institutions should declare the sources of data they use to make credit decisions. This is important with the advent of various lending platforms like mobile lending and online banking lending. There is a shift towards greater responsibility and disclosure on non-financial performance including but not limited to customer relations, ethical standards and sustainability in specific reports.[28] This paper argues that there is need to push for greater disclosure on the implementation of the CIS mechanism by banks in their annual reports as part of their corporate disclosures to shareholders and stakeholders. This would help stakeholders see if their banks and their boards are geared towards sustainability of the financial sector or short term gains at the expense of key stakeholders such as borrowers.

The other aspects of corporate governance and closely related to customer information gathering and use as per CIS mechanism is where banks being subscribers to Credit Reference Bureaus (CRBs) request for periodic 'Bureau Scrubs.'[29]

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[26] Ibid, p. 290.

[27] Collin Tapper, Computer Law, 2nd edition, Longman Group ltd (1982) at p.119 state that "..it is feared that this information is available to anyone who wishes whether their access is authorized or unauthorized, open or clandestine, legal or illegal."

[28] Tricker, Bob, Corporate Governance, Principles, Policies and Practices, 2nd Edition, Oxford University Press, 2011 p. 239

[29] The researcher has worked in three financial organisations and the information here is from his own observation or from trusted sources within Credit functions of those organisations. 'Bureau Scrubs is raw data requested by a subscriber that shows the financial borrowings of a customer and the status of those borrowings. This information is then used by various departments for example for remedial strategies where the loan is in arrears. This use may or may not have been communicated to the customer raising corporate governance issues. The assumption here is that by a customer signing away that his financial performance information may be shared gives freedom for the lenders to use this information as they deem fit. The 'Bureau Scrub' can show performance of customer borrowing in other financial institutions. It may not be true that the customer envisaged nor consented to this wide use of his data.

Some of these interventions include: First, the publishing of Credit Reference Bureau Regulations in 2008.[30] The Central Bank of Kenya through the National Treasury Cabinet Secretary, published The Banking Act, Credit Reference Bureau Regulations 2013[31] (CRB Regulations, 2013), which became effective on 17th January 2014. The CRB Regulations, 2013 vide rule 56 repealed the CRB Regulations 2008. The CRB Regulations allowed Micro Finance Institutions to list credit and personal history of borrowers just like the main-stream banks. It also allowed for compulsory listing of all credit data of borrowers whether positive or negative.

Secondly in 2016 the National Assembly amended the Banking Act[32], a cap was put on the rate of interest charged on loans and fixed the minimum rate of interest that banks must pay on deposits they receive from their customers.[33] In the amendments, banks or financial institutions are now required to disclose all charges and terms relating to a loan to a borrower. The president assented to the Finance Bill 2019 on 7th November 2019.[34] This Act amended the Banking Act by scrapping the capping of interest rates charged by banks. Although it is expected that banks will raise the interest rates, existing loans will not be affected. Although the interest rate capping has been capped, the banks will now have to contend with the Banking Charter 2019[35] and a more vigilant CBK that is not keen to return to the banking sector to the state interest regulation regime again.

Despite the above interventions, it still appeared that the plights of the ordinary borrowers have not been duly addressed. CBK, the regulator, had largely failed to protect the consumer or borrower from exploitative interest rates by banks until parliament intervened in 2016. The amendments were meant to be a reprieve from high interest rates charged on the borrowers. In addition, the 2013 CRB regulations that allowed banks to share credit information on borrowers were also partly intended to help the borrower to easily access bank loans since by production of a CRB

[30] The CRB 2008, provided for the listing of bank customers with default history only and did not have provisions for any other financial or service providers to list with the CRB.

[31] Section 31(3) and (4), section 55(1)of the Banking Act Cap 488 and sections 34(4),(5) and 48(2) of the Micro Finance Act No. 19/2006

[32] The Banking (Amendment) Act 2016 vide Kenya Gazette Supplement of 31st August 2016 effective date 14th September 2016

[33] The Amendments set the maximum interest rate chargeable by a credit facility at below 4 per cent of the base rate set by the Central Bank of Kenya. They also guaranteed a minimum interest rate of at least 70 per cent of the base rate set by CBK.

[34] The Bill became The Finance Act 2019 upon assent on 7th November 2019

[35] Issued under Banking Act Sections 33(4) and Micro Finance Act Section 48(2A) (6) became effective on 31st March 2019 through Circular No. 1 of 2019. The Charter has stringent rules on interest application by lenders

report, a bank could easily tell if the borrower was a risky customer or not. The advent of the (CIS) initiative in 2008[36] and later enhanced by the CRB Regulations 2013 was hailed as a milestone that will bring benefits to the financial industry. The benefits envisioned included helping borrowers negotiate the better terms and conditions of their loans including lower interest rates, flexible repayment periods, non-reliance on asset security and a faster appraisal process[37] of the borrowers' applications for credit.

However, there has been a general failure in implementation of or proper application of some key regulations that tend to favor borrowers by the banks. While some bank directors or managers have been implicated in fraudulent activities involving huge insider loans, ordinary borrowers have not realized the fruits or benefits of some of the key legal interventions meant to cushion them against exploitation by banks.

A cursory glance of the lending practices in many banks in Kenya show that bank customers get to know of the Credit Reference Bureau statuses when their loans have been declined and not beforehand.[38] At this point the damage may have already been done through declining to grant the facility requested for. It could be that the information contained in the CRB is inaccurate or is disputed between the customer and the listing institution. The disclosure of the fact that CRB status shall be used to determine successful or unsuccessful outcome of a credit application should be disclosed before the application is processed so as to give the customer the right to know "the name and agency used, to obtain a copy of the information registered against him, and if incorrect, can have the same corrected or erased."[39]

Yet, as noted above, there have been attempts to formulate policies and regulations and efforts to adopt best practices and on consumer lending laws and regulations that define how financial

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[36] The Banking (Credit Reference Bureau) Regulations, 2008 pursuant to Section 31(3) and (4), section 55(1)of the Banking Act Cap 488

[37] http://akcp.co.ke/legislation-on-cis/ accessed on 22-06-2018

[38] This is a case of the banks using the CRB and CIS mechanism to their own benefit, not giving the customer a chance to dispute or seek rectification in case of error. Sometimes time is of essence for example in most personal credit applications such as medical emergencies, school fees needs, short term financing among others require quick resolution, where a borrower is listed by error, the rectification takes a minimum of seven days as per the 2013 CRB Regulations or more. This background application of CIS initiatives beats the purpose since it cuts out collaboration between customer and bank.

[39] Paul Raby, The Law Relating to Banking Services, 2nd Edition, Longman Group UK Ltd,1992 p. 10

service providers operate. Articles 10, 130(2) and 232 of the Constitution, among others, underscore integrity, transparency, accountability, inclusion, equity and good governance. The banks are not excluded when it comes to how they apply laws and regulations relating to how they do business.

The Kenyan borrower, who is also the ultimate consumer of banking services, ought to enjoy the full benefits that stem from key policy and regulatory interventions in the banking regime. Putting the consumer interests at the forefront is necessary for sustainability of the financial system and the global economy, to ensure financial inclusion and equitable growth and improved governance of financial institutions. Some key considerations for consumer protection include access to information, disclosure practices and effort in increase of consumer awareness. These initiatives have been spearheaded as a joint effort by key stakeholders led by CBK in an effort to increase financial literacy. Some of these considerations have now been codified and the remaining challenge is implementation or application of these in a manner that benefits the borrowers, the focus of this study.

1.1 Statement of the problem

This study examines the challenges borrowers' face when accessing credit facilities from banks, the challenges range from high interest rates, indiscriminate interest rates to outright denial of much needed financial facilities. These challenges shouldn't exist when there exists a CIS mechanism in the banking sector. Part of the contribution to these challenges could be due to poor corporate governance practices by banks especially as regards application of the legal and regulatory framework.

Borrowers in Kenya continue to have trouble accessing bank loans despite the enactment and amendment of various banking laws and regulations in the recent past. Two main challenges that this study focuses relate to first, the emergence of complaints and suits against financial institutions for example in the case of Obadhia Gitonga Micheu v Co-operative Bank of (K) Ltd[40]

[40] [2018] eKLR See also Amy Kagendo Mate v Prime Bank Limited Credit Reference Bureau & another [2013] eKLR accessed at http://kenyalaw.org/caselaw/cases/view/90844/ on 22-06-2018, and Amson Njoka Mwenda & another v CFC Stanbic Bank Limited & another [2019] eKLR among others

where the court found that the defendant bank was negligent in listing the plaintiff without issuing him with a notice of intention to list him adversely as provided for under the CRB Regulations.. There is clearly a gap in the application of the CIS mechanism so that the borrowers are unaware of its existence and if they are, they are still not aware of its benefits and implications and banks are doing little to improve the situation.

The CRB regulations of 2013 were partly meant to help banks in centrally and easily accessing borrowers' credit information thereby making credit access and processing easier for the borrowers. In fact, the CRB Regulations 2013 envisioned financial institutions making lending decisions based on the credit history of the borrowers by reviewing individual credit history and pricing the borrowers depending on their credit history. However, these regulations seem to have benefitted banks and financial institutions more than the borrowers . Borrowers who are the primary targets of the CIS initiatives are not actually benefitting from the reduction in information asymmetry in the banking sector. There is contention as to whether there are any current developed mechanisms that give differentiated interest rates according to the credit score of an individual borrower, and more critically whether financial service providers are taking any effort to encourage their staff to recommend lower interest rates, flexible repayment periods or reduce reliance on asset for prospective borrowers.

Second, ordinary borrowers are now experiencing new difficulties in accessing bank loans even after the passing of the 2016 amendments to the Banking Act[41] that put a ceiling on interest rates chargeable by banks. These challenges mainly relate to the unwillingness by bank management to fully implement the benefits envisioned on the one hand, and the regulatory agencies' failure or laxity to oversee or enforce implementation of such regulations to the benefit of ordinary customers on the other. The Finance Act[42] has repealed the capping of interest rate. This change though significant in itself, it will have little impact on this study as the focus is on the application of the CIS mechanism, corporate governance by banks and what effect this has on the borrowers.

A major challenge that still abounds, especially after the capping of interest rates is that many ordinary borrowers are likely or have been denied loans due to extraneous reasons which banks

[41] Supra Note 32
[42] Supra Note 34

have had to come up with. Reportedly, banks have now explored new ways of making profits[43] and loans are not easily accessible and if accessible introduction of new tariffs has ensured that the Credit history of the borrowers matters little in the lending decisions. This challenge seems to have been anticipated even before the passing of the recent amendments.[44]

Banks have reportedly introduced additional fees for appraisals and negotiations which costs when annualized as annual percentage rate (APR) have the effect of pushing the total interest rate charged at higher than the capped rate, further banks started lending to the government as they moved away from lending to individual borrowers whom they perceived as risky hence watering down some of the gains anticipated.[45] Generally, the rate at which banks give loans has shrunk since the advent of the interest rate capping regime in 2016. The repeal of the interest rate capping[46] heralds another chance for banks to lend more due to the attractiveness of higher interest rates however, as stated earlier CBK may not allow unjustifiable interest spreads, this is because it may want to avoid attracting the censure of the legislature.

1.2 Research questions

The following four pertinent questions are investigated and as much as possible answered in this study:

1. What is the regulatory regime governing the financial sector and specifically the banking sector in Kenya and the CIS Mechanism?

2. Is the corporate governance practice regime in the banking sector adequate to offer key borrowers as key stakeholders intended benefits of the CIS mechanism?

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[43] These include phasing out physical branch network, mobile lending, over-emphasis on online banking platforms

[44] The president noted this challenge while assenting to the new law in 2016 in the following words:
"We will implement the new law, noting the difficulties that it would present, which include credit becoming unavailable to some consumers and the possible emergence of unregulated informal and exploitative lending mechanisms."

[45] Otiato Guguyu, *The Standard*, (2016), 28th November 2016, https://www.standardmedia.co.ke/business/article/2000225109/borrowers-starved-of-credit-as-economy-slows-down (accessed 3/7/2018).

[46] Supra Note 34

3. Can the CIS mechanism be utilized to not only improve the performance of the credit market but also benefit borrowers?

4. What are the possible suggested interventions necessary to achieve the benefits of the CIS mechanism?

1.3 Objectives of this study

1.3.1 General objective

To find out the whether the CIS Mechanism has brought any benefits to the borrowers in the banking sector and and if not, whether the lack of benefits thereof is linked to poor corporate governance practices by banks and what interventions if any may be needed in order for the borrowers to benefit from the CIS Mechanism.

1.3.2 Specific Objectives

a. To find out whether the CIS mechanism has benefited the borrowers who are the key stakeholders in the financial sector in Kenya.

b. To establish the whether “poor corporate governance” if any, has led to lack of benefits or impacted borrowers negatively.

c. To determine and suggest what steps should be taken, if any, to strengthen regulation, supervision or corporate governance in banks in such a way that the borrowers and the financial sector can benefit.

1.4 Hypothesis

This study proceeds on three assumptions:

First, that the key stakeholders in the financial sector, the borrowers have not not benefited from the current legal and regulatory regime especially the Credit Information Sharing (CIS) framework.

Second, that the challenges faced by borrowers in enjoying the intended benefits of the CIS mechanism is as a result of "poor corporate governance" in banks that focus inward as opposed to embracing the borrowers for a mutually beneficial relationship.

Third, that addressing the challenges of application of the CIS mechanism by banks shall greatly benefit the borrowers and the financial sector as a whole.

1.5 Theoretical Framework

1.5.1 Stakeholder theory of corporate governance

This study is informed by the stakeholder theory of corporate governance. The theory is traceable to Edward Freeman in his treatise entitled "Stakeholder Theory of the Modern Corporation."[47] Freeman defines stakeholder as "any group or individual who can affect, or is affected by, the achievement of a corporation's purpose." Stakeholders therefore include employees, customers and suppliers and even the environment within which a corporation operates. This theory is premised on the realization that for a company to grow, real attention ought to be paid on all the related ecosystems starting from stakeholder interests to the interests of the shareholders. Companies or organizations exist to cater for the economic interests of both shareholders and the stakeholders.

Consequently, this theory propounds that the directors of a company are not strictly responsible or answerable to the shareholders only, as provided under statutes or laws or business norms from eras gone by, but that they are generally accountable to all individuals who affect and are affected by the activities of the organization. According to Freeman, interests of stakeholders have legitimacy because stakeholders are capable of affecting the direction of a company. As such, it is imperative that the management of any organization pays necessary attention to stakeholder interests.

The main argument for stakeholder management under the Stakeholder Theory is that there are more than just shareholders who contribute to a corporation, and there are others, in addition to

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[47] Edwin Freeman, *Stakeholder Theory of the Modern Corporation,* at https://businessethics.qwriting.qc.cuny.edu/files/2012/01/Freeman.pdf (accessed 4/7/2018)

shareholders, who are affected by the actions of the corporation.[48] This view is also supported by the Organization for Economic Co-operation and Development (OECD).[49] In fact the OECD Principles of Corporate Governance, 2015 recognize the role of stakeholders in two ways, one, that a corporation must recognize that its success is as a result of teamwork from all stakeholders and two, where the rights of stakeholders rights are established by law, the companies must respect those rights.[50]

For purposes of this study, the key stakeholders of the financial services industry are borrowers. This theory is therefore apt and relevant to this study as it helps the write view the actions of corporations that is, financial institutions from the lens of stakeholders or borrowers. There are competing theories with the stakeholder theory such as the agency theory[51] which presupposes a contract between the shareholders and the owners to the exclusion of or with minor regard to other stakeholders. This point of view has been tempered with realizations that companies work within societies and not in a vacuum.[52] The upshot of this is the stakeholder theory but which currently faces boundary problem in the definition of stakeholder. This has led to such fashionable acts such as Corporate Social Responsibility.

Banks and financial institutions should not be managed with a view to only safeguarding the interests of managers, shareholders, directors or other beneficial owners of the institutions. Interests of borrowers need to be clear regards in the management of the financial institutions. This entails the holistic application of relevant laws and regulations and guidelines, whether they work to the benefit of the institutions or the borrowers. It also implies that top governing institutions in the banking and finance sector, including the regulator CBK and Parliament should consider the interests of all stakeholders in making policies and legislations and in pushing for their implementation. This would ensure success for both the financial institutions on one end and the borrowers on the other end.

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[48] Supra Note 28 p.7
[49] www.oecd.org
[50] OECD Principles of Corporate Governance 8 July 2915 available at www.oecd.org/corporate cf OECD Corporate Governance Fact Sheet, 2019
[51] Supra Note 28 p.58
[52] Ibid p.71

1.5.2 Information Asymmetry Theory

This study also relies on the information asymmetry theory. Information asymmetry describes the condition in which relevant information is not known to all parties involved in an undertaking.[53] This theory is closely linked with the moral hazard theory which "may occur if one party is insulated from risk and has more information about its actions and intentions than the party paying for the negative consequences of the risk."[54] Further the theory of asymmetry of information is also linked with the theory of adverse selection explaining "that in the market, the party that possesses more information on a specific item to be transacted (in this case the borrower) is in a position to negotiate optimal terms for the transaction than the other party (in this case, the lender)"[55] which postulates that the party that knows less i.e. the banks had to price the risk appropriately, in this case higher since they did not have enough information about the borrowers. In a study to review the impact of CRBs and loan recovery rate at the Higher Education Loans Board (HELB), it was recommended that customers should be educated about the role of CRBs and how it will help in addressing the problem of the "informative asymmetry between lenders and borrowers regarding their creditworthiness."[56] The writer proposes that this can also happen in reverse where banks taking advantage of research on particular class of borrowers can engage in aggressive marketing[57] including selling of credit to borrowers where no fair balance of contract or information exists as would be expected in an Elysian condition.[58] The banks may know that the loans might not be repaid hence end up pricing them so high to cover for default yet on the selling

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[53] Mercy Chemutai et al, "Contribution of Credit Reference Bureau in Managing non-Performing Loans among Commercial Banks in Uasin Gishu County, Kenya" *Research Journal of Finance and Accounting,* Vol.8, No.18, 2017 available at www.iiste.org p. 78

[54] Chantal, M., Namusonge, G. S., & Shukla, J. (2018*).* Influence of Information Asymmetry on Commercial Banks Lending Performance in Rwanda. *International Journal of Academic Research in Business and Social Sciences*, 8(3), P. 170

[55] Ibid

[56] Gichimu Ben*, "Credit Reference Bureaus, Loans Advancement and Recovery Performance by The Higher Education Loans Board of Kenya"* (2013), A Research Project Submitted in Partial fulfilment For the requirement of the award 0f the Degree of Masters in Business Administration in The School Of Business of University of Nairobi. http://erepository.uonbi.ac.ke/bitstream/handle/11295/60387/Loans_Credit%20reference%20bureaus%2C%20loans%20advancement%20and%20Recovery%20performance%20by%20the%20higher%20education%20loans%20Board%20of%20Kenya.pdf?sequence=3&isAllowed=y Accessed on 5 September 2018.

[57] Carnell, R.S , The Law of Banking and Financial Institutions, 4th Edition Wolters Kluwer,, New York, 2009

[58] Philpott, F, The Law of Consumer Credit and Hire, Oxford University Press, 2009 P.537

front they position these products as financial inclusivity efforts. This, in the end, makes the loans more costly and expensive to the borrowers leading to higher defaults.

In summary, information asymmetry happens where the borrower knows his repaying power more than the bank which is lending money; only the borrower knows whether he will repay the money judging by his financial arrangements which the bank may not know. The bank on the other hand, without this 'borrower's repayment ability knowledge' will tend to price the loans at interest rates not necessarily fair but the one it thinks will cover for this information gap. The banks may also take advantage of information such as held by CRBs to adversely select out customers instead of pricing them accordingly.

1.5.3 Other Relevant Theories

There are other theories that were considered but were not used in this study and to highlight just two; the first one is the agency theory or the principal-agent theory. This theory looks at corporate governance from the lens of the managers of a corporate as being the agents of the shareholders.[59] In this theory, the agent does whatever is in their powers in order to bring the highest possible return on investments of the principals or shareholders. This theory was not used since it is not always true that although the managers have a duty to the shareholders, their actions are always guided by the shareholders wish unfettered, their omission or commission could be due to ignorance or negligence and thus the study could have judged the managers harshly. The other theory that was considered but not used in this study is the consumer public interest theory whose proponents such as Baumol[60] insist that whenever there's a market failure states must come in since they are best suited to offer equal protection and treatment. One of the weaknesses of this theory as relates this study is that banks will always find a way to stay ahead or circumvent the regulation efforts by the government. This has already been seen in our country where banks introduced charges such as 'negotiation fees or appraisal fees' to make up for what they would lose out on when lending at the government set interest rates.

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[59] Supra Note 28 p. 60

[60] Baumol, William J. (1952), Welfare Economics and the Theory of the State, Cambridge Massachusetts, Harvard University Press. P.98

1.6 Literature Review

There have been various studies that have been undertaken in relation to CIS and its impact in the financial institutions.[61] These studies though detailed in their nature, have not had an in depth look into the impact the CIS mechanisms have had on the primary target of the very same CIS framework, who are the borrowers. The aspirations of the CIS mechanism is to help "good borrowers distinguish themselves from persistent defaulters" and as a result the good borrowers could negotiate for many benefits including better credit terms, flexible repayment periods and lower reliance on collateral such as land when borrowing.[62] The apparent bias in the investigation of CIS towards the financial institutions has been due to the fact that it is the financial institutions that spear head these CIS initiatives and naturally any analysis will be looked from their perspective. However there is a silent actor, the borrower who is the primary target of these initiatives.

Ocharo in his thesis[63] on the effect of credit information sharing on the non-performing loans among commercial banks in Kenya concluded that non-performing loans tend to reduce with increase in credit information sharing. CIS has therefore benefited banks and financial institutions. According to the author, Central Bank of Kenya and commercial banks can reduce the level of non-performing loans by increasing credit information sharing. This can be achieved by formulating rules and regulations to register more credit reference bureaus to enhance credit information sharing environment.[64] This study leaves a gap on the effect of CIS on borrowers who are significant players in the financial sector.

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[61] Rose Wairimu Gitahi "*The Effect of Credit Reference Bureaus on the Level of Non- Performing Loans in The Commercial Banks in Kenya,"* (2013), A research project presented in partial fulfilment of the award of Master of Business Administration, School of Business, University of Nairobi, available at http://chss.uonbi.ac.ke/sites/default/files/chss/Rose%20Wairimu%20Gitahi%20D61-72764-2012.pdf last accessed 11/9/2018.

[62] https://ciskenya.co.ke/ FAQs

[63] Ocharo Ongosi Frank *, "The effect of credit information sharing on the non performing loans among commercial banks in Kenya,* (2013), Research project submitted in partial fulfilment of the requirement for the award of the degree of Master of Science in Finance, University of Nairobi.

[64] Ibid.

In his study on factors affecting loan repayment among customers of commercial banks in Kenya,[65] Ochung recommends, *inter alia*, that banks should apply efficient and effective credit risk management that will ensure that loans are matched with ability to repay, and that they should ensure no or minimal insider lending. Commercial banks should also pool together and establish a credit information bureau to which reference can be made before a loan is disbursed.

Henry Kiplangat Koros looks at the effect of credit information sharing on the credit market performance of commercial banks in Kenya.[66] The study finds, *inter alia*, that credit market performance of commercial banks in Kenya has been positively affected following the establishment of credit information sharing system. There has therefore been an increase in credit market performance following the operationalization of CIS.

Koros concludes that credit information sharing improves the banks' knowledge of applicants' characteristics and permits a more accurate prediction of their repayment probabilities. Perhaps a positive impact on the borrower according to this study is that effect it can operate as a borrower discipline device on the borrower. CIS is supposed to help eliminate incentives by borrowers to take too many loans hence become "over-indebted" by drawing credit simultaneously from many banks without any of them realizing.[67]

Koros recommends that the government should extend credit information sharing beyond the commercial banks and also facilitate sharing of both positive and negative information on borrowers. This is the gist of the argument in this thesis, that since the introduction of the CIS, borrowers have not benefitted from the process since only their negative credit history is shared, while their positive credit history is not shared. The study by Koros majorly concentrates on the effect of CIS on commercial banks but pays little or no attention to its negative impact on borrowers. Additionally, the study mainly addresses the practical issues on CIS but does not address the legal and regulatory aspects. This is the gap that this thesis seeks to fill.

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[65] Kenneth Ogol Ochung, *"Factors affecting loan repayment among customers of commercial banks in Kenya: A case of Barclays Bank of Kenya, Nairobi County*," A research project report submitted in partial fulfilment for the requirements of Masters of Arts degree in project planning and management, University of Nairobi.

[66] Henry Kiplangat Koros *"Effect of credit information sharing on the credit market performance of commercial banks in Kenya,"* (2015) A research project submitted in partial fulfilment of the requirements for the award of the degree of Master of Business Administration (MBA), School of Business, University of Nairobi.

[67] Ibid, p 44.

A recommendation almost similar to that of Koros on the need to include other financial institutions in CIS system was made in another study by Omukoko.[68] The author recommended that the government needs to strengthen credit information regulations and include other credit providers like SACCOs, Micro Finance Institutions (MFIs,) Development Finance Institutions (DFIs). In addition, utility firms like water and electricity suppliers and providers of goods and services should also be strengthened to join the mechanism. The author also underscored the need to put in place specific initiatives to create awareness to consumers and increase financial literacy on the benefits of CIS.[69] However, like the earlier studies seen above, focus is majorly on the positive impact of CIS on banks, and not on borrowers.

Ocharo's study further sought to find out from the employees whether they actually thought the CIS had improved the lending process and made it more transparent and fast. Though the study found out that the percentage of Non-Performing loans declined over a five year period as compared to the total loans and advances, it did not interrogate the fact that the loan and advances over that period had more than tripled, hence significantly skewing the conclusion. In a second question as to whether employees thought the CIS had improved the lending process and made it easier for borrowers and staff to make credit decisions, majority of staff actually when you include the ones who replies 'am not aware' indicated that the CIS had not improved any process or bank customer relationship.[70]

It was found out that CIS helped reduce the Non-Performing Loans of the institution under study. However, this study only focused on the financial institution and did not look at the effects of CIS on the individual borrowers during that period whether they got corresponding benefits for example lower lending rates. In another study[71] it was found that financial institutions may access borrowers' credit information for monitoring risk-taking and financial behavior of the borrowers post taking credit facilities. This is commonly known as bureau scrub in the banking sector. Such

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[68] Omukoko Samuel "*The effect of credit information sharing on non-performing loans of commercial banks in Kenya,"* (2016), Research project is submitted in partial fulfilment of the requirements for the award of Master of Science in Finance, University of Nairobi.

[69] Ibid.

[70] Supra Note 63

[71] Oira, S. M. & Wamugo, L. (2018). Credit Information Sharing and Performance of Selected Commercial Banks in Kenya. *International Academic Journal of Economics and Finance,* Vol.3(2), pp. 21-43 http://www.iajournals.org/articles/iajef_v3_i2_21_43.pdf

use of the CIS mechanism, give the banks and early alert and thus enables them to take intervention measures to reduce possibility of default. However, is the customer afforded fair rates for not changing their behavior?

It common knowledge that the interest rate component of a loan determines the amount of loan a borrower may qualify for since the higher the interest rate, the more the loan installment amount. Banks need therefore need in the application of the CIS mechanism, ensure they price the borrowers s fairly as possible enabling them to take as much credit as they could to stem the temptation to seek further loans from other lenders. The study recommended that emphasis be put on information accuracy by banks and CRBs.

In another study[72] that sought to look at the effect of CIS in recovery of loan advances by Higher Education Loans Board, it was concluded that CIS helped in faster recovery of loans and improved processing of loans by applicants. However this study sought to answer these questions limiting itself to applicants to the Higher Loans Board, this is a special type of borrowers since they are students who are unlikely to be listed at the Credit Reference Bureaus, being either first time applicants for a credit facility or even if repeat applicants the initial loan advanced would not become due until at least after one year after conclusion of school or earlier if the student happens to find a formal job. This is a specialized group of borrowers who mostly do not have credit history of any kind. It can be argued here that the CIS would be applicable to them after the grace period usually one year after finishing of their studies and hence proper appraisals would be applicable to them then. The fact that again this study aligned itself with the financial lender, just like the first one, it did not consider studying the actual effect of CIS on a borrower who is either positively or negatively listed at the Credit Reference Bureau.

These studies have left a gap in the information knowledge on the impact of CIS on one of the key stakeholder in the financial sector and that is the borrower. The borrower has been left to fend for himself. This has now led to the many rising cases of borrowers taking financial institutions to court in regard to CIS. This has caught the attention of the Association of Kenya Credit Providers

[72] Supra Note 56

(ACPK)[73] that has had to commission a study on how this trend can be stemmed to avoid likely reversal of the gains made on the CIS initiative front. The study among other recommendations suggested an alternative dispute mechanism be put in place to handle the customer complaints. It is apparent that although there is some effort towards ADR[74] in the CIS mechanism, there still exist weaknesses that make this route for dispute resolution less appealing as was noted by the court in the case of Gervase Maina Ndonga v AAR Credit Services Limited & another where the court stated that the ADR mechanism within the CRB Regulations 2013 lacked completeness as it did not provide for remedies for the wronged party.[75] This must truly be addressed in order for the borrowers as key stakeholders in the financial sector to start enjoying the benefits.

CIS plays an important role in an economy.[76] Gaitho[77] posits that one of the key benefits of CIS that banks get is that "they are able to get credit information on prospective borrowers that will facilitate assessment of credit requests to mitigate risks of bad debts" while the borrowers, with good credit records, the records act as an motivation for lower interest pricing of the borrowers' loan facilities.[78]This study seeks to find out whether actually the borrower has benefitted from the CIS initiatives and seeks to link the lack of benefits to failure in corporate governance in banks. The researcher believes that if good corporate governance is practiced in banks as relating the CIS mechanism, individual credit scoring techniques would be an ubiquitous practice, the use of CRB information for adverse selection i.e. denial of credit would be a thing of the past and CBK would

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[73] An association set up in 2013 as a joint initiative of KBA and CBK under the CIS mechanism whose members include "registered companies or sole traders who undertake transactions with members of the public whether they be individual consumers, groups of individuals or commercial entities." One of its objectives is to see that Scorecard and scoring techniques are becoming prevalent. See generally https://ciskenya.co.ke/

[74] FSD Kenya, "Towards positive selection in the Kenyan credit market: An assessment of the current and prospective future effectiveness of credit information sharing" FSD Kenya (2016) at http://www.ciskenya.co.ke/sites/default/files/CIS%20Effectiveness.pdf (accessed 26/8/2018), p 13.

[75] [2018] eKLR available at http://kenyalaw.org/caselaw/cases/view/156214/

[76] Mituga Jared *Omari "Credit Reputation as Collateral: A Case for Improvement of the Legal Regime on Credit Referencing in Kenya,"* (2012), A Research Project Submitted in Partial Fulfillment of the Requirements for the Award of the Degree of Master of Laws(LL.M) of the University of Nairobi, available at http://erepository.uonbi.ac.ke/bitstream/handle/11295/9390/Mituga_Credit%20Reputation%20As%20Collateral%20A%20Case%20For%20Improvement%20Of%20The%20Legal%20Regime%20On%20Credit%20Referencing%20In%20Kenya.pdf?sequence=1&isAllowed=y (accessed 13/5/2019).

[77] Gaitho, Wanjiru *"Role of Credit Reference Bureaus on Credit Access in Kenya: A Survey of Commercial Banksin Kenya"* (2013) Vol. 9 No.13 European Scientific Journal ISSN: 1857 – 7881 (Print) e - ISSN 1857- 7431

[78] Ibid

have an easier time regulating the financial markets, that reliance on 'psychological collateral' e.g. salary or pay slip would cease.

The researcher believes that banks boards should be structured in such a way that directors appointed to lead consumer credit sections in the banks, fully sensitize their direct his staff and teams, to give full effect to the CIS initiatives. The researcher believes that if this happened, the national assembly would not have interfered with the financial sector for example as seen in the 2016 amendment to the Banking Act that introduced interest rate caps, further, CBK would only have to enforce the Prudential Guidelines[79] and not belabor to issue circulars that appears to coerce banks to undertake what they would otherwise do with good corporate governance.

Indeed the researcher believes that it could be very well that the financial service providers' inward-centric application of CIS could be a reason for the rise in litigation in this area and this research can help show the relationship and hence lead to a better application of the CIS mechanism to the mutual benefit of the industry participants and also help other researchers look at the CIS mechanism and push forward its application to new and emerging areas like mobile lending and online banking. While the effects of CIS on banks have been a subject of research, scanty systematically documented information exists on the effects of credit information sharing on borrowers.

The other limb of this study is on the challenges still faced by borrowers despite the capping of interest rates in 2016.[80] Research studies[81] and opinion articles on the impact of the amendments to the Banking Act to cap interest rates by banks have revealed that borrowers are likely to continue experiencing challenges in accessing bank loans. An opinion published by Anjarwalla & Khanna Advocates following the enactment of The Banking (Amendment) Act, 2016 projected that following the interest rate capping; banks would restrict lending to "good borrowers" and that this would make access to credit from banks even more difficult than before; thus leading to a possible

[79] Supra Note 14 P.70
[80] Supra Note 34
[81] Supra Note 20

"credit crunch."[82] Another research study by Amuhinda[83] found out that for banks to remain profitable they had to channel funds elsewhere, reduce staff through redundancies, closure of branches in addition to introducing some charges that would effectively net off the effect of the reduction in interest.[84]

Indeed, there has been a general decline in credit issuance by banks towards ordinary borrowers. Partly as result of the Kenya's dwindling economy and hard economic conditions of living reported, cases of debt-defaulters increased and banks have consequently lowered the rate at which they issues loans. For instance, according to a CBK data report, between January and February 2016, credit growth fell by KShs 800 million.[85] This can be partly attributed to the banks' use of the credit information sharing mechanism as a tool to simply say yes or no to a prospective borrower. Banks appear not to regard CRBs as repositories of information that can guide them to know the borrowers better but as a data base to check who is negatively or positively listed.[86]Also the blacklisting appears to be done mechanically without putting into regard the plight of borrowers. How does one explain blacklisting of customers with less than Kshs 100/- debt and this is even without following the Prudential Guidelines on credit classification?[87]

The connection between good corporate governance and banking sector consumers' benefit cannot be gainsaid. It becomes very difficult for a financial institution to pass on the benefits intended under the various legal and regulatory interventions when such an institution practices poor corporate governance. An organization where the manager inflates profits, under declares losses, withholds full disclosure of accurate organization performance position, will not willingly pass on

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[82] See Anjarwalla & Khanna Advocates "The Banking (Amendment) Act, 2015 and its impact on the financial sector in Kenya, (2016), available at https://www.africalegalnetwork.com/kenya/wp-content/uploads/sites/22/2016/09/Memorandum-on-Banking-Amendment-Act.pdf (accessed 13/6/2019).

[83] Amuhinda, Rebecca A, *Effects of Interest Rate Capping On Performance of Commercial Banks*, (2018) A Research Project Submitted in Partial Fulfillment of the Requirements for the Award of the Degree of Master of Business Administration of the University of Nairobi, available at http://erepository.uonbi.ac.ke/bitstream/handle/11295/105545/Amuhinda_Effects%20of%20Interest%20Rate%20Capping%20on%20Performance%20of%20Commercial%20Banks%20in%20Kenya.pdf?sequence=1&isAllowed=y

[84] Ibid

[85] https://www.centralbank.go.ke

[86] Guguyu Otiato, *The Standard* (Nairobi) 12th June 2018 https://www.standardmedia.co.ke/article/2001283856/credit-data-sharing-keeps-wayward-borrowers-in-line

[87] Ngigi George, *Business Daily* (Nairobi) 9th September 2016 https://www.businessdailyafrica.com/markets/Pain-of-Kenyans-blacklisted-for-amounts-as-small-as-Sh100/539552-3374802-10hqsr1z/index.html

benefits such as reduction of interest rates and lending on borrower history. This is because any slight reduction in interest will lead to more pressure on non-performing loans and possibly collapse of such institutions.

The Global Corruption Report of 2009[88] by Transparency International highlighted some of the challenges facing Kenya's financial sector that are still prevalent today. According to this report, poor corporate governance is a key contributor to the problems ailing the financial sector in Kenya.

It is observed in the report that poor corporate governance results in the banking sector rendering the creditors (banks), employee and the borrowers helpless. Various reports in the past have indicated that some bank directors have engaged or have been suspected of indulging in insider trading and have thus contributed to the collapse the respective institutions.[89] Whenever these happen, the impact is felt by all the relevant stakeholders including ordinary borrowers.

According to the TI report above, for good corporate governance to be realized, sector players should be seen to be responsible in the conduct of their business in at least three ways: First, demonstrating their integrity in providing value to customers. Second, adopting ethical employment practices and third, showing commitment to communities.[90] There is a general perception that banks serve the interests of the shareholders to the exclusion of the rest of the stakeholders. This view is held not only by the public but also the legislature as the court stated in the case of Boniface Oduor v Attorney General & another; Kenya Banker's Association & 2 others (Interested Parties).[91] The legislature has resisted the advice of CBK, World Bank and financial experts to insist on retaining the interest rate cap since its re-introduction in 2016, however, the interest rate capping was removed in 2019.[92]

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[88] Transparency International "Global Corruption Report of 2009," (2009) at http://www.tikenya.org/phocadownload/adili113.pdf (accessed 15/6/2019).

[89] For instance, the reports around the collapse of the Uchumi supermarkets in June 2006 that raised suspicions of insider trading by some directors, the collapse of imperial bank in 2015, collapse of Chase Bank in 2016, among others. .

[90] Ibid.

[91] [2019] eKLR http://kenyalaw.org/caselaw/cases/view/169536/ (accessed on 28-8-2019) see par. 1 and 130 of the judgment

[92] Supra note 34

Another report presenting the findings of a case study on the implementation of corporate governance disclosure requirements in Kenya was published by the United Nations in 2003.[93] The report reviews the repealed Company's Act and other relevant acts, as well as other sectoral laws on banking and corporate governance in Kenya. The report underscores the importance of disclosure as a means to the attaining of better corporate governance practice in Kenya and the need for further legal, regulatory and policy reform. Notably, Kenya has made tremendous strides in terms of improving the regulatory and policy framework on governance since then. Key to this study are the recommendations on how and what Kenya should do in order to attain or realize international standards on corporate governance, among others.

The Central Bank of Kenya through the Prudential Guidelines[94] on Guideline on Corporate Governance[95] has elucidated several corporate governance practices that licensed banks and other financial institutions have to follow in carrying out their business. The benefits to be derived from following the guideline are stated to be able to maintain a stable and efficient banking system.[96]

The Guideline on Corporate Governance has defined corporate governance as "the manner in which the business and affairs of an institution are governed by its board and senior management"[97] and these include structures by which company objectives and thereafter how those objectives are going to be met. The Guideline requires the board and management in pursuit of the company objectives to also ensure that the interests of company, its shareholders, and stakeholders are taken into consideration through following all applicable laws and regulations.

The Guideline contemplates that banks would take upon themselves principles of corporate governance apply them not only to the benefit of the shareholders but also to the benefit of the stakeholders and in this case the borrowers. This research utilizes the stakeholder theory of corporate governance to try and determine to what extent it has colored the decision of boards while applying the CIS mechanism.

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[93] United Nations Conference on Trade and Development "Case study on corporate governance disclosures in Kenya," (2003) available at http://unctad.org/en/Docs/c2isar19a3_en.pdf (accessed 15/6/2019).

[94] Supra Note 14

[95] Supra Note 14 p. 34 CBK/PG/02

[96] Supra Note 14 p.36 par 1.2

[97] Supra Note 95 par 1.4.1

A study by Owino[98] that sought to find out the influence of governance structure in credit information sharing as one of its objectives, found out that governance structure positively influenced credit information sharing. The study among other recommendations suggested that a strong body be established to monitor credit information sharing institutions with ability to investigate wrong-doings and publicize consumer rights with accountability to the public.[99] These studies show that on the field of CIS and financial institutions a lot of ground is yet to be covered to create a trust worthy mechanism that can drive the financial sector towards elimination of information asymmetry and increase benefits to the borrowers.

1.7 Significance of the study

The findings of this study will enhance existing body of knowledge and provide information for further research on the challenges borrowers face in relation to Kenya's financial legislative and governance framework among academics and researchers. It will provide a critical perspective on whether credit information sharing can also be utilized to not only improve the performance of the credit market but also benefit borrowers.

Through a review on the existing regulatory framework, this study will also guide Government and financial institution to draw up policies, make necessary amendments, enact legislation and put in place measures that improve the welfare of borrowers in the banking sector.

This study also shall help explain the relationship between the increasing litigation on matters relating to CIS, increasing complaints against banks by borrowers, and the legal regimes and interventions that may be resorted to by the regulators to help in conferring benefits envisaged under the CIS mechanism. This shall then lead to a better understanding and application of the statutes, rules and regulations touching on CIS to the mutual benefit of both the banks and their key stakeholders.

[98] Owino, Maurice Influencing Factors on Credit Information Sharing in Kenya, *Strategic Journal of Business and Change Management,* Vol. 2 (65), pp 559-570, Aug 26, 2015.

[99] ibid p. 568

1.8 Research Methodology

The researcher has worked in the financial industry for over ten years, specifically within the Retail Banking Segment. This segment targets the mass market and he has handled both secured and unsecured products in this segment and hence he is very familiar with the environment.

This research will employ qualitative method of research that is, the use of desk review/library studies (documentary review). The desk work will entail review of the banking legislation, relevant statutes, case law, government reports, journals, periodicals, books and other available literature materials on issues of financial institutions in Kenya. It shall entail wide reading and analysis of the relevant materials in the library and in the internet. This is important as this is a current growing area of concern and application of corporate governance is a stretch to ensure accountability, fairness on the part of banks when handling the borrowers who are key stakeholders in this sector. The information gathered is important in making a decision whether the study questions are answered in the affirmative or in the negative. Thus the research is anchored on literature review, library materials, legislation, case law and internet sources.

1.9 Limitation of the Study

The research is limited to the legal aspects of the problem and is not expandable to touch on the societal and other facets of the topic that might arise.

1.9.1 Chapter breakdown

Chapter One

This essentially entails the proposal which introduces the thesis, sets down the problem statement, objectives and hypothesis of the study, among others.

Chapter Two

Chapter Two reviews and analyses the regulatory framework for the financial institutions and banking sector in Kenya. It reviews the laws and regulations that guide financial institutions. The chapter traces how financial institutions are incorporated and subsequently regulated. The aim is to

find out if at the onset, there are any intended principles of good corporate governance in these laws and regulations. A special focus is given to those areas of the laws and regulations that touch on the interests of key stakeholders that is, the borrowers. The key pieces of legislation include the Companies Act[100], Capital Markets Act,[101] Banking Act[102], with emphasis on Prudential Guidelines,[103] CRB Regulations, among others.

Chapter Three

This chapter looks at the advent of CIS mechanism, the efforts of CBK to pass on the benefits thereof, the financial institutions application of the CIS mechanism, and the re-introduction of interest capping and the challenges that Kenyan borrowers still endure under the CIS mechanism.

Chapter Four

Chapter four looks at the inter-play between principles of corporate governance in the banking sector, CBK's effort to inculcate and enforce them, the banks' effort to run around these efforts and the resultant negative impact on borrowers. The chapter concludes with a look at emerging case law regarding CIS depicting poor corporate governance practices within the banking sector.

Chapter Five

Chapter Five is a summary of findings, conclusions and recommendations

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[100] No.17 of 2015 Laws of Kenya
[101] Cap 485A
[102] Supra Note 10
[103] Supra Note 14

CHAPTER TWO

REVIEW OF THE REGULATORY FRAMEWORK ON GOVERNANCE OF THE BANKING AND FINANCIAL SECTOR IN KENYA

2.1 Introduction

This chapter shall concern itself with the first research question that is the regulatory framework governing the banking sector in Kenya. The financial sector is wide and includes pension schemes, insurance subsector, micro-finance institutions among others. The regulatory regime for these subsectors is also varied. These sub-sectors also supply information to the Credit Reference Bureaus under the CIS mechanism. It would thus be easy to lump them together when a litigious matter arises. Since this study is concerned with the banking sector, the other subsectors may be mentioned in passing while touching on the CIS framework.

In making a case for regulation of the financial sector, the overriding principle is to formulate policies and regulations and to adopt best practices that define rules within which financial service providers may operate. A country with an enabling policy environment reduces costs and risks of doing business thus encouraging economic development. Most importantly, consumer interests are necessary for sustainability of the financial system and the global economy, to ensure financial inclusion and equitable growth and improve governance of financial institutions. Commercial banks play an important role in mobilizing financial resources for investment by extending credit to various businesses and investors.[104]

The financial and banking sector in Kenya is regulated by relatively elaborate laws and regulations. They include the Constitution,[105] the Banking Act,[106] Consumer Protection Act,[107]

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[104] Irene N. Murimi, "*The effectiveness of Credit Reference Bureau (CRB) on the provision of credit by Commercial Banks in Kenya,"* (2017), available at http://erepo.usiu.ac.ke/bitstream/handle/11732/3395/IRENE%20N.%20MURIMI%20MBA%202017.pdf?sequence=1&isAllowed=y (accessed 15/6/2019).

[105] Constitution of Kenya 2010

[106] Supra Note 10

[107] No. 46 of 2012

Public Finance Management Act,[108] Microfinance Act,[109] Sacco Societies Act,[110] Capital Markets Act,[111] Companies Act,[112] and various regulations and guidelines such as Credit Reference Bureau Regulations 2013 (CRB Regulations, 2013), Capital Markets Authority Guidelines on Corporate Governance Practices by Public Listed Companies in Kenya, 2002, Gazette Notice No. 3362; Capital Markets (Securities) (Public Offers, Listing and Disclosures) Regulations, 2002, Code of Corporate Governance for the Issuers of Securities to the Public, 2015, Gazette Notice No.1420 among others.

The Central Bank of Kenya regulates banks and micro finance institutions in Kenya. Further, the financial sector in Kenya comprises several sub-sectors that include insurance companies, securities markets, pension schemes and savings and credit cooperative societies (SACCOs) among others. These sub institutions are regulated by different statutory bodies which include the Capital Markets Authority (CMA), Sacco Societies Regulatory Authority (SASRA), Insurance Regulatory Authority (IRA), Retirement Benefits Authority (RBA), among others. This adds to the mix that is the financial offerings that the Kenyan financial services customer has to choose from.

The Constitution of Kenya 2010 has a dedicated chapter on Public Finance. Chapter twelve of the Constitution provides for the principles and framework for effective management of public finance by the national and county governments. The law also outlines the oversight responsibility of Parliament and county assemblies and the different responsibilities of other government organs in regards to public finance. These principles find their way in the wider financial sector.

Although it may be argued that the current regulatory framework is inadequate and displays evidence of conflict and duplication of legislations among other challenges as well as emerging trends in the sector,[113] it has also been acknowledged that the institutional model of regulation for the Kenyan financial services sector has continued to face a lot of challenges, including poor

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108 No. 18 of 2012
109 No 19 of 2006
110 No 14 of 2008
111 Cap 485A Laws of Kenya
112 No .17 of 2015
113 Nzomo Mutuku, Case for Consolidated Financial Sector Regulation in Kenya (Retirement Benefits Authority 2008) http://ssrn.com/abstract=1837354> (accessed 15/6/2019).

governance and insufficient regulation to adequately cater for the services offered by the sector. There is also the challenge related to the questions of independence of the regulatory bodies.[114] Add to these, the rapid changing landscape of financial services for example financial technology commonly known as fintechs has continued to pose challenges in the regulatory sector.[115] The move to regulate the fintechs is due to the advantage they may be taking of consumers[116] and the ever changing space and spectrum in which they operate.

This chapter reviews the regulatory framework governing banks with a focus on the CIS mechanism and how this guides the behavior is banks in making lending decisions when faced with credit applications.

2.2 Definition of relevant terms

The financial sector has some key parties; these include but not limited to banks, borrowers, regulators the legislature and the judiciary. Others are microfinance institutions, Credit Reference Bureaus among others. The proper description of the parties is critical. It is notes for example that a borrower is not defined both in the Banking Act and even in the Prudential Guidelines but is defined by an Act that is purely of a non-financial nature, also the term financial institution may refer to a bank or a microfinance or to an institution designated by CBK as such thus it is important to understand the terms used herein.

2.2.1 Borrower

As per the Consumer Protection Act a "borrower means a consumer who is or may become a party to a credit agreement and who receives or may receive credit or a loan of money from the other

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[114] Ibid. See also Angela Anyango *"Financial services regulation in Kenya: A critical analysis of the proposed unified financial services regulator*," available at http://erepository.uonbi.ac.ke/bitstream/handle/11295/97121/Anyango_Financial%20Services%20Regulation%20In%20Kenya%20A%20Critical%20Analysis%20Of%20The%20Proposed%20Unified%20Financial%20Services%20Regulator..pdf?sequence=1&isAllowed=y (accessed on 15/6/2019).

[115] Guguyu Otiato, *Business Daily* (Nairobi) 1st June 2016 article accessed on 7/7/2019 at https://www.businessdailyafrica.com/markets/CBK-sets-stage-for-tighter-mobile-lending-regulations/539552-3228022-ksfv88/index.html

[116] Mwiti Lee, *The Standard (Nairobi)* 3rd August 2018 https://www.standardmedia.co.ke/business/article/2001290469/central-bank-moves-to-rein-in-exploitative-mobile-lenders accessed on 7/7/2019

party, but does not include a guarantor".[117] The Central Bank of Kenya Prudential Guidelines[118] mention the term borrower but does not explicitly define it. It must be noted that not all bank customers are borrowers. Customers can run current accounts, savings accounts and fixed deposits among other services. The Banking Act does not define a borrower as well.

2.2.2 Financial Institutions

The Central Bank Act defines a financial institution as "a body corporate or other body of persons, carrying on, whether on their own behalf or as agent for another, financial business within the meaning of the Banking Act[119]whether in Kenya or elsewhere."[120] It is worth noting that the CBK can designate as a financial Institution a company that is not carrying out financial business for example a Micro Finance Company (MFI), in which case it becomes a specified Financial Institution.[121] The Banking Act[122] defines a financial institution as a "company, other than a bank, which carries on, or proposes to carry on, financial business and includes any other company which the Minister may, by notice in the Gazette, declare to be a financial institution for purposes of this Act."

2.2.3 Credit Information

Credit information means information about a consumer as to name, age, occupation, place of residence, previous places of residence, marital status, spouse's name and age, number of dependents, particulars of education or professional qualifications, places of employment, previous places of employment, estimated income, paying habits, outstanding debt obligations, cost of living obligations and assets.[123] The CRB Regulations 2013 define Credit Information as "means any positive or negative information bearing on an individual's or entity's credit worthiness, credit standing, and credit capacity, to the history or profile of an individual or entity with regard to credit, assets, and any financial obligations"[124]

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[117]Section 2 of the Consumer Protection Act No. 46 of 2012.

[118] Supra Note 67

[119] Supra Note 14

[120] Central Bank of Kenya, Act Cap 491 Revised. 2013.

[121] ibid

[122] Supra Note 10

[123] Section 2 of the Consumer Protection Act.

[124] Regulation 2 of the Credit Reference Bureau Regulations, 2013

It is worth noting that Regulation 2 defines specifically what Credit Information should entail, Regulation 18 opens up a Pandora's Box by allowing any type of information to be shared. It provides that "in the case of a natural person his name, date of birth, national identity card number, personal identification number, passport number, driving license number, past and current addresses and other contact details and related matters;[125] It is argued here that by leaving the information to be shared open to related matters, it is possible to include information that is not useful to a customer's financial dealing but useful to third parties who then use such information for other purposes other than credit dealing.

2.2.4 Credit Information System

Credit Information Sharing (CIS) is a framework where credit providers (such as banks, microfinance institutions, SACCOs, and other designated institutions exchange information on their customers' credit facilities, outstanding loans and advances through licensed Credit Reference Bureaus (CRBs).[126] Further the Credit Information Sharing Systems allow a Credit Bureau to collect, receive, collate, compile, and disseminate information of a customer of an institution. The sources of information are so wide they could include non-financial institutions and public bodies.[127] This information is processed, stored and may then be availed to subscribed institutions at a fee.

The obvious wide room to collect and store information has had its share of problems especially as regards what amount and what kind of data the Bureaus should share with third parties and whether the customer should be notified when such a request is made. This became apparent during election period where unsolicited campaign messages were sent to customers mobile phones. Currently with Financial technology companies (FinTechs) for example mobile money operators, it is not uncommon for a customer to receive enticing text messages asking him or her to

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[125] CRB 2013 Regulations Regulation 18 (4)(a)(i)

[126] CIS Kenya "What is Credit Information Sharing (CIS)," available at http://www.ciskenya.co.ke/cis (accessed 7/7/2019).

[127] CRB Regulations 2013, Regulation 23(1),(2) and (3)

take an easy mobile loan. The question remains where did these Fintechs get your mobile number, how do they know you need a loan? What data do they have, what is the source?

2.2.5 Credit Reference Bureau

A Credit Reference Bureau is mentioned in Section 36(A)(2) of the Central Bank Act but it is not defined. The Consumer Protection Act[128] does not have reference to the Credit Reference Bureau despite the fact that it came into place four years after the Credit Reference Bureaus were in existence in Kenya.[129] Under the CRB Regulations 2013, a Credit Reference Bureau means an institution licensed under the Regulations "to prepare or provide credit reports to credit information recipients based on data maintained by the Bureau and to carry out such other activities as are authorized under these Regulations"[130] Simply put, a credit reference bureau (CRB) is a company licensed by Central Bank of Kenya to collect, store and collate credit information on individuals and companies from different sources and provide the information in form of a credit report upon the request of a lender.[131]

2.2.6 Open Credit

Open credit means credit or a loan of money under a credit agreement, that:

(a) anticipates multiple advances to be made as requested by the borrower in accordance with the agreement; and

(b) does not define the total amount to be advanced to the borrower under the agreement, although it may impose a credit limit.[132]

2.2. 7 Non-Performing Loans (NPLs)

There is no single adopted definition of Non-Performing Loans. What is applicable in one country may not be applicable in another. A generally acceptable definition is by the International

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[128] Supra Note 107

[129] For example we had the Credit Reference Bureau Regulations of 2008 in place

[130] CRB Regulations 2013, Regulation 2.

[131] Murimi Irene, *The Effectiveness of Credit Reference Bureau (CRB) on the Provision of Credit by CommercialBanks in Kenya* (2017) A Research Project Report Submitted to the Chandaria School of Business in Partial Fulfillment of the Requirement for the Degree of Masters in Business Administration (MBA) http://erepo.usiu.ac.ke/bitstream/handle/11732/3395/IRENE%20N.%20MURIMI%20MBA%202017.pdf?sequence=1&isAllowed=y (accessed 7/7/2019).

[132] Section 2 of the Consumer Protection Act

Monetary Finance to the effect that "a loan is non-performing when payments of interest and/or principal are past due by 90 days or more, or interest payments equal to 90 days or more have been capitalized, refinanced, or delayed by agreement, or payments are less than 90 days overdue, but there are other good reasons —such as a debtor filing for bankruptcy—to doubt that payments will be made in full. After a loan is classified as non-performing, it (and/or any replacement loans(s)) should remain classified as such until written off or payments of interest and/or principal are received on this or subsequent loans that replace the original."[133]

The Central Bank of Kenya has adopted a similar definition of Non-Performing loans as found in its Prudential Guidelines.[134] The Prudential Guidelines provide that "non-performing loans and advances for purposes of Sections 20, 31 and 44A of the Banking Act means…loan accounts and other credit extensions having pre-established repayment programs, when any of the following conditions exist, principal or interest is due and unpaid for 90 days or more or interest payments for 90 days or more have been re-financed, or rolled-over into a new loan.[135]

2.2.8 Savings and Credit Co-operative Societies

Savings and Credit Co-operative Societies (SACCO) is a type of co-operative whose objective is to pool savings for the members and in turn provide them with credit facilities. Other objectives of SACCOs are to encourage thrift amongst the members and also to encourage them on the proper management of money and proper investments practices. The Cooperative Societies may be classified as financial institutions. Under the Prudential Guidelines[136], Cooperative Societies are eligible to act as banking agents.

2.2.9 Financial Technology Company (Fintech)

It has been difficult to define a financial technology company. Various suggestions have been given such as, that a financial technology company (fintech) is "as any new application of technology to existing financial products while others have called for a more restrictive approach

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[133] Statistics Department International Monetary Fund "The Treatment of Nonperforming Loans," Issue Paper Prepared for the July 2005 Meeting of the Advisory Expert Group on National Accounts, available at https://www.imf.org/external/pubs/ft/bop/2005/05-29.pdf (accessed 20/7/2019).

[134] Supra Note 14 p.125 *(CBK/PG/04)*

[135] Ibid Guideline 1.4.8 and 1.4.8.1

[136] Supra Note 14 P.347, Guideline on Agent Banking - CBK/PG/15

to defining 'FinTech', focusing on the more disruptive, transformative technologies."[137] Another definition of fintech has been offered thus; "FinTech is a combination of technology and innovative business models which change, disrupt or enhance financial services/products."[138] This is a rapidly growing financial sector and the Central Bank is grappling with its control and regulation.[139]

2.3 Central Bank of Kenya as the overall regulator of Kenya's financial sector

The Constitution establishes the key institutions and officers in the public finance sector. These include but are not limited to the Treasury, Central Bank of Kenya (CBK), offices of the Auditor General and Controller of Budget. Articles 10, 130(2) and 232 of the Constitution, among others underscore principles that must be adhered to by state agencies. These include integrity, transparency, accountability, inclusion, equity and good governance

CBK is created under Article 231 of the Constitution and section 3 of the Central Bank of Kenya Act.[140] The Banking Act[141] does not define Central Bank of Kenya as a bank although it has the word 'bank' in its name. This is because Central Banks world over play regulator role and thus are not strictly speaking 'banks' even though they may carry on some form of banking business.[142] Also, by dint of section 3(5),[143] Central Bank of Kenya is not subject to the provisions of the Companies Act.

The Central Bank of Kenya has several objectives first, is to formulate and implement monetary policy directed at achieving and maintaining stability in the general level of prices. Second, is to

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[137] Anton Didenko, Regulatory challenges underlying FinTech in Kenya and South Africa, 2017 at p. 4 https://gomedici.com/fintech-companies-kenya-2017/ accessed [24th July 2019]

[138] J Blythin and J Cooten, The Development of FinTech in Nairobi: Contributions to Financial Inclusion and Barriers to Growth, 2017 accessed at http://lup.lub.lu.se/student-papers/record/8917326/file/8917329.pdf on 24 August 2018

[139] On 29th May 2018 various media outlets ran a story on the CBK governor calling for regulation of fintechs. One such was Reuters; 'Kenya's central bank governor calls for regulation of fintech lenders https://af.reuters.com/article/kenyaNews/idAFL5N1T012R accessed on 24th July 2019.

[140] Cap 491 Laws of Kenya

[141] Supra Note 10 Section 3

[142] Finance, Banking, and Money, https://2012books.lardbucket.org/zips/finance-banking-and-money-v2.0.zip, accessed on 27th July 2019 The book states that "A central bank1 is a bank under some degree of government control…" ordinarily governments do not have direct control of private banks.

[143] Supra Note 140

foster the liquidity, solvency and proper functioning of a stable market-based financial system.[144] Third, is to formulate and implement foreign exchange policy. Fourth, is to license and supervise authorized dealers. Fifth, is to formulate and implement such policies as best promote the establishment, regulation and supervision of efficient and effective payment, clearing and settlement systems. Sixth, act as a banker and advisor to, and as a fiscal agent of the Government and seventh, issue currency notes and coins.[145]

The Board of Directors provides oversight of the Bank's functions by formulating policies, other than the formulation of monetary policy, and reviewing performance. The Board comprises eleven members consisting of the Chairman, the Governor, the Permanent Secretary to the National Treasury and eight non-executive directors appointed by the President.[146]

The Bank's Management team includes the Governor and two Deputy Governors, all of whom are recruited through a transparent and competitive process, approved by Parliament and then appointed by the President. The Governor is the Chief Executive Officer of the Bank and is therefore responsible for its overall management. The Governor is also the Bank's official spokesperson. The Governor and Deputy Governors serve for a four-year term and are eligible for a further appointment of one additional term.[147]

The principal object of CBK is to formulate and implement monetary policy. In doing this, CBK is required to submit to the minister for finance a monetary policy statement for the succeeding 12 months. It must submit the statement at intervals of not more than six months.

Upon receipt of every statement submitted, the minister is required to lay it before the appropriate committee of the National Assembly not later than the end of the subsequent session of parliament after the statement is so submitted.

Section 4C of the CBK Act requires that there be regular consultations on monetary policy between the minister and the bank. Where, in the opinion of the minister, the bank adopts a monetary policy inconsistent with the principal object of the bank, he may, after obtaining a

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[144] Ibid Section 4(1) and (2)
[145] Ibid Section 4A(i-f)
[146] Central Bank of Kenya, https://www.centralbank.go.ke/governance/ (accessed 27/7/2019).
[147] Ibid.

resolution of the cabinet, direct the bank in writing to adopt such monetary policy as the minister may specify.

In coming up with the monetary policy, CBK through its Monetary Policy Committee (MPC) conducts market perception surveys every two months to obtain feedback on the performance of the economy, perceptions by the private sector on access to credit from commercial banks and responses by the private sector to Monetary Policy Committee decisions.[148] Subsequently, the results of the survey are aggregated without any regard to institutional or individual identity. This gives leads on the appropriate economic and financial policy options to be explored by the MPC. As at June 2018, CBK had issued nineteen Biannual Reports of the MPC.[149] The regular consultations may lead to CBK issuing regulations, policy notes and guidelines on banking business in Kenya.

As a regulator, it is interesting to note that CBK does not draw direct power from its establishing Act as the Act positively establishes the functions of the bank in sections 4 and 4A. However, reading section 4(1) which gives one of the principle objects of CBK as formulation and implementation of the monetary policy, one cannot but conclude that some form of interaction with financial institutions is contemplated. In issuing regulations and licenses to carry out foreign exchange businesses it can also be argued that CBK is playing regulator role.

2.3.1 Regulatory framework for Commercial Banks

The CBK's direct regulation of the financial institutions does not stem from its own Act but the power stems from the Banking Act[150] sections 3 and 4. Section 4(1) provides that "Every institution intending to transact banking business, financial business or business of a mortgage finance company in Kenya shall, before commencing such business, apply in writing to the Central Bank for a license." Further, section 3(1)(a) provides that "no person shall in Kenya, transact any banking business or financial business or the financial business of a mortgage finance company

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[148] Central Bank of Kenya, https://www.centralbank.go.ke/reports/monetary-policy-reports/ (accessed 27/7/2019). This authority and function is derived from section 4D (6) of the Central Bank of Kenya (CBK) Act which states that there shall be a Committee of the Bank, to be known as the Monetary Policy Committee of the Central Bank of Kenya, which shall have the responsibility within the Bank for formulating monetary policy.
[149] Ibid.
[150] Supra Note 10

unless it is an institution or a duly approved agency conduction banking business on behalf of an institution which holds a valid license." The section also provides restrictions on the use of the word 'bank' that is, no institution can use the word bank or finance in its name except investment banks licensed under Capital Markets Authority Act.[151] This is the first form of regulation, by ensuring that all institutions that are carrying on formal financial business in Kenya are licensed.

The Central Bank of Kenya also regulates commercial banks through issuing various regulations and guidelines aimed at achieving certain financial and economic goals for example in trying to ensure customers get the best interest rates, CBK sought to reduce the information asymmetry in the financial sector by issuing regulations that ushered into the financial sector the sharing of borrowers credit information through the Credit Information Bureaus and mandating banks to share certain customer financial information.

CBK also regulates through issuance of rules and procedures.[152] Section 55 empowers the minister to make regulations generally for carrying out the provisions of the Act[153] and also make regulations for prescription of fines for institutions that fail to comply with the directions of the Central Bank of Kenya under the Act. This is an explicit exposition that the Central Bank of Kenya may issue directions to institutions carrying out financial and banking business in Kenya.

Some of the notable regulations and guidelines that have been issued by the Central Bank of Kenya relating to the CIS mechanism include the Credit Reference Bureau Regulations, 2013 and the Prudential Guidelines, 2013 as revised from time to time and more recently the Banking Charter 2019. There are other guidelines or directives for example the MPC regulations on interest rate and Central Bank Base Rate which dictate the maximum interest rate chargeable by banking institutions in Kenya among others.

2.3.2 Prudential Guidelines, 2013

The Prudential Guidelines, 2013[154] has twenty two guidelines that cover a wide range of areas concerning the banking sector. The four key guidelines to this study are, licensing of new financial

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[151] Cap 485A Laws of Kenya

[152] For example Kenya Electronic Payment and Settlement System (KEPSS) rules and procedures, 2005

[153] ibd

[154] Supra Note 14

institutions[155], corporate governance[156], publication of financial statements and other disclosures[157], Prompt Corrective Action[158] and Consumer Protection.[159] The subsequent chapters shall deal with these guidelines in detail with a view to establishing whether as part of the regulations, they are adequate to offer key stakeholders such as borrowers intended benefits under the CIS mechanism or they are bank centric. The emphasis shall be on the Guideline on Corporate Governance.[160]

The Central Bank of Kenya is also empowered to inspect and carry out audits on banks. CBK under the Kenya Deposit Insurance Act[161] is also charged with tasks that involve management of a bank while in management crisis, undergoing liquidity pressures, financial challenges that may lead to a bank being placed under protection, receivership or liquidation. This is done through a strategic partnership with Kenya Deposit Insurance Corporation (KDIC).[162]

2.3.3 Regulatory framework for Micro Finance and Deposit Taking and Non-Deposit Taking Banks

The Central Bank of Kenya also regulates the Micro Finance institutions in Kenya.[163] The operational regulatory framework is set in motion by the Micro Finance Act.[164] Section 4 of the Act prohibits any person or entity from carrying out any form of Micro Finance and Deposit Taking business, unless such an entity is registered as a company under the Companies Act or an agent of a licensed Micro Finance bank.[165] After registration of the company, the company is required to apply for a license from the Central Bank of Kenya.[166] This sets the stage for regulation. Upon the passage of the Micro Finance Act, the Central Bank issued the Microfinance

[155] Supra Note 14 CBK/PG/01 p.2
[156] Supra Note 14 CBK/PG/02 p.34
[157] Supra Note 14 CBK/PG/10 p.253
[158] Supra Note 14 CBK/PG/21 p.467
[159] Supra Note 14 CBK/PG/22 p.485
[160] Supra Note 156
[161] Act No 10 of 2012
[162] See Section 4 of Kenya Deposit Insurance Act 2012
[163] https://www.centralbank.go.ke/bank-supervision/ where CBK states that one of the institutions they regulate is the Micro Finance and Deposit Taking Microfinance Banks.
[164] No 19 of 2006 which came into effect in 2nd May 2008 and amended by Act No 41 of 2013 The Micro Finance (Amendment) Act 2013
[165] Ibid
[166] Ibid Section (5)(1)

(Deposit- Taking Microfinance Institutions) Regulations, 2008[167] to operationalize the Act. The fate of a failed Micro finance institution follows the same fate as that of commercial banks in liquidation or closure as the Act provides that CBK may appoint KDIC as sole and exclusive receiver of any institution.[168]

2.3.4 Regulation of Foreign Exchange Bureaus

The Central Bank of Kenya also regulates forex bureaus and money remittance providers.[169] It has issued guidelines to that effect. The guidelines are amended from time to time to reflect the operating conditions, the latest being 2011.[170] There are currently over 126 licensed forex bureaus. The Guidelines provide that any person seeking to carry out foreign exchange business must seek the consent of CBK to use the words denoting “Forex Bureau” or “Bureau de Change”. The regulation of peripheral service providers to the financial system by CBK is important in achieving its principle objectives.

2.3.5 Regulation of Credit Reference Bureaus

The Central Bank of Kenya regulates Credit Reference Bureaus.[171] The establishment, licensing and regulations started in 2008.[172] The current regulations are the Credit Reference Bureau, 2013 (CRB Regulations, 2013). The CRB Regulations 2013 provide for establishment, licensing and supervision of Credit Reference Bureaus, the Bureaus are registered companies licensed by Central Bank.[173] The core functions of Credit Reference Bureaus is to collect, store and collate credit information on individuals and companies from different sources and provide the

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[167] These Regulations set out the manner of institution, applying for a licence power of Central Bank of Kenya to inspect the licenced micro finance institutions.

[168] Section 43 of the Kenya Deposit Insurance Act, 2012, Act No. 10 of 2012

[169] Under CBK Act Sections 33(A) and 33(O)

[170] Forex Bureau Guidelines, 2011

[171] Irene N. Murimi, “*The effectiveness of Credit Reference Bureau (CRB) on the provision of credit by Commercial Banks in Kenya,*” (2017), available at http://erepo.usiu.ac.ke/bitstream/handle/11732/3395/IRENE%20N.%20MURIMI%20MBA%202017.pdf?sequence=1&isAllowed=y (accessed 28/7/2019).

[172] The Credit Reference Bureau 2008, which were repealed in 2013 and replaced with the CRB Regulations 2013

[173] Currently there are 3 licensed Credit Reference Bureaus.

information in form of a credit report upon the request of a lender. The lender then uses this customers' credit report to score a potential borrower.[174]

From the foregoing, the criticality of ensuring the Credit Reference Bureaus deal and handle customer data properly and that customers' information is not misused to distort financial system cannot be gainsaid especially in ensuring credit flow in the economy. Holding large customer credit information without regulation can easily lead to distortion of financial environment.

The Central Bank of Kenya in consultation with stakeholders such as the Kenya Bankers Association (KBA), the Ministry of Finance, among others had licensed three bureaus, namely Credit Info CRB Limited, CRB Africa Limited (trading as TransUninon Africa) and Metropol CRB Limited.[175]

It was thought that lack customer credit history had, in the past hampered access to credit facilities due to stringent conditions imposed by commercial banks in trying to protect themselves against risk of loss due to default. In order to make banks more confident through reduction of information asymmetry and in order to reward good borrowers, the Credit Information Sharing mechanism was launched in Kenya following the gazettement of the Banking (Credit Reference Bureau) Regulations, 2008. Further the 2008 Regulations were repealed and replaced by CRB Regulations 2013. The case of Barbra Georgina Khaemba v Cabinet Secretary, National Treasury & another [176] illustrates the importance attached to information. Although the petitioner lost the petition, the issue of data privacy, use, processing and dissemination had been brought to the fore.

According CIS Kenya, CIS is beneficial to borrowers, lenders and the economy at large in many ways. Through CIS, a good customer can distinguish himself/herself through their credit report from regular defaulters and as such, they can safeguard and protect their reputation. CIS enables

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[174] Supra Note 171

[175] Ibid,

[176] [2016] eKLR In this case the petitioner had sought to challenge the constitutionality of collection of customer information, dissemination of the same to licensed subscribers. The Petitioner further alleged that the regulations were discriminatory against those with no financial credit history. The High Court was emphatic that the CIS mechanism as espoused by the CRB Regulations 2013 did not violate the constitutional right to privacy nor create a discriminatory lending regime. Thus the banks were free to apply the CIS mechanism as part of their credit lending processes. This case is instructive on the power of information at the hands of an individual or institution and the importance that should be placed on the manner of handling that information. This is because information is power.

the consolidation of a customer's positive credit information in a credible database which both the bank or credit provider and the customer can access. With this ideal framework, a customer is expected to easily negotiate credit terms based on the weight of their positive repayment history. Essentially, it is expected that by CRB making credit reports available as evidence of good performance, there would eventually be realised the outcomes beneficial to customers or borrowers including a lower cost of credit, flexible repayment periods, and lower reliance on tangible collaterals such as land.

It can be seen from the foregoing that Credit Reference Bureaus play such an important role in the financial system and Central bank of Kenya justification in regulating the same is sound and ensures the financial system is safe and secure and usage of customer financial data is regulated.

2.3.6 Regulation of Representative Foreign Banks

Finally, the Central Bank also supervises the representatives of foreign banks.[177] Currently there are nine foreign banks representative offices in Kenya. The representative offices do not carry out banking services, however they can carry out research, marketing and liaison roles on behalf of their banks.[178]

2.4 Other Financial Sector Regulators

2.4.1 Kenya Bankers Association

Kenya Bankers Association (KBA) is the umbrella body which acts as a lobby group[179] of the financial institutions licensed under the Banking Act[180] and the Kenya Post Office Savings Bank Act Cap 493B. It was registered as an Industry Association on 16th July 1962 by the Registrar of Trade Unions and it currently has membership of 47 financial institutions.[181]

It is not strictly speaking a regulator. The main objective of KBA is to cater for the interests of the member banks in negotiating terms and conditions of service of its employees. KBA also develops

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[177] https://www.centralbank.go.ke/bank-supervision/ accessed on 23rd July 2019.
[178] ibid
[179] It describes its Vision as to be the "voice of banking"
[180] Supra Note 10
[181] See KBA website at http://www.kba.co.ke/about_us.php (accessed 26/7/2019).

banking principles and practices that are intended to contribute to the banking sector's development through collaboration and engagement with the government and sector regulator, Central Bank of Kenya (CBK). The most recent case of collaboration can be seen in effort to resolve customer complaints. Although this is addressed in the Prudential Guidelines, 2013,[182] there is now developed the Banking Sector Charter, 2019(The Charter).[183]One of the notable requirements of the Charter is the implementation of the risk based scoring mechanisms by financial institutions. KBA has worked hand in hand with the regulators and other organizations like CIS Kenya in supported the development of the CIS framework.

2.4.2 Capital Markets Authority

The Capital Markets Authority plays the general role of promoting, regulating and facilitating the development of an orderly, fair and efficient capital market in Kenya. The objectives of CMA as listed in section 11 of the Capital Markets Act include:

(a) the development of all aspects of the capital markets with particular emphasis on the removal of impediments to, and the creation of incentives for longer term investments in, productive enterprises;

(b) to facilitate the existence of a nationwide system of securities market and derivatives market and brokerage services so as to enable wider participation of the general public in the securities market and derivatives market;

(c) the creation, maintenance and regulation of a market in which securities can be issued and traded in an orderly, fair and efficient

(d) the protection of investor interests;

(e) the facilitation of a compensation fund to protect investors from financial loss arising from the failure of a licensed broker or dealer to meet his contractual obligations; and

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[182] Prudential Guidelines 2013 Part IX Consumer Protection at p.370

[183] Issued under Banking Act Sections 33(4) and Micro Finance Act Section 48(2A) (6)

(f) the development of a framework to facilitate the use of electronic commerce for the development of capital markets in Kenya.

2.4.3 SACCO Societies Regulatory Authority

The Sacco Societies Regulatory Authority (SASRA) is a statutory state corporation established under the Sacco Societies Act[184] which came into full operation upon the gazettement of the Sacco Societies (Deposit-taking Sacco Business) Regulations, 2010 (the Sacco DTSB Regulations 2010) on 18th June 2010.

The principal mandate of the Authority is to license Sacco Societies to undertake deposit-taking Sacco business in Kenya,[185] and to supervise and regulate such Sacco Societies in Kenya. Other mandates include holding, managing and applying the General Fund of the Authority in accordance with the provisions of this Act; to levy contributions in accordance with this Act; and to perform such other functions as are conferred on it by this Act or by any other written law.[186] Currently there are efforts to amend the Sacco Societies Act[187] which has already undergone the first reading as at 7th July 2018.[188] Under the Sacco Societies Act the SACCOs are also key stakeholders in the CIS framework as they are allowed to share and also access CRB data[189] for use in their financial lending decisions.

2.4.4 Competition Authority

The Competition Authority is established under section 7 of the Competition Act.[190] Its functions among others include to:[191]

(i) promote and enforce compliance with the Act;

(ii) receive and investigate complaints from legal or natural persons and consumer bodies;

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[184] Act No. 14 of 2008.

[185] Popularly known as Front Office Service Activity or FOSA

[186] See the Sacco Societies (Deposit-taking Sacco Business) Regulations, 2010.

[187] The Sacco Societies (Amendment) Bill 2018

[188] Mwiti Lee, *The Standard* (Nairobi) 7th July 2018 https://www.standardmedia.co.ke/business/article/2001287012/sacco-s-bill-goes-through-first-reading

[189] Finance Act No 38 of 2016

[190] Act No. 12 of 2010 commenced on 1st August, 2011

[191] Ibid Section 9

(iii) promote the creation of consumer bodies and the establishment of good and proper standards and rules to be followed by such bodies in protecting competition and consumer welfare;

(iv) recognize consumer bodies duly registered under the appropriate national laws as the proper bodies, in their areas of operation, to represent consumers before the Authority;

It is the argument of this study that the Competition Authority has a role to play in the financial sector to protect the borrowers though its wide mandate. For example when financial institutions decide to create a credit crunch[192] on critical stakeholders, there is need for the Authority to step in and investigate if the banks are engaging anti-competitive practices.

2.4.5 Kenya Consumers Protection Advisory Committee

The Consumer Protection Advisory Committee is established under section 89 of the Consumer Protection Act.[193] The committee comprises twelve persons including nine appointed by the Minister. The three other members entail the Attorney-General, the Permanent Secretary, and chairperson elected by members.

Through Gazette Notice dated 20th December, 2013, the Cabinet Secretary for East Affairs, Commerce and Tourism appointed a 9-member statutory Kenya Consumer Protection Advisory Committee.

The functions of the Committee include:[194] (a) advising the Cabinet Secretary and ensuring relevant action on all aspects relating to consumer protection; (b) formulation of policy relating to this Act and legislative proposals in the interest of consumers and the modification, consolidation or updating of legislation providing protection to consumers in the areas covered under, or related to this Act; (c) the co-ordination and networking of consumer activities and the development of linkages with consumer organizations and the competent authorities and agencies locally and outside Kenya for the protection of consumer interests; (d) promotion or participation in consumer education programmes, locally and elsewhere, and activities, the dissemination of consumer issues with a view to proposing corrective measures; (e) providing advice to consumers on their rights

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[192] Supra Note 45
[193] Supra Note107
[194] Ibid Section 90.

and responsibilities under appropriate laws, and making available to consumers general information affecting the interest of consumers; (f) creating or facilitating the establishment of conflict resolution mechanisms on consumer issues, investigation of any complaints received regarding consumer issues, and where appropriate, referring the complaint to the appropriate competent authority and ensuring that action has been taken by the competent authority to whom the complaint has been referred; (g) working in consultation with the Chief Justice, County governors and other relevant institutions on the establishment of dispute resolution mechanisms; (h) monitoring and keeping under review the trading and business practices relating to the supply of goods and services to consumers and to activities related or ancillary thereto; (i) undertaking or commissioning any study or research which may be necessary to promote consumer protection and thereby publish the State of National and County Consumer Protection Annual Report; (j) monitoring the working and enforcement of laws that directly or indirectly affect the consumer; (k) drawing up and reviewing consumer protection directives and minimum service standards for submission to the Cabinet Secretary. The Consumer Protection Advisory Committee is a key stakeholder in the CIS framework, under its mandate for example of finding better mechanisms for dispute resolution and working with the Judiciary, the area of ADR would have benefitted from their input. When the Courts find that the ADR mechanism under the CIS framework is inadequate,[195] it is a wakeup call that borrowers are not benefitting at all from this option and it is time to review the same for the better.

2.4.6 The Consumers Federation of Kenya (COFEK)

The mandate of COFEK is drawn from Article 46 of the Constitution of Kenya 2010, the Consumer Protection Act, 2012 and the Competition Act, Cap 504 among other statutes.

Its objects are to defend, promote, develop and pursue consumer rights as guided by Article 46 of the Constitution of Kenya 2010, the Consumer Protection Act, 2012 and the Competition Act, Cap 504 and make it possible for the consumers to get value for money.

[195] Supra Note 75

Under its constitution,[196] COFEK undertakes to:

a) serve as a repository of research, welfare, information, policy and partnerships reference centre on consumers' issues in Kenya

b) To promote the common interests of all members of the Federation and in particular to promote mechanisms that will continually and cost-effectively address consumer issues in all parts of Kenya.

c) To foster improved relations between members of the Federation and between individuals comprising the members of the Federation and to pool such resources and expertise as the members may from time to time agree for the benefit of the Federation, its objects and its members.

COFEK has a wide mandate and the researcher believes that this federation has a critical role to play under the CIS framework since borrowers as stakeholders in the banking industry are also invariably customers of the same banking services. For example the Federation has raised concern over levying of fees by Commission for University Education (CUE).[197] This is the same vigor that the Federation should apply when banks circumvent interest rate capping by introduction of novel fees and charges such as facility fees whose result is that when the total cost of credit is annualized, the interest rates are even higher than pre interest rate capping regime.

2.5 Legal developments in Kenya's financial and banking regulatory framework

There have been numerous legal developments in Kenya's banking sector. As mentioned earlier CBK through the National Treasury Cabinet Secretary, published The Banking Act, Credit Reference Bureau Regulations 2013[198] (CRB Regulations, 2013), which became effective on 17th January 2014. The CRB Regulations repealed the older CRB Regulations 2008 and allowed Micro Finance Institutions to list credit and personal history of borrowers just like the main-stream

[196] Consumers Federation of Kenya Constitution, Available at https://www.cofek.co.ke/CONSUMER%20FEDERATION%20OF%20KENYA%20CONSTITUTION%20_1_.pdf (accessed 27/7/2019).

[197] Cofek to National Treasury Secretary Mr Henry Rotich: Stop Commission for University Education Abuse of Regulatory Powers to Levy Fees available at http://www.cofek.co.ke/index.php/consumer-alert

[198] Section 31(3) and (4), section 55(1)of the Banking Act Cap 488 and sections 34(4),(5) and 48(2) of the Micro Finance Act No. 19/2006

banks. It also allowed for compulsory listing of all credit data of borrowers whether positive or negative. This was a monumental development that was meant to reduce information asymmetry in the financial sector, reduce the cost of transactions and further discourage the practice of moral hazard selection.

In 2016 amendments were done by the legislature to the Banking Act re-introducing interest capping. This amendment tied the banks' latitude on how much interest rate they would charge borrowers on credit facilities. This fixed the minimum rate of interest that banks also must pay on deposits they receive from their customers.[199] In the amendments, banks or financial institutions are now required to disclose all charges and terms relating to a loan to a borrower.[200]

There were many issues that were raised about the Banking Amendment Act 2016.[201] First, under the Act there is a challenge in determining interest rates on credit facilities. Some of the issues raised by KBA included; it was unclear whether the maximum interest rate chargeable for credit facilities should be set at 'no more than 4% of the base rate set by CBK' or at 'no more than 4% above the CBK base rate.'

Secondly, the term 'credit facility' is not defined by the Act. This makes it difficult to determine if the maximum interest rate applies only to term loans or also to other loans such as credit card loans and mobile loans.[202] Third, the Act does not clarify whether the maximum interest rate is an annual or monthly interest rate. Fourth, it is unclear whether the maximum interest rate chargeable also applies to loan default interest, which is also an interest rate.

[199] The Amendments set the maximum interest rate chargeable by a credit facility at below 4 per cent of the base rate set by the Central Bank of Kenya. They also guaranteed a minimum interest rate of at least 70 per cent of the base rate set by CBK. The latter amendment was repealed by the Finance Act 2018

[200] CBK Circular No 4 of 2016 while acknowledging these changes noted that a lot more needs to be done to improve the credit environment, this became operational in 2017.

[201] See KBA Report and action points of the meeting of the special legal committee meeting held on 26th August, 2016.

[202] In fact where the researcher works, the institution took credit facility to mean all credit facilities and thus its credit card rate is controlled while other lenders took a different view that a credit card is a revolving fund and thus not a credit facility, their interest rates range between 36 and 48% per annum. The vagueness of the terms became a subject of Boniface Oduor's case where the court agreed that indeed some provisions of the amendments were vague.

In June 2018, the Cabinet Secretary for Treasury proposed amendments to the Banking Act seeking to lift the capping so as to enable borrowers to access loans.[203] This decision was informed by the CBK reports on the impact of the cap on performance of banks and the general economy. According to the Cabinet Secretary, the move to remove the capping will boost banks' profitability in the coming months and support economic growth by reviving lending to the private sector. As at June 2018, Parliament was to act on this proposal by the Cabinet Secretary. It is likely however that the rates capping will be retained by parliament.[204] In fact after the court ruling that the interest rate capping was unconstitutional, it gave parliament 12 months to bring it in line with the constitution.[205] All indications are that parliament shall retain the interest rate capping.[206]

There is also in place a pending Bill (Financial Services Authority Bill 2016) seeking the merger and takeover of the functions of the regulatory agencies in the financial sector including the Insurance Regulatory Authority (IRA), Capital Markets Authority (CMA), Retirement Benefits Authority (RBA) and Sacco Societies Regulatory Authority (SASRA).[207] In Section 116 of the Bill, there is established an ombudsman with the powers to deal with complaints of consumers relating to financial products and service providers. This is a move that has been a subject of previous scholarly interrogation and it had been recommended as a positive move towards the development of Kenya's financial regulation.[208] It appears the plan is on hold to merge[209] but it is surely not out of reach.

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[203] See The Finance Bill, 2018 however the National Assembly was opposed to scrapping of the interest rate capping. The National Assembly held onto this position until 2019 when it took the presidential rejection of the Finance Bill 2019, for the National Assembly to accept to scrap the interest rate capping provisions from the Bill in order for the president to assent to the same..

[204] The National Assembly did maintain the interest rate capping until November 2019

[205] Supra note 91

[206] https://www.bloomberg.com/news/articles/2019-09-18/kenya-set-to-retain-rate-cap-law-opposed-by-central-bank-chief

[207] http://www.president.go.ke/2017/04/06/cabinet-approves-bill-to-merge-functions-of-financial-regulatory-bodies/ (accessed 28/7/2019).

[208] Supra Note 8

[209] The Financial Services Authority Bill (2016) it appears that the government is not keen on proceeding with this Bill, however there is the Financial Markets Bill, 2018 which seeks to apply uniform standards across "lenders" this term is instructive as it appears the authority will have power all sectors of the financial sector.

2.6 Conclusion

In this chapter the study sought to answer the question on the regulatory framework that govern or regulate the banking sector. In doing so, it has been found that the financial sector is wide and there are various statues that govern those sectors. As regards the banking sector, the primary legislation is the Central Bank Act, the Banking Act and for those banks that are listed the Capital Markets Act also applies. It can be safely concluded that the financial sector is well regulated and as more ways are being sought to regulate this sector to match with emerging challenges.

It would not have been possible to discuss banking and CIS mechanism without touching on these statutes. For example, in as much as banks are regulated through the Banking Act, they are first and foremost companies and thus they must be regulated under the Companies Act. The big banks are also listed at the Nairobi Stock Exchange thus they cannot escape the purview of the Capital Markets Act.[210]

The Banking Act[211] gives CBK a key role to play in regulating the banks and banking business in Kenya. CBK regulates through issuance of various regulations and guidelines. The importance of looking at the regulatory regime is that itbrings to the fore the basis, rationale and reason for inception of the CIS mechanism.[212] The borrowers generate a lot of financial information every time they use the banks product.[213]The dilemma of whether to look towards a single financial regulatory authority or not shows the dynamism in this sector and perhaps this may be inescapable in the future. The financial regulatory regime shall continue to evolve in response to new needs and challenges. The argument to be posed here is how much regulation is too much in a free and liberalized financial sector? This question shall continue to remain a challenge which CBK must be alive to especially in the recent wake of the National Assembly direct regulation through interest capping.[214] The borrowers or customers are also watching and are willing to approach

[210] Supra Note 101

[211] Supra Note 10

[212] The CIS mechanism encompass Banks, SACCOs, MFIs, Forex CRBs among others.

[213] This happens when customers interact with these institutions they leave a transaction history that could be of much benefit to the banks when appraising a prospective borrower.

[214] Supra Note 33, through the Finance Act 2019 the interest rate capping has been repealed. This is however a warning shot to the banking sector that legislature is watching and more needs to be done to avoid undue scrutiny from the legislature.

courts for appropriate remedies should new regulations be perceived to be injurious to them as illustrated the Barbra case.[215]

It can be seen from the foregoing that, the various laws, regulations, guidelines are aimed at ensuring a stable, predictable, fair and beneficial relationship of all key stakeholders in the financial sector especially in banking. Regulation can have a positive impact to the stakeholders as well as a negative impact. The tussle between CBK and the legislature as seen above[216] and hereinafter is bad for all the stakeholders. For the financial sector to operate optimally it should have a stable, certain and progressive regulatory regime whose sole aim is to reduce the information friction in the market between the key stakeholders.

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[215] Supra Note 176

[216] Supra Notes 92 and 92 and others

CHAPTER THREE

APPLICATION OF THE CREDIT INFORMATION SHARING FRAMEWORK BY THE KENYAN BANKS AND ITS EFFECT ON THE BORROWERS

3.1 Introduction

This chapter lends itself to the research question on whether the CIS mechanism can be utilized by the banks in a manner that not only increases profitability of the banks by improved lending decisions and reduction of NPLs but also to offer more affordable lending products to their borrowers due to better borrower information availability through the CRBs.[217] As seen in Chapter Two, under the Credit Information Sharing (CIS) framework, banks and financial institutions are required to share borrowers' credit information through licensed Credit Reference Bureaus.[218] The purpose is to build information capital that would help to solve information asymmetry problems in the financial sector. Information asymmetry leads increases in costs of a transaction between the parties and particularly in the financial markets, the lack of information about a prospective borrower will lead the lender to charge premium interest rate to ensure that the lender covers the unknown risks.[219] It is also a mechanism meant to develop templates for ratings either for individuals or projects where sustainability can be an indicator. Credit is the backbone of modern economies for contributing to enterprise growth which in turn contributes to growth of employment opportunities and the national economy.[220]

Access to finance is linked to social, economic and political empowerment. This chapter looks at the advent of CIS legal framework and its application by Kenyan banks and the shortfalls that appears in the application that led to the subsequent involvement of the national assembly direct regulation through the re-introduction of the interest regulation regime and the challenges that Kenyan borrowers still endure at the hands of financial institutions, if any. Consequently, the chapter seeks to, in a general sense, discuss the existing framework its efficacy in the financial

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[217] See generally chapter 1 Under the Agency theory the where the bank managers primary concern is to increase the shareholders' value, however under the Stakeholders theory, the bank managers cannot do this while disregarding the borrowers who are stakeholders as patrons of the banks products.

[218] CRB Regulations, 2013

[219] Supra Note 52

[220] Supra Note 61

sector as a means of providing relief to the borrowers whom this research argues, are a critical key stakeholder constituent in the financial sector.

3.2 Advent of the CIS Framework

The stakeholders in the CIS mechanism include borrowers, CRBs, Commercial Banks, SACCOs, Micro Finance Institutions, Industry associations and Regulators. There have been at least three phases in the development of Kenya's CIS framework and all these have been supported by the Financial Sector Deepening Kenya (FSD Kenya)[221] among others. These stakeholders have worked together to oversee the inception and implementation of the CIS mechanism at various stages. The formalisation and operationalisation of the CIS mechanism in Kenya culminated in 2010 following the release of the Banking (Credit Reference Bureau) Regulations of 2008. Commercial banks were mandated to share negative information with licensed CRBs under a framework of closed user group.[222]

During the second phase of the CIS project (2012-2015), the CIS reporting system was expanded so as to cover other financial institutions in addition to banks.[223] The microfinance sector was growing and thus there was need to "loop in" this group into the CIS framework hence leading to the amendment of the Banking Act[224] and Microfinance Act[225] The Banking Act was amended through the Finance Act[226] in 2012 to bring on board SACCOs and utility companies to the CIS framework. The Minister further promulgated the CRB Regulations 2013, on 17th January 2014 prompting CBK to issue a circular to all licensed banks and MFIs to henceforth start sharing both negative and positive credit information of borrowers among banks.[227] This amendment paved way for the adoption of full file reporting.[228]

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[221] This is a leading independent trust that was established in 2005 by the UK's Department for International Development to support development of inclusive financial markets in Kenya and is supervised by professional trustees, KPMG Kenya, with policy guidance from a programme investment committee. Current funders include the Bill and Melinda Gates Foundation and the Swedish International Development Agency. https://fsdkenya.org

[222] Supra Note 30

[223] Supra Note 68 and the Finance Act 2013

[224] Supra Note 10

[225] Supra Note 164

[226] Act No 57 of 2012

[227] CBK Circular No 1 of 2014 dated 18th January 2014

[228] That is, sharing of both negative and positive information. This is also referred to as whitelisting for positive information and blacklisting for negative information.

Credit bureaus were thus expected to assist in making loans accessible to more people, while enabling lenders and businesses reduce risk and fraud on the other hand.[229] Essentially, greater availability of information was aimed at reducing default rates and improving access to credit at the same time.[230]In fact by including utility companies in the CIS mechanism, financial institutions were meant to have better understanding of the borrowers' behaviors in meeting their financial obligations. It was the thinking that this would now lead to individualized scoring due to further reduction of information asymmetry between the banks and the customers.

Significant progress was actually made in second phase of the CIS project. The number of credit providers that could submit information to CRBs either on a voluntary basis or through official mandate was increased. In addition, there was a significant rise in the number of CRBs which could assist banks and deposit taking micro finance banks in sharing both negative and positive information for all their debtors.[231] At the end of this phase in 2013, the Credit Reference Bureau Regulations under the Banking Act and the Microfinance Acts were adopted.[232]

Apart from operationalizing the sharing of full-file information by banks and microfinance banks, the CRB Regulations 2013 also allowed non-bank credit providers to participate in the mechanism as voluntary data providers.[233] It should not be lost that the aim and goal of the CIS mechanism as noted by the then CBK governor was and still remains largely to eliminate information asymmetry and to enable borrowers either as individuals or in the small and microenterprise sector access credit using their good credit performance track record.[234]

The third phase of CIS framework entails the fortification of the gains made and making them work for the borrowers and the financial institutions. The inclusion of the non-financial institutions such as utility companies has not yet taken root. Further, the banks' use of the shared credit information as a tool to say simply say yes or no to a borrower clearly shows that more needs

[229] Supra Note 223
[230] Supra Note 53
[231] FSD Kenya, "Towards positive selection in the Kenyan credit market: an assessment of the current and prospective future effectiveness of credit information sharing," FSD Kenya (2016) at http://www.ciskenya.co.ke/sites/default/files/CIS%20Effectiveness.pdf (accessed 22/9/2019).
[232] See CRB Regulations 2013
[233] Ibid, Regulation 23
[234] https://www.centralbank.go.ke/images/docs/speeches/2009/CreditSharing.pdf

to be done in order to start pricing actual risk.[235] It is anticipated that in this phase the participation of the non-bank financial institutions should increase and that these institutions adopt the full-file reporting that would further help reduce information asymmetry, enable banks price risk appropriately as opposed to shutting out borrowers simply due to negative listing, that eventually we shall see an era of individual credit scoring as envisioned in the Banking Charter 2019 (The Charter).[236]

3.3 Structure of the CIS Mechanism

The Commercial banks followed by Micro Finance Banks (MFBs),[237] SACCOs and lastly MFIs comprise the main users of CRB products in addition to borrowers. The legal framework governing CIS as seen in the preceding chapters comprises Regulations emanating from the Banking Act and the Micro Finance Act. Proper coordination among institutions created under these laws is necessary for the operationalisation of CIS framework. These institutions include the CRBs and the supporting organisations such as CIS Kenya which functions as the central body that oversees the local CIS mechanism. CIS Kenya works with players in the financial sector including but not limited to CBK, KBA, Association for Micro Finance Institutions (AMFI), and SASRA among others to regulate credit providers on specific aspects such as information sharing and marketing.[238] There is now need for the association to work with more industry players to include such entities as Digital Lenders Association of Kenya (DLAK)[239] who are pushing and expanding the boundaries of financial services in Kenya. This is more apt given that mobile money borrowers are being listed with CRBS.[240] In one instance Kenya Commercial Bank (KCB) increased interest rate on its mobile lending arm from 4.08% per month to 7.5% per month. The lender in an engagement with a customer online indicated that the increase was for both good

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[235] Supra Note 77

[236] Issued under the Regulatory powers of CBK under sec 33(4) Banking Act and sec 48(2A) of the Microfinance Act available at www.centralbank.go.ke

[237] An example of a Micro Finance Bank is Caritas Micro Finance Bank that had a total loan book of about Kshs. 700M, as at financial year 2019 see www.caritas-mfb.co.ke

[238] Supra Note 12

[239] www.dlak.co.ke

[240] Kamau Macharia, *The Standard* (Nairobi) 21st July 2019 https://www.standardmedia.co.ke/business/article/2001334661/crisis-as-mobile-lenders-blacklist-2-5-million-borrowers

payers and defaulters alike.[241] This clearly demonstrates that individualized scoring is not yet practiced in the banking sector.

The Banking Act was further amended by the Finance Act 2016[242] to provide that SACCOs, utility companies and any other institution mandated to share credit information under any written law is allowed to share.[243]Under the current arrangements between the credit providers and CRBs, is that both positive and negative data is shared and or updated on a monthly basis.[244]The advent of mobile loans, digital lending among others has required more current data and there is a push towards more frequent sharing and refreshing rate of the customers' information. This need was met by CBK's circular[245] which amended the data submission template to include mobile lending, required daily data submission and also blacklisting of mobile lending to follow the Prudential Guidelines. These changes have been necessitated by the need to rein in on banks which had put a large pool of borrowers of less than Kshs.200/- loans as defaulters noted hereinabove.

3.4 Dispute resolution mechanism in the CIS system

At the onset, the CRB regulations, 2013 attempted to address the lack of a strong consumer dispute resolution mechanism in the CIS system by declaring the right of consumers to make use of an ADR mechanism to address disputes that were not resolved satisfactorily through bilateral procedures.[246] In a bid to address the disputes or complaints that arise from the CIS framework among credit providers, customers and CRBs, an institution known as Tatua Centre was established in 2015.[247] Tatua Centre is a subsidiary of CIS Kenya and is touted as the Credit Information sharing alternative dispute resolution center. The disputes could involve consumers and banks, borrowers and CRBS and even tripartite disputes involving banks, borrowers and CRBs. Mediation is the main form of dispute resolution used at Tatua Centre. It was anticipated

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[241] Kariuki James, *Daily Nation* (Nairobi) 5th August 2019 https://www.nation.co.ke/news/KCB-raises-interest-rates-on-mobile-loans/1056-5224198-k1evg0/index.html
[242] No 38 of 2016
[243] Ibid
[244] http://www.ciskenya.co.ke/cis accessed on 28th September 2019
[245] CBK Circular No. 5 of 2019 issued under CRB Regulations 2013, Regulation 18(5)
[246] Regulation 28 (2) (f) of the CRB Regulations 2013.
[247] https://www.loans.or.ke/all-about-tatua-center-to-resolve-your-crb-disputes/

that through this ADR system, timely resolution of disputes would be guaranteed, as opposed to the traditional court processes which take too long.[248]

Tatua Centre currently has two main offices and among these and is run by a Steering Committee. The committee comprised representatives from the AG's office, Consumer Federation of Kenya, Judiciary, Inter-religious Council of Kenya, FSD Kenya and CIS Kenya. A consumer who has a complaint lodges the complaint at the CRB in writing and within five days, the CRB is supposed to respond to the lender against whom the complaint is lodged with a report indicating that some information on the credit report is being disputed.[249]

The Credit provider or lender has fourteen days to review the dispute and give a reply or response. Where there are errors, the same is to be communicated to the customer promptly within the 14 days. If there is no response from the lender or credit provider within the 14 days, CRB is allowed to delete the listing. And in the event the CRB takes more than 21 days to complete investigations regarding a complaint, it is required to delete the disputed information as demanded by the customer.[250] When the investigations are over at a later date, the CRB can still reinstate or revise the information.[251]

In the event the lender gives a response which the customer/borrower does not agree with, he/she has the option of approaching Tatua Centre as a way to resolve the dispute.[252] After reviewing the complaint and process taken, and advising the client, CRB and credit provider on the steps they should take, Tatua Centre through its registrar organizes a mediation session. This session brings together all the parties to amicably resolve the dispute and if the parties fail to resolve the dispute through the mediation, only then is when a customer can go to court.[253] The costs of conducting an investigation by the CRB are borne by the borrower/customer in the event the disputed

[248] The writer, when he used Tatua Center to resolve a negative listing he had discovered when he tried to access a mobile loan, was shocked with the lack of respect the bank had towards the Tatua Center. The bank unashamedly asked the Centre to refer the matter back to the bank as opposed to resolving the issue at the Centre. The dispute remains outstanding to date since 2016. This is after the researcher properly filling the notification of dispute as provided for under the CRB Regulations 2013 The researcher feels that he would have gotten a mandatory order faster in court. This leaves a lot to be desired with the current CIS ADR arrangement.

[249] CRB Regulation 2013, regulation 35(5)

[250] Regulation 35(10)

[251] Regulation 35(11)

[252] Supra Note 247

[253] Ibid.

information turns out to be false.[254] However, as seen earlier the ADR mechanism is not well developed and its help to the borrowers is minimal and more needs to be done by way of either legislation or supervision supported by good corporate governance practices.[255]

Under the Prudential Guidelines[256]the customers have several rights including a right to be informed about data-sharing, a right to access data and a right to obtain prompt correction and/or deletion of inaccurate, or unlawfully collected or processed data.[257] This guideline obligates financial institutions to be active partners with the borrowers so that cases of prejudice to borrowers are minimized. The extent to which this happens is under test as it has been found that some consumers have been listed either erroneously as happened in the case of Alice Njeri Maina v Kenya Commercial Bank Ltd.[258] In this case the plaintiff had a similar name with another customer whose account was domiciled in the defendant's Nairobi branch whereas the plaintiff's account was domiciled at the defendant's Nakuru Branch. The Nairobi branch customer defaulted on her loan and due to similarity of names the defendant listed the plaintiff although her account was domiciled in Nakuru and she was not in default. When she alerted the defendant of the anomaly, the defendant did not respond to her nor delist her for a period of three months. In finding for the plaintiff the court stated that the defendant had acted recklessly and negligently. This case illustrates poor corporate governance, not resolving a customer's CRB query for three months can cause serious prejudice to the customers financial circumstances for example where loan approvals are pending in other lenders and are held back due to erroneous listing. It shows that the lender had not taken seriously the importance of the CIS mechanism in the economy. In yet another case of Amson Njoka Mwenda & another v CFC Stanbic Bank Limited & another,[259] the plaintiff cleared his loan on 28th December 2010, yet the defendant bank listed him as a defaulter on 4th February 2011 leading. The court in finding for the plaintiff for the wrongful listing of the plaintiff and awarded him KShs. 1,000,000.00 as damages. These cases illustrate the manner in which banks treat borrowers' information. Failure of internal processes that would ensure quality data is held and maintained in accordance with the CRB Regulations appears to be weak. In the

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[254] CRB Regulations 2013, Regulation 35 (14)
[255] Supra Note 68
[256] CBK/PG/22 par. 3.2.11 P.496
[257] Supra Note 199 par. 3.2.11 (iii) p. 496
[258] [2018] eKLR http://kenyalaw.org/caselaw/cases/view/156361
[259] [2019] eKLR available at http://kenyalaw.org/caselaw/cases/view/175138/

latter case the customer did not attempt the ADR mechanism provided under the CRB Regulations, this also points out to lack of sensitization of the borrowers on their recourse should they have complaints under the CIS mechanism. The Banking Charter 2019 has imposed an obligation on banks and lenders to educate borrowers on the products they are taking.

3.5 Challenges of the borrowers and the general stakeholders in the Banking sector

The challenges are two-pronged: First, those arising from the application of the CIS mechanism. Second, those arising from the interest rate capping. As seen earlier interest rate capping was a response to what was deemed irresponsible and reckless behavior by banks.[260] The interest rate capping law has been repealed through the Finance Act 2019. For this study, the problem of the interest rate capping was seen as a cause of "credit crunch" to borrowers as banks were lending to the government as opposed to the borrowers. The limb of the challenge that remains relevant is, will the banks apply the Banking Charter 2019 in its entirety? Will the interest rate the banks shall charge borrowers be farer when compared to pre 2016 period? This remains to be seen and shall form am interest subject for enquiry.

3.5.1 Challenges relating to CIS

These are operational, administrative and legal challenges that still face borrowers, lenders and CRB in the use of CIS mechanism. These challenges can be approached as follows:

3.5.2. Lack of clear guidelines on type data and manner of submission of data

There is lack of a unified regulatory framework over all types of credit providers. The breadth and depth of information is mainly affected by the lack of a uniform regulation that caters for both banks and non-bank credit providers. As such, the quality of analysis that a CRB can conduct is negatively affected. This shortcoming is being addressed by CBK and banks. It is expected that going forward, the data will be more representative and accurate due to the recent adoption of the Data Specification Template version 4.[261] This template according to CBK aims at "completeness, uniformity and comparability of shared data."[262]

[260] Supra Note 91
[261] Supra Note 245
[262] Ibid

Although the advent of CIS mechanism was a joint effort between CBK and the financial institutions, the subsequent development has not been robust only left to CBK. This partly due to the existence of strong lobbying from KBA has ensured that the banks' best interests are always guarded and taken care of with little regard to the borrowers. Thus CBK should now more than ever be at the forefront in guiding the banks constantly in looking at how best to make the CIS mechanism give intended benefit to the borrowers and the economy at large. CBK has enough arsenal to marshal banks and financial institutions to order.[263]

Although the CRB Regulations of 2008 provided that banks were to share negative information only[264] by not being elaborate enough a gap was left to be filled by the banks, who themselves are interested parties. The result was a haphazard application of the regulations where each bank developed its own templates and decided what threshold of loan balances were to be reported. This plagues the CIS mechanism to date as a recent report has shown that even customers with less than Kshs. 100 are being black listed.[265] These examples show a weakness in the CIS mechanism that denies borrowers opportunity to benefit from this CIS framework.

3.5.3 Use of negative only information against borrowers

Under Article 46 of the Constitution of Kenya, 2010 there is established the right of consumers to protection in provision of services and goods in the general market. Although the constitution came into place while the efforts at CIS had already started,[266] it is still an important reference to the entrenchment of the need to protect consumers of services and goods. It can be argued that the advent of CIS mechanism was for support and protection of both the lenders and the borrowers.[267]

A major challenge that affects the borrowers is the use of negative-only information credit reporting by some providers. This practice helps banks identify defaulters but it excludes a previous defaulter from accessing credit despite their financial situation at the moment that they need the credit having improved. The length your default information stays at the CRBs is also

[263] This CBK can do through the Banking Act circulars or guidelines and where necessary Regulations.
[264] The CRB Regulations, 2008 were repealed by the CRB Regulations, 2013
[265] Supra Note 87
[266] By the time the constitution was being promulgated the CRB Regulations 2008 were already in place.
[267] See generally Supra note 76

relatively long, that is periods of up to five years.[268] The five year period comes about because that is basically the data retention period in the market.[269] A borrower listed for such facilities as mobile money which have less than 30 days tenor will find himself waiting for 5 years for such a record to be erased to be unfair. However, banks appear not perturbed as they mechanically negatively list even those borrowers with less than Kshs 100/-. This surely needs to be addressed.[270]

In principle, CIS was expected to reduce the non-performing portfolio by awarding borrowing customers with a good repayment record with flexible repayment terms, lower interest rates among other advantages.[271] In the same breadth, CIS was meant to offer those with poor repayment profiles an opportunity to improve their credit score. However, credit providers are not passing the benefits of the CIS mechanism to good borrowers.

There has been rising frequency of credit-worthy applicants being denied or delayed access to credit due to CIS inefficiencies. Yet CRBs were partly meant to be used by borrowers to develop evidence of their good repayment history or reputation against reliance on collateral to access credit.[272]

The nature of information to be shared under the CRB Regulations included "Customer information which shall be exchanged pursuant to these Regulations is any customer information concerning a customer's non-performing loan. Non-performing loan is defined by the prudential Guidelines[273] and any other negative information and may include details specified in sub-regulation (4)."[274] Essentially, the nature of information to be shared is negative and always adverse to the borrower or customer. Thus, it is indicative that the nature of information that is subject to compulsory sharing is essentially negative. There is need to also encourage borrowers to share positive activities they think could help in improving their credit scores and this should be

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[268] .Supra Note 31 Regulation 33(1)(a)
[269] Ibid.
[270] Supra Note 245 where CBK seeks to standardise the information shared by financial institutions.
[271] CIS Kenya "Research consultancy on current and prospective effectiveness of credit information sharing in Kenya," http://www.daystar.ac.ke/downloads/research/TOR-CIS-Effectiveness.pdf (accessed 15/9/2019).
[272] Ibid
[273] Supra Note 14 CBK/PG/04 Guideline 1.4.8 P.128
[274] Regulation 18(1) of the CRB Regulations, 2013.

accepted in a defined template. Leaving reporting to the banks alone will grow the available information so slowly that individualized scoring will take ages to build.

3.5.4 Centralization of CRBs and the lack of capacity for CIS to develop the market

Consumers and especially borrowers have also complained about the centralization of CRBs databases in Nairobi. Bank customers from rural or upcountry areas are compelled to travel to Nairobi to access reports, lodge complaints or seek other services from CRBS. This is a time consuming and expensive.[275] On the other hand, it is quite challenging for CRBs to develop because the credit market in Kenya is still relatively small and it may be unsustainable to establish and maintain many branches of CRBs in those various grass root areas. In an effort to tackle this deficiency the CRBs have launched short messaging services (SMS) codes through which customers can query and receive their credit reports. An example is CRB Africa trading as Transunion which asks customers to send their ID number to short code 21272 to know their credit status.[276] CBK in partnership with all stakeholders should find a way that borrowers can easily access their credit reports. CRBs make money from selling the borrowers' information they hold, it would be important to account how they are using this data and offer less costly services to borrowers are already in need when they are seeking financial services.[277]

There many micro lenders and digital lenders who are serving a big population yet CBK lacks jurisdiction to regulate them.[278] CIS Kenya also lacks capacity and resources to enforce compliance, procedures and processes that cater for the lodging complaints before credit these providers. Although CBK has given indications it is working on some regulations, the immediate response of the digital lenders was to form an association ready to go head to head with CBK.[279] CBK needs to be careful not to lag behind and allow to be led, some of these mobile loans are lent

[275] https://www.centralbank.go.ke/bank-supervision/directory-of-licenced-credit-reference-bureaus/

[276] https://www.transunionafrica.com/kenya

[277] For example to obtain a CRB certificate of clearance would cost you anything between Kshs 1200/- and Kshs 2200/- (see for example https://www.transunionafrica.com/kenya) this is disproportionate to a loan of KShs. 5000/-

[278] Currently the laws regulating digital and mobile lending are vague if not non-existent leaving desperate borrowers to be exploited. See for example Oruko Ibrahim, *Business Daily*, (Nairobi) 28th May 2019 https://www.businessdailyafrica.com/economy/Senators-call-for-regulation-of-mobile-phone-loans/3946234-5135738-wtcl1yz/index.html;

[279] Supra Note 239

at an annualized interest rates of 120%.[280]This expressly defeats the very essence of CIS framework of making credit affordable to borrowers.

3.5.5 Lack of information for consumers

Many borrowers have nothing to do with borrowers until something goes wrong and they are forced to confront the CRBs. Many customers do not know that they are entitled to obtain one free copy of a credit report from each Bureau in each calendar year.[281] CRBs are also mandated to draw and make public a list of the rights of customers which rights must include the ones listed in the regulations.[282] But a challenge most customers (borrowers) face is that in most instances, one may not know that they are listed until they are turned down for credit, and at such a time nothing can be done even if it is a mistake on the part of CRBs.[283] It can easily be concluded that the CRB's report have now turned out to be used as selection criteria, to select out anyone with a negative history.

In an interview conducted under the auspices of FSD Kenya, it emerged that there are low levels of awareness of the entire CIS mechanism from the points of view of both consumers and credit providers.[284] Credit providers were observed and found to be largely uninformed and unaware of the full product offerings available to them from the CRBs. Consequently, as a result of limited knowledge and awareness, most credit providers have tended to misuse certain CRB data to the detriment of the consumer.

On the other hand, most consumers are said to appear to lack full knowledge of their consumer protection rights under the Constitution and the relevant statutes.[285] Some have consequently

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[280] Kamau Macharia, *The Standard* (Nairobi) 25th June 2019 https://www.standardmedia.co.ke/article/2001331308/mobile-loans-the-new-gold-rush-minting-billions-from-the-poor

[281] Regulation 28 of the CRB Regulations 2013. Even if this right is established, the TransUnion Africa, asked the the researcher to pay Kshs 50/- for mobile registration as a requisite to obtaining this report. In the view of the researcher, a borrower seeking a report pursuant to a right should not be asked to buy additional services unless the statutes say so. This can turn away potential borrowers from using the service.

[282] Ibid.

[283] Supra Note 258 as an example

[284] ISupra Note 271

[285] Under Article 46 of the Constitution and under the Consumer Protection Act, 2012, among others.

moved to resolve the disputed information about them through wrong channels. Many remain unaware of the benefits of having positive credit information.[286]

Remarkably, most credit providers typically only communicate with borrowers about the CIS mechanism when they have been issued with an adverse notice against them.[287] Even in the instances where sensitization has to be done by regulators and stakeholders, there has been little or no impact because the frequency of the campaigns has been low and expected results have thus not been achieved.

3.5.6 Lack of awareness on the existence of ADR system within CIS and the duplicate avenues for dispute resolution

Most consumers and stakeholders are not aware of the alternative dispute resolutions mechanism within the CIS mechanism. As such, the existing ADR system has not been utilized to its optimal potential by both consumers and other stakeholders. Most of the aggrieved customers within application of the CIS mechanism go to courts to litigate on even simple matters that ought to have been resolved through ADR but customers filed suits instead. In the cases of Daniel Gachanja Githanga -vs- Credit Reference Bureau Africa Ltd & 2 Others[288] and Amy Kagendo Mate -vs- Prime Bank Ltd -vs- Credit Reference Bureau & Another[289] in both instances the court found that the suits were premature as the borrowers had not exhausted the ADR mechanism provided for under the CRB regulations 2013. Such disputes should have been resolved through Tatua Centre but this did not happen. In most instances, credit providers fail to give feedback within the time allocated. There is no regulation at the moment that prevents customers from seeking legal recourse while there is a pending dispute at the Tatua Centre undergoing active ADR management. Further it has been noted by the courts that the ADR framework lacks completeness as it has no remedies for aggrieved borrowers.[290] There is therefore need for more civic education and sensitization on the CIS system generally. The general public especially borrowers continue to

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[286] Supra Note 68
[287] Ibid
[288] [2013] e KLR
[289] (2013) e KLR
[290] Supra note 75

perceive CRBs and the lenders negatively due the practice by these stakeholders of only availing to customers information when the report is adverse or against them.

Tatua Centre is still subject to subversion as it is not compulsory for parties in dispute to approach it and even if they do; either party can still go to court. Indeed, under Regulation 28 of the CRB Regulations 2013, there is a right of a customer "*to refer a dispute to an alternative dispute resolution mechanism or a court of law where he feels that his dispute has not been resolved to his satisfaction."* The regulations only grant rights to seek the ADR system but they do not make it compulsory, hence the frequent recourse to courts of law even where ADR could have been more efficient.

Some lending institutions, as well as CRBs are also yet to establish functional departments dedicated to resolving disputes through ADR as stipulated by the regulations. For this reason, many disgruntled consumers still go to court and hence suffer the consequences of incurring huge expenses and delays associated with the litigation process. The location of Tatua center in Nairobi also majorly inconveniences those who do not reside in Nairobi. This underlines the need to decentralize Tatua Center and ensure similar centers are established in all major towns.

3.5.7 General negative perception of CRBs

Given the history of the advent of CIS framework in Kenya in 2008[291] through the CRB Regulations 2008 (now repealed), where only negative information about borrowers was traded and used as a 'stone wall' against borrowers, the scary and general fear and bad perception still follow CRBs even in this age of full file reporting. Due the already formed negative attitude towards CIS, consumers have largely failed to demand better services from their lenders/banks as well as from CRBs. With no pressure to do better, there has been witnessed a general failure or lack of a desire for change in the credit market system by CIS Kenya and the relevant CRBs. There is need to encourage CRBs to out there and educate the borrowers to join in and be partners for the good of all the parties.

[291] See repealed CRB Regulations 2008

3.6 Other challenges facing borrowers in the banking sector

In 2016, Kenya passed amendments to the Banking Act introducing a cap on the rate of interest charged on loans. The Act fixed the minimum rate of interest that banks must pay on deposits they receive from their customers.[292] In the amendments, banks or financial institutions are now required to disclose all charges and terms relating to a loan to a borrower.

As observed in Chapter One of this study, the 2016 amendments to the Banking Act were meant to be a reprieve for the customers or borrowers specifically, just like the 2013 CRB regulations that allowed banks to share credit information on borrowers were partly intended to help the borrower to easily access bank loans.

Following the capping of interest rates, most banks mutated and changed tact on how to continue making huge profits at the detriment of ordinary borrowers. Borrowers started experiencing new challenges immediately. Most banks became unwilling to fully implement the benefits envisioned, that is, making loan more affordable for borrowers. The regulators, including CBK which is the main overseer failed or adopted a cavalier attitude towards enforcing implementation of the laws and regulations to the benefit of ordinary customers.

As it stands, many ordinary borrowers are likely or have been denied loans due to extraneous reasons which banks have had to come up with. Since 2016 to 2018, banks have cleverly explored new ways of making profits.[293] To borrowers, especially small borrowers, loans have become difficult to access and in the instances where they are accessible, the introduction of new tariffs has ensured that the Credit history of the borrowers matters little in the lending decisions.[294]

The rate of issuing loans by banks diminished since 2016. Banks have reportedly introduced additional fees for appraisals and negotiations and this has eroded some of the gains that had been anticipated. This is done purely to protect the banks profit margins while not bearing in mind that under the CIS mechanism the borrowers have given banks a lot of information which if used

[292] The Amendments set the maximum interest rate chargeable by a credit facility at below 4 per cent of the base rate set by the Central Bank of Kenya. They also guaranteed a minimum interest rate of at least 70 per cent of the base rate set and published by CBK. This latter requirement was repealed by Finance Act 2018

[293] These include phasing out physical branch network, mobile lending, over-emphasis on online banking platforms

[294] Cf Chapter One of this Study.

properly would enable banks lend profitably and sustainably. The introduction of high appraisal fees and other charges was a clever move to ensure that the annualized interest rate was actually higher than declared rate by requiring customer to pay upfront these charges and fees.[295] This behaviour by banks shows lack of willingness to take the long road of sustainable lending through the use of individualized scoring techniques. This has now forced CBK to come up with the Banking Charter 2019 wherein CBK has indicated that it will do serious supervisory work including "mystery shopper" calls to banks, physical visit to banks to witness the application of the individualized scoring techniques. And the bearer of the brunt and consequences of these legislative, administrative and governance hauls is the borrower.

3.7 Conclusion

Kenya has sought to make efforts to cushion or make the life of ordinary borrowers bearable through various legislative, administrative and governance interventions. One of the key interventions was the establishment of the CIS mechanism which was projected to reduce information asymmetry and thus reduce transaction cost leading to better credit decisions by banks and reduced interest rates leading to affordability of loans to borrowers. Thus the advent of the CIS was projected to be a game changer creating value for both the lenders and the borrowers.

Since the advent of the CIS mechanism in 2008 and its subsequent enhancements in 2013 challenges still abound. One of challenges stems from the history of the advent of the CIS mechanism itself being mandatory listing of the defaulters, this has scared borrowers so much to the point they have mistrust for the CIS mechanism. The failure by banks to positively use the credit reports as trusted depictions of a borrower's financial status and hence use that report to offer borrowers differentiated interest rates has eroded confidence in the CIS mechanism. It appears as if banks use the CRBs declining loan applications.

From the foregoing it can be concluded that the CIS mechanism is step in the right direction in the banking sector. What is now required is the consumer protection bodies to step up their efforts in sensitising borrowers of their rights under the CIS mechanism, the importance of the CRBs, need for centralized CRB centers as well as push for cost effective and ease to access to CIS services.

[295] Supra Note 83

Without the active follow up by all concerned stakeholders, the CIS mechanism benefits to the borrowers shall remain but an aspiration. Banks cannot be faulted for seeking the highest interest rates possible for that is what they are in the market to do for their shareholders what is required is a constant reminder that the same cannot be eclusive of the borrowers who have given so much information to the banks that they are now vulnerable as opposed to emboldened. This is a balance that shall be brought about by appropriate legislative, operational, administrative and corporate governance measures.

CHAPTER FOUR

CORPORATE GOVERNANCE CHALLENGES IN THE BANKING SECTOR IN KENYA AND THEIR IMPACT ON THE BORROWERS

4.1 Introduction

This chapter seeks to look at the question of corporate governance in banks specifically regarding the application of the CIS mechanism. The chapter shall also look at the pronouncements of the courts in regard to the CIS mechanism. From the courts pronouncements on the conduct of the banks may give a glimpse of the corporate practices as regards the CIS mechanism. The banking sector is well regulated starting with the Constitution of Kenya, several legislations and regulations thereof.[296] When banks efficiently mobilize and allocate funds, the cost of capital to firms is lowered, capital formation is boosted and economic activities are stimulated.[297] Further, banks play an important part in societal resource mobilization when they do their core activity, that is, deposit taking and lending.[298] Banks handle public funds through public deposit mobilization whereby these deposits are then lent to borrowers at a cost.[299] Banks lend money to borrowers with the hope that the money shall be repaid in full and on time. However it is not always the case that all borrowers shall repay their loans. In order to hedge against the risk of non-repayment banks charge an interest rate they believe will cover for the eventuality of non-repayment. This risk is spread to all borrowers of a certain class where banks decide that all borrowers seeking personal unsecured loans shall be charged a particular interest rate. This group model of interest rate pricing lumps bad and good borrowers on the same scale and this was primarily driven by lack of financial information on an individual level. The CIS mechanism was meant to eliminate this gap by ensuring a lender has access to credit history of a borrower and that this credit history shall assist the lender in subjectively risk rating and pricing of the borrower.

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[296] Supra Note 106,,107,108,109,110,111,112

[297] Osebe and Chepkemoi, Corporate Governance and Banking Sector in Kenya, *International Journal of Economics, Commerce and Management,* Vol. IV, Issue 9, September 2016

[298] Cranston Ross, Principles of Banking Law, Clarendon Press ; New York : Oxford University Press, 2002 p. 3

[299] Good Governance in Management of Public Funds, Mohamed Nyaoga CBK Chairman, https://www.centralbank.go.ke/uploads/speeches/1779832853_CHAIRMAN'S%20SPEAKING%20NOTES%20-%20ICPSK%20GOVERNANCE%20FORUM%202%20March%202016.pdf (accessed 22-8-2019)

In the past, the regulation of financial institutions centered on investor protection while consumer protection was a rarity.[300] Corporate governance concerns itself with the manner in which an organization is structured management-wise in order to achieve the highest possible level of performance and thus enabling the organization stay in the market for a long time while fulfilling both its shareholders and stakeholders legitimate expectations of value in returns on their investments. With the advent of the CIS mechanism, bank managers from a corporate governance perspective were expected to lead their banks in ensuring the benefits meant to accrue to borrowers are realized. It is the hypothetical position of this chapter that even with the CIS mechanism, the banks continued to operate in the old way thus depriving customers of the very benefits they were meant to enjoy. Among the benefits envisaged were lower interest rates and individualized credit assessment of borrowers. However, as shall be seen the banks were more concerned with locking out perceived bad borrowers as opposed to pricing them appropriately. The study thus hypothesizes that were the CIS mechanism to be implemented by banks in full, the National Assembly would have had no reason to intervene as it did in capping the interest rates as seen earlier.

The practices by banks such as failure to fully disclose the total cost of credit[301] and introduction of upfront fees and charges onto borrowers' loans are pointers at banks' management focus on the shareholders rather than stakeholders as well. In this chapter, this study looks at the practices by banks regarding the CIS mechanism in order to determine whether there are weaknesses in management that can be improved in order to give greater efficiency in the application of the CIS mechanism. In Kenya the era of consumer protection was ushered in by the Consumer Protection Act. The codification of consumer rights meant corporations had certain corresponding obligations.[302]The Prudential Guidelines mention the word borrower, but does not define the same, the Consumer Protection Act however does define who a borrower is[303] thus thrusting the borrower as one deserving of protection. This protection gives a borrower various rights under a

[300] Note 111 Sec 11

[301] CBK has asked banks to upload their lending rates on the total cost of credit website. It appears that banks only uploaded the interest rates for some loans and not others. Further they did not disclose additional charges to borrowers for example 'appraisal' or 'negotiation fees' also some banks lowered the interest rates for credit cards to 14% per annum while majority of them maintained them unchanged at an average of 39-48% www.totslcostofcredit.co.ke

[302] Supra Note 107 Part IV generally

[303] Supra Note 117

credit arrangement. It follows then that banks have corresponding obligations to the borrower. The extent to which banks act responsibly and with the borrower in mind is the subject of enquiry of this chapter; this is because actions of the banks reflect the corporate governance culture of the banks. This chapter focuses on a specific corporate governance aspect that is, the application of the CIS mechanism by the banking sector.

Chapter two looked at the regulatory framework of financial sector and Chapter three dealt with the advent of the CIS mechanism in the financial sector. The CIS mechanism was meant to bring benefits to the borrowers by lowering costs of credit through elimination or reduction to a large degree of borrower information asymmetry.[304] The Central Bank of Kenya through various Acts and Regulations together with circulars and practice notes has tried to regulate the financial sector towards benefitting the borrower.[305] The fruits of these efforts however remain low or are yet to be realized fully especially regarding the CIS mechanism.[306]This is partly because of banks' inward focus which tends towards protecting and increasing shareholder value so much so that any measures that are perceived to reduce that value are looked down upon or are to be avoided. The banks therefore tend to devise ways to work around the regulations or when enforcing the same, they do so half-heartedly without regard to the effects these actions or inactions have on the borrower. For example in the earlier days, "although taking of interest had been prohibited, all sorts of arrangements grew up to disguise interest payments and thus permit commercial relations to exist in ostensible compliance."[307]

4.2 Principles of Corporate Governance

Corporate governance is expected to improve efficiency in monitoring and supervision of bank management to ensure stability and robust financial performance.[308] Corporate Governance involves the manner in which the business and affairs of an institution are governed by its board and senior management and provides the structure through which the objectives of the company

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[304] Supra Note 234
[305] Supra Note 150, 153
[306] Supra Note 171
[307] Supra Note 58
[308] Douglas Kivoi, (2016) "Corporate Governance and Bank Performance: A Case of Kenya's Banking Sector," *Journal of Research in Humanities and Social Sciences*, Volume 1, No. 1, available at https://www.researchgate.net/publication/306391757_Corporate_Governance_and_Bank_Performance_A_Case_of_Kenya's_Banking_Sector (last accessed 21/8/2019).

are set, and the means of attaining those objectives and monitoring performance are determined.[309]

Any attempt to define corporate governance runs into immediate problems as the definition of corporate is not universally accepted, however generally it would mean 'checks and balances to ensure that decisions makers are accountable to stakeholders…it is the process of regulating and overseeing corporate conduct and balancing the interests of internal and other parties who can be affected by the corporations' conduct.[310] The writer has adopted a wider scope of the definition of corporate governance which goes further than just defining how the shareholders and the management of a company relate. The definition scope includes "all stakeholders involved with the company…such as shareholders, managers, and other employee, suppliers, customers, consumers, bankers, but also other stakeholders outside of the company…including local, national, and international societal interests".[311] This scope of definition is particularly important in the developing countries including Kenya "whose main goal is to promote economic growth to raise the standards of living of the people."[312] This broad definition of corporate governance has been adopted in the Code of Corporate Governance Practices for Issuers of Securities to the Public, 2015.[313] Whereas this research shall not go into the various complexities of corporate governance, it suffices to note that, the recent failures of companies in other jurisdictions has not been primarily due to Boards' malfeasance but due to other factors such as having independent directors who do not know enough about the business, boards which also carried the executive role exclusively among others.[314]

It has been argued that the reason for regulation of banks is four fold; one, systemic risk, two; prevention of fraud, money laundering and terrorism, three; consumer protection and deposit

[309] Peter Rawlings Osebe & Penvilia Chepkemoi, (2016) "Corporate governance and banking sector in Kenya," *International Journal of Economics, Commerce and Management*, Vol. IV, Issue 9, available at http://ijecm.co.uk/wp-content/uploads/2016/09/4933.pdf (last accessed 22/8/2019).

[310] Gakeri, Jacob "Enhancing Kenya's Securities Markets through Corporate Governance: Challenges and Opportunities" (2013) Vol 3 No. 6 Special Issue, *International Journal of Humanities and Social Science (March 2013) p 95*

[311] Supra Note 39 p.30

[312] See www.president.go.ke The Big Four Agenda which seeks to transform Kenya development landscape

[313] Gazette Notice No.1420 issued under Section 11(3)(v) of the Capital Markets Act, Cap 485A on 4th March 2016 and became operational in March 2017

[314] Supra note 28 p 23-25

insurance, and four; competition (antitrust) policy.[315] This Chapter is concerned with the actions of banks when viewed against the CIS mechanism, are the banks' actions geared towards giving greater effect of the CIS mechanism?

In Kenya, the practice of institutionalized corporate governance was ushered in 2002 through the 'Guidelines on Principles for Corporate Governance in Kenya, 2002,[316] these guidelines have been replaced by the 2015 Code.[317] These guidelines have moved from the "comply or explain" principle to "apply or explain". The "comply or explain" is more straight jacket and rule based with some form of consequences for failure to comply.[318] The "apply or explain" approach means that "the regulations may not be applicable to all the listed companies and where this happens, the companies are given time to explain where non-compliance may be accepted.[319] However, there are some minimum requirements which publicly listed companies must apply. One of the provisions in the amendment is that "The Board of an issuer shall protect, enhance and invest in the well-being of the economy, society and the environment."[320] Twelve largest banks in Kenya are publicly listed.[321] This makes the provisions of the 2015 Code very important to the financial sector thus there is every need to pay heed to its guidelines as part of good corporate governance in the financial sector as a whole.

The Code defines 'internal control' as; "means the process effected by a company's board of directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of effectiveness and efficiency of operations, reliability of financial reporting, and compliance with applicable laws and regulations"[322] This is an important provision for a borrower since Banks need to have adequate internal controls to ensure they are in compliance of

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[315] Supra note 309
[316] Gazette Notice No 3362 of 2002
[317] Vide Gazette Notice No 1420 of 2016 and came into force on 4th March 2016
[318] The "apply or explain" is principle based and allows a board to satisfactorily explain a non-compliance aspect. The 2015 Code however retains mandatory provisions that are set as minimum requirements. See generally Tricker Note 28
[319] See notes on https://www.cma.or.ke/index.php?option=com_content&view=article&id=178:new-corporate-governance-code-for-listed-companies-and-guidelines-on-prevention-of-money-laundering-and-terrorism-financing-in-capital-markets-gazetted&catid=12&Itemid=207 (accessed 26-8-2019)
[320] Chapter 5 of the 2015 Code Recommendation 5.3.3. This is an important provision as society includes stakeholders such as borrowers in case of a financial institution.
[321] https://www.nse.co.ke/listed-companies/list.html (Accessed on 26-8-2019)
[322] 2015 Code Chapter 1 part 1.1.2

applicable laws and regulations. In the Banking sector some of the important regulations relating to the borrowers in this research paper are the Prudential Guidelines[323] and the CRB Regulations.[324] The Prudential Guidelines put the governance mechanisms in place and the CRB Regulations put those mechanisms to the test.

4.2.1 The Prudential Guidelines as the Corporate Governance mechanism for Banks in Kenya.

From the foregoing, we have seen that publicly listed companies have to adhere to the principles of corporate governance through the 2015 Code[325]and that at least twelve banks are publicly listed and thus bound by this Code. The Code began as a private sector initiative in 1999 and thus the Code is highly persuasive even on non-publicly listed companies and thus the rest of the banks. It might be thought that non-listed banks would escape the application of the principles of good corporate governance, this is not so as the Prudential Guidelines brings the application of the principles of good corporate governance to all licensed banks in Kenya.[326]

The purpose of the Guidelines is to provide the minimum standards required from shareholders, directors, chief executive officers and management of an institution so as to promote proper standards of conduct and sound banking practices, as well as ensure that they exercise their duties and responsibilities with clarity, assurance and effectiveness.[327]

The first application of these principles is through the requirement of full disclosures on the proposed directors, significant shareholders and proposed senior officials.[328] The importance of this cannot be gainsaid, since it is fruitless to start a rogue institution and then try to apply principles of good corporate governance later.

The second way the Central Bank of Kenya enforces principles of good corporate governance is through the specific provisions of 'Guideline on Corporate Governance (the Guideline).'[329] The

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[323] Supra note 14
[324] Supra Note 31
[325] Supra Note 317
[326] Supra Note 95
[327] Supra Note 95 PART II 2.1 referring to the purpose of the guidelines P.38
[328] See CBK/PG/01 Part I generally which has forms that must be submitted for vetting to CBK for the bank and 'significant' officials
[329] Supra Note 95 P. 34 CBK/PG/02

Guideline applies to all licensed institutions under the Banking Act. The Guideline adopts wide definition of corporate governance to include recognized stakeholders. The Guideline contains fourteen principles of corporate governance. Although all the principles are inter-linked and important, this research shall highlight the most relevant principles to the research, the others will be mentioned in passing.

The first principle is ethical leadership and integrity.[330] The board should provide effective leadership based on an ethical foundation…effective, responsible leadership characterized by the ethical values of responsibility, accountability, fairness and transparency. The second principle is on responsibilities of shareholders.[331] The third principle deals with overall responsibilities of the Board. The board has overall responsibility for the bank…including…implementation of the bank‘s…corporate governance and corporate values. The board is also responsible for providing oversight of senior management.[332] The oversight of senior management who include heads of departments is an important role for the Board as the day to day risks of the institution stem from the directions and actions of the senior managers.

The fourth principle is on the role and competence of Board members.[333] This is a very crucial requirement to the protection of the consumers of financial services.[334] Where the Board is incompetent and thus unable to properly supervise management, there is a high risk of malfeasance in order to achieve company objectives, mostly profits. Although it cannot be said that the Boards of all banks are incompetent, the emergent suits against banks by borrowers gives a pointer to a greater need for Board competence and a hands-on approach.[335]

The fifth principle is on Board's Governance practices. This principle deals with the manner in which the Board should conduct itself and requires clear roles for the directors and sets minimum attendance threshold. The sixth principle is on Corporate Governance in a group structure. Here the Board of the parent company is given the responsibility of the companies within the group. The

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330 Supra Note 14 p 39
331 Ibid p 40
332 Ibid, p 41.
333 Ibid p 44.
334 See Note 28 p. 17-20 An incompetent Board or a board that is focused on profits without regard to the stakeholders is a recipe for disaster leads to increased costs through legal suits by stakeholders which should have been avoided.
335 Supra Note 40 exemplifies emerging suits against banks on account of Credit Reference Bureaus.

seventh principle is on Senior Management. The senior management should ensure that the bank's activities are carried out as per policies approved by the board. The eighth principle is on risk management framework.[336]

The ninth principle is on compliance with applicable Laws, Rules, Codes and Standards both externally and the institution's own rules, codes and standards.[337] One of the key requirements of this principle is that the Board should ensure there is a compliance risk monitoring within the organization and also the directors should familiarize themselves with these laws, rules and regulations. This is one of the main challenges facing banks when it comes to implementation. The detailed nature of the CRB Regulations have found banks on the wrong side of the law as shown by cases such as and public perception as was.[338]

The tenth principle is about the internal control functions. The board and senior management are required to appreciate the work conducted by internal audit functions, external auditors and internal control functions.[339] This means that the audit functions whether internal or external should be given due regard and their findings used to improve service delivery. The recent cases against the banks put to doubt the efficacy of internal audit within banks. In the case of Stanley Njogu Karari t/a Monaco Engineering Limited v Standard Chartered Bank Kenya Limited,[340] the respondent bank charged interest rates in excess of 9% per annum above what was agreed. This anomaly was not discovered until the customer raised a complaint. In yet another case, the bank listed with CRB a wrong customer and similarly this anomaly was not discovered until the customer complained after she was denied a loan in another financial institution. The banks' internal management also came into sharp focus in the case of Mwatech Enterprises Ltd v Equatorial Commercial Bank Ltd[341] where even after recording a consent in court to remove the default history of the plaintiff from CRB, the defendant bank did not do so leading to the failure of the plaintiff from getting a loan from another financial institution which loan, was to be used to

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[336] Supra Note 330 p. 58
[337] Ibid, p. 61.
[338] Supra Note 258 and 259 where instead of bring positive change in the economy, the banks applied the CIS mechanisms in such a way that borrowers were starved of credit and changed lending policies so that to lend to the government as oppsed to individual borrowers see note 45 above.
[339] Supra Note 330 p 61.
[340] [2017] eKLR
[341] [2018] eKLR

repay the defendant's loan. These and many other cases reveal internal management weaknesses at banks that are either incompetent or outright against borrowers once in distress. The instances reveal banks that are zealous in listing borrowers as defaulters but very apathetic when it comes to lifting their names from the defaulters list.

The eleventh principle is on Board compensation while the twelfth principle is on governance of information technology. The thirteenth principle is on the Bank's Operational Structure. The board and senior management should know and understand the bank's operational structure and the risks that it poses. Finally but not least, the fourteenth principle is on disclosure requirements. The governance of the bank should be adequately transparent to its shareholders, depositors, other relevant stakeholders and market participants.[342]

In summary, the above principles are elaborate on what institutions should do to enhance good corporate governance. Good governance aims at increasing profitability and efficiency of organizations and their enhanced ability to create wealth for shareholders, increased employment opportunities with better terms for workers and increased benefits to stakeholders. The transparency, accountability and probity of organizations make them acceptable as caring, responsible, honest and legitimate wealth creating organs of society.[343] Within the financial sector such principles when followed adequately help make banks and other financial provides true agents in achieving borrowers' welfare while increasing shareholders value. This is critical in achieving one of the three main pillars of the country's vision 2030.[344]

4.3 The Corporate Governance Challenges

The relationship of a banker to his customer is one of contract.[345] This may presuppose that being contractual, the parties are dealing at 'arms-length' however, this may not be entirely true as stated by Howells that "Credit is a product about which consumers are very easily confused. It is a

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[342] Supra Note 330. 66

[343] See Linyiru Bruno Mugambi (2006) *"A survey of corporate governance practices of Banks in Kenya,"* A Research project submitted in partial fulfilment of the requirement for the award of Master of Business Administration Degree of The University of Nairobi, P 9 , available at http://erepository.uonbi.ac.ke/bitstream/handle/11295/22127/Linyiru_A%20survey%20of%20corporate%20governance%20practices%20of%20banks%20in%20Kenya.pdf?sequence=3&isAllowed=y (accessed 30/8/2019).

[344] The three main pillars are economic growth, Social and political governance available at www.vision2030.go.ke (accessed 27-8-2019)

[345] Foley V. Hill (1848) 2 HL Cas. 28

product which consumers often seek when they are at their most vulnerable".[346] It can be argued that credit can cause "untold hardships to consumers who are induced to over-commit themselves by blandishment of sales or promotional techniques or the pressures of social milieu,..who find that they default when unexpected events like sickness or unemployment occur"[347]

With the recognition that consumers need some form of protection, the principles of good corporate governance become even more important. Notably, the Consumer Protection Act was the one that defined who a borrower is[348] thus bringing the borrower to the clear protection of the law as an important stakeholder in the financial system. There have been cases of bank failures from as early as 1984 and to as recent as 2017 underscoring the importance of better application of the principles of corporate governance in their whole spectrum. A research by Mugo[349] highlights several failures in corporate governance that led to the closures of these banks to the detriment of shareholders and customers. These failures were highlighted as but not limited to; formation of 'friendly' Boards, insider lending, improper lending practices among others.[350]

The Central Bank of Kenya as a regulator has tried to achieve greater benefits to borrowers through broad regulations such as the Prudential Guidelines and Circulars, it has also led concerted efforts in conjunction with the industry players such as KBA to come up with initiatives such as the Banking Charter, 2019 (herein the Charter)[351] which became effective on 1st March 2019, banks and MFIs were given until 31st May 2019 to submit plans for compliance with the Charter. The reading of the Charter shows weaknesses that have been experienced by borrowers such as high interest rates even with enhanced CIS framework introduced with CRB Regulations 2008 and enhanced through CRB regulations 2013 among others.

A closer look at the Charter reveals that this is a further attempt to foster principles of good governance. The Charter is premised on the following four central pillars to the banking industry:

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[346] Howells,Geraint, Consumer Protection Law, 2nd edition, Ashgate Publishing Ltd,(2005 p.437

[347] Scott, Colin and Black J, Cranston's Consumers and the Law, 3rd edition, Canbridge University Press, 2000. P.232-233

[348] Supra Note 64

[349] Mugo, Alice W, "*Preventing Failure of Commercial Banks in Kenya: An Analysis of the Supervisory Role of the Central Bank of Kenya.*" A Research project submitted in partial fulfilment of the requirement for the award of Master of Laws Degree of The University of Nairobi, P 18-33

[350] Ibid

[351] . Supra Note 236

i. Adoption of customer-centric business models by banks;

ii. Risk-based credit pricing;

iii. Enhanced transparency and information disclosure; and

iv. Enhancing an ethical culture in banks-doing the right thing.

The Charter is to be read together with the provisions of the Banking Act, Microfinance Act, Regulations and Guidelines, Credit Reference Bureaus Regulations, 2013 and other regulations issued by CBK from time to time.[352] CBK admits that the various interventions including the CIS mechanisms have not addressed the consumers plight as the consumers continue to suffer poor customer service and high cost of credit. Further, it is admitted that measures such as introduction of the Kenya Bankers Reference Rate in 2014 (herein KBRR)[353]which had, as its singular objective to ensure the cost of credit by banks is easily determinable by setting a benchmark cost upon which banks and MFI would add their cost so as to arrive at the effective rate they would charge a borrower. This also meant that a borrower would quickly shop around and easily determine a bank that offered credit at the lowest cost on top of the KBRR. KBRR was also meant to enable banks price customer on an individual basis by judging the risk profile of a prospective borrower as maintained by CRBs. This was thought to work since the CIS mechanism was already in the market through the enhanced CRB Regulations, 2013. Further, CBK and KBA launched the 'Total Cost of Credit' website which enables "consumers to compare different bank loan costs based on standardized parameters and a common computation model."[354]

All the above efforts as acknowledged have come a long way in alleviating the plight of a borrower and has afforded the borrower some platform with which to engage lenders. However, the principled approach to corporate governance and weak supervision quickly saw banks find ways

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[352] Supra Note 236 p.1

[353] The KBRR framework was introduced in July 2014 to enhance transparency in the pricing of credit as well as to improve transmission of Monetary Policy signals into the banks' lending rates. See CBK circular 1 of 2015 available at www.centralbank.go.ke

[354] CBK Circular No. 3 of 2017 available at https://www.centralbank.go.ke/uploads/banking_circulars/136870827_Banking%20Circular%20No.%203%20of%202017%20-%20Cost%20of%20Credit%20Website%20Portal.pdf and www.costofcredit.co.ke

to charge way more than had been anticipated thus negating to a large extent the strides made.[355] This is indeed not new as seen earlier banks are notorious for finding ways to get past the law[356] or in such a way to starve the borrowers of credit.[357]

Although the Guidelines are couched in both obligatory and non-obligatory terms leaving financial institutions with choices on compliance, the Charter is couched in mandatory terms and stern. For example it states:

> "Some of the structural rigidities that led to market failure and prompted the interest rate caps still remain. The removal of the interest rate caps is critical to developing a market-led financial sector; however, the banking sector must fully demonstrate that they are responsible and disciplined"[358]

These rigidities have continued even in the advent of serious efforts by CBK and KBA. Ironically KBA has defended the obtaining position stating that since there is transparent costs disclosure, borrowers are free to shop for lowest rate. What KBA forgets is that borrowers mostly approach the banks when the borrowers are at their point of most need. This coupled with blitz marketing[359] and further the reluctance of banks to fully disclose the cost of credit. The banks prominently display the legal rate as per CBK but load several other cost which are either paid upfront or to third parties. These costs effectively move the annualized interest rate sometimes as high as 10% points above the approved rate.[360]

From the foregoing it is clear that the "implementation of the Guidelines on corporate governance has not been without challenges. In fact, the author posits that one of the challenges would be the cost of compliance, for example the position of chief finance officer would be too costly for many companies or that the post is too sensitive to be held by a qualified person who does not understand the company culture." [361] These challenges are not isolated nor unique, in a study on one of the

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[355] Juma Victor, *Business Daily* (Nairobi) 8th January 2018 https://www.businessdailyafrica.com/news/Bank-charges-loophole-raises-cost-of-loans-to-19pc/539546-4255160-b43os8/index.html
[356] Supra Note 58
[357] Supra Note 45
[358] Supra Note 245 p.2
[359] Supra Note 57
[360] Supra Note 301
[361] Supra Note 310 p.102

local banks, several challenges on implementation of corporate governance were identified, these included; poor understanding of the corporate governance strategy by employees, competing activities diverting attention, lack of necessary skills by employees, insufficient allocation of resources and inadequate monitoring of activities and progress.[362]

In the Kenyan context, it can be argued that through the various enabling Acts of parliament, Regulations and Guidelines as issued by CBK regarding the CIS mechanism, the duty of care of bank directors has been extended beyond that to the company so that the inward looking view of the Board is now frowned upon just like other jurisdictions for example the UK.[363] The Banking Charter, 2019 is an important step towards removing the rigidities that deny borrowers the benefits of the measures put by the government through CBK aimed benefitting borrower and consumers of credit.

Generally looking at the totality of corporate governance there seems to be tension between full implementation of good corporate governance in this case full application of the CIS mechanism and keeping the profits as high as possible for the banking sector. It appears that the banks have always won the battle as they continue to rake record high profits even in interest rate cap regime thanks to the ingenious inventions such as appraisal fees.[364] In fact it has been posited that their implementation has been unenthusiastic and where implemented it has been out of necessity and not choice.[365] One wonders therefore, how comes the banks continue to make record profits while operating in a slowing economy and the borrowers starved of credit?[366] The inescapable conclusion would be either, the banks are not dealing with individual borrowers and are now diversifying to other areas such as government securities or they have devised ways to still make their profits. This is an age old problem that won't go away easily as directors are chasing for

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[362] Mwongera P.M, "*The Challenges of The Implementation of Corporate Governance Strategy by the Oriental Commercial Bank Limited, Kenya*" A Research project submitted in partial fulfilment of the requirement for the award of Master of Business Administration of The University of Nairobi, P 40-43

[363] Davies, Paul L and Worthington Sarah, "Gower and Davies' Principles of Modern Company Law," 9th Edition, Sweet & Maxwell, 2012 p.509

[364] Alushula Patrick, *Business Daily* (Nairobi) 5th March 2019 https://www.businessdailyafrica.com/news/Banks-earn-Sh152bn-record-profit-2018/539546-5009688-15ft5ygz/index.html

[365] Supra Note 310 p.104

[366] Supra Note 364

profits for the shareholders and investors as a primary concern and unless tempered they will continue to do so.[367]

Macey and O'Hara in their article have argued that commercial banks pose unique corporate governance problems for managers and regulators, as well as investors and depositors.[368] They observe that the intellectual debate in corporate governance has focused on two very different issues: First, whether corporate governance should focus exclusively on protecting the interests of equity claimants in the corporation or whether corporate governance should instead expand its focus to deal with problems of other groups like stakeholders or non-stakeholder constituencies.[369] This is a debate that "would not go away soon"; however as the principles of good corporate governance gain prominence and as companies transform into multifaceted organizations, there is a favorable view towards recognition of other stakeholders such as borrowers as deserving duty of care by the corporates.

4.4 Poor Corporate Governance and its Impact on borrowers

From the foregoing, it is clear that despite efforts by CBK, CMA and other regulators towards achieving credit benefits to the borrowers, banks have always found a way to make greater profits while ignoring the plight of the borrower. It is arguable if disclosure requirements for the banking sector in Kenya are adequately transparent to their shareholders, depositors and other stakeholders and market participants.[370] It can be argued the market participants here include the borrowers. When Regulations or guidelines have been set, the Board of directors should ensure the they are implemented in such a way as to give effect to the intended purpose of the regulations. What have seen is that banks have from time to time interpreted those regulations and guidelines to the detriment of the borrowers. This can clearly be seen, soon after the implementation of the rate cap for example in 2017, the banks' profits dipped ever slightly.[371] Thereafter it has been an upward

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[367] Supra Note 111

[368] Macey, Jonathan R. and O'Hara, Maureen, The Corporate Governance of Banks. *Economic Policy Review*, Vol. 9, No. 1, April 2003

[369] Ibid

[370] Peter Rawlings Osebe & Penvilia Chepkemoi, (2016) "Corporate governance and banking sector in Kenya," *International Journal of Economics, Commerce and Management*, Vol. IV, Issue 9, available at http://ijecm.co.uk/wp-content/uploads/2016/09/4933.pdf (last accessed 30/8/2019).

[371] https://kippra.or.ke/interest-rate-cap-two-years-on-outcomes-for-the-kenyan-economy/ (accessed on 30-8-2019)

trend to what can be termed astronomical profits.[372] This is what exactly the interest rate cap was meant to address, the perception in the market that banks were not practicing good corporate governance to the detriment of the borrowers and thus there was need to reign in on banks trajectory through legislation such as the 2016 amendment.[373] The petition to reverse this seeming interference on the independence of CBK noted that among reasons that led to the reintroduction of interest rate cap were;

> "a) High interest rates had resulted in an increase in the costs of doing business in Kenya.
>
> b) While World Bank recommended that market forces should determine interest rates, banks in Kenya seemingly have formed cartels in order to manipulate the rates and further, that CBK had been unable to effectively control the alleged cartels."[374]

This perception that the borrower needed protection from exploitative rates and cartels[375] is a clear indictment on the failure of corporate governance on the part of the financial institutions. Unfortunately for the borrower, the failure of corporate governance shall always benefit the financial institutions to the detriment of the borrower. This is clearly depicted by the fact that when the interest rate capping became effective, the banks tightened their lending criteria leading to locking out of the masses and the Small and Micro-Enterprises (SMEs)[376] and when they were done starving the borrowers, the banks found new loopholes to charge even more interest rates as disclosed by the 'Total Cost of Credit' website when one applies the annual percentage rate (APR) together with additional costs such as 'negotiation' and 'appraisal' fee the net effect is an interest rate above the limit set by law.[377] This has led the banks bank to their record profits.[378] The Kenyan borrower like any borrower everywhere in the world approaches financial institutions when they are in need, thus they will always be in the weaker bargaining power and easily lured by sleek advertisements leading them to overlook insistence on basic rights such as information on total cost of credit that would lead them to make better choices. This is detrimental to borrowers and banks need to exercise high level of corporate governance especially on implementation of

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[372] Supra Note 364
[373] Supra Note 32
[374] Supra Note 91 par.57
[375] Ibid par.56
[376] Supra Note 45
[377] Supra Note 301
[378] Supra Note 278

guidelines issued by the regulators as regards consumer protection. There are still strong positions by the National Assembly that the rate cap needs to stay as banks are behaving like cartels by withdrawing credit to the borrowers to force the government to reverse the interest rate cap.[379]

The Central Bank of Kenya has done a lot in trying to instill good principles of corporate governance in order to protect the borrowers. Using its regulatory powers CBK has issued the Prudential Guidelines touching on good corporate governance and consumer protection, overseen the introduction and implementation of CIS mechanism, introduction and implementation of the total cost of credit initiative that enables borrowers to compare credit facilities and more recently the Banking Charter 2019 that is mandating banks to implement risk based credit scoring techniques,[380] uploading full costs of all their products on the 'total cost of credit' website, asking banks to provide financial literacy to borrowers that is distinct from advertisements among others.[381] All these initiatives are aimed at raising the bar on corporate governance and ultimately benefitting the borrower. It can be argued that so far there is turbulence in the sector and the benefit of the borrowers is yet to be seen.

As can be seen from the foregoing, corporate governance challenges have resulted in the banking and financial sector suffering a negative impact on the part of the lenders, a more strict and mandatory regulations of the principles of corporate governance, anxiety and low income as happened in 2017 when profits for many banks dropped.[382] On the side of the borrowers poor corporate governance has seen the banks circumvent the law, regulations and guidelines[383] hence continuing exploiting the borrower meaning the lack of transparency and transfer of benefits have not improved the borrowers' life even with increased regulations.[384]

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[379] Omondi Dominic, *The Standard* (Nairobi) 17th March 2019 https://www.standardmedia.co.ke/business/article/2001316916/mps-set-for-new-bruising-battle-over-interest-rates accessed 30-8-2019. The Finance Act 2019 however has repealed the interest rate capping.

[380] CBK notes that banks have been reluctant to use the the above technique even after the advent of the CIS thus lumping together all borrowers. This enabled them to charge high interest rate. CBK has also determined to follow through on implementation by doing on site assessment i.e. visit to banks to see application of this mechanism.

[381] Supra Note 351

[382] Supra Note 371

[383] Supra Note 301 and 355

[384] Supra Note Ibid

The fact that the banking sector interest regime is under government control in a free market economy speaks volumes on the state of corporate governance in the banking sector. The banks' are viewed as exploitative due to high interest rates leading them to earn astronomical profits. The Banks do not seem to slow down on their quest to charge above set minimum interest rates leading to the government seeking to now include the annual percentage rate thus ensuring banks have no room to wriggle out of the capping. Although the High Court has said the amendments do not conform to the constitutional threshold,[385] the court did give a twelve months period for parliament to realign the same to the constitution. The banks have taken this opportunity to once again ask for repealing of the interest rate capping but the National Assembly seems adamant to retain the same claiming they need to protect the borrowers.[386] Although the Finance Act 2019 repealed the interest rate capping, the position of the National Assembly serves to show the indignation the borrowers have against banks failure to apply the regulations and guidelines set by CBK to the fullest.

From 2008 and onwards, the advent of the CIS, the introduction of KBRR and the promulgation of the Prudential Guidelines among other initiatives, these were thought to bring benefits to the borrowers, but as has been admitted by CBK, the regulator, the banks have not conferred the intended benefits to the borrowers.[387] The result has been the introduction of direct government regulation through the National Assembly a fact that deprives CBK of its independent regulatory role.[388] CBK is now attempting to convince the National Assembly and the country at large that there are enough mechanisms in place including the Banking Charter 2019 that would help tame the excesses and ills of the banking sector. It now remains to be seen whether the National Assembly will accept these overtures and remove the interest capping law. Subsequently the interest rate capping has been repealed by the Finance Act 2019. What now remains to be seen is whether banks will exercise good corporate governance practices as espoused in the Prudential Guidelines 2013 and the Banking Charter 2019 to confer the CIS benefits to the borrowers and keep the wrath of the National Assembly at bay.

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[385] Supra Note 91
[386] Supra Note 379
[387] Supra Note 351
[388] Supra Note 91

Financial innovations through fintechs also have opened a new frontier that the banks are using to exploit the borrowers.[389] This will no doubt attract the scrutiny of the regulator and the government, In recent times, when banks considered interest rate capping unprofitable, they quickly adopted a different business model leaning towards mobile banking and using the same as a channel to advance credit to the borrowers.[390] The thought is that this channel would render the maximum profits to the companies while suffering more lenient regulation. Indeed banks such as NIC has touted itself as being able to lend as much as Kshs. 3,000,000/- through its mobile application Loop.[391] Just like had been posited earlier,[392] corporate directors will seek that which will bring maximum returns for the shareholders, this is not entirely evil. When it gets overboard forcing the government to intervene, then it means there is clearly a failure in the corporate principles governing these institutions. Perhaps a clear example is the mobile lending where interest rates are as high as 90% per annum whereas normal loans are being charged at 14% per annum.[393]Banks are claiming that they would rather lend to the government and institutions than lend to individual borrowers and SMEs, yet they turn around and lend to this very same cadre at exorbitant rates through short term mobile lending[394] when annualized.

Failure to implement individual credit pricing using the risk based scoring techniques in their loan application screening processes, through full adoption of the CIS framework already in place as noted by CBK[395] is a further demonstration of the corporate governance challenges beleaguering the banking sector. In fact, in the Banking Charter 2019, CBK states that it shall carry on-site checks and do mystery shopping surveys in order to monitor compliance.[396] This wouldn't be necessary except where there is a noted failure.

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[389] Supra Note 301
[390] Supra Note 9 and 12
[391] Kenyan lender CBA upgrades app to offer highest mobile phone loan available https://af.reuters.com/article/commoditiesNews/idAFL5N1UM4C1
[392] Supra Note 206
[393] Kariuki James, *Daily Nation* (Nairobi) 5th August 2019 https://www.nation.co.ke/news/KCB-raises-interest-rates-on-mobile-loans/1056-5224198-k1evg0/index.html
[394] Supra Note 9, 18 and 23
[395] Supra Note 351
[396] Ibid

4.5 Analysis of case law regarding banks' actions on the application of CIS mechanism.

The Central Bank of Kenya as a regulator in the financial sector has demonstrated from the initiatives it has put in place that it truly would like to see banks self-regulating and following proper corporate governance practices that would yield benefits to the borrowers as stakeholders.[397] However, repeated failure to follow these regulations and guidelines in a manner that accrues benefits not only to the financial institutions but also to the borrowers has resulted in not only the National Assembly seeking to directly regulate the actions of the financial institutions relating to the interest rates they are charging borrowers[398] but has also forced CBK to issue circulars couched in mandatory terms.[399] None other than the independent regulator, CBK has stated that the financial sector, a fully liberalized sector, would face challenges due to the National Assembly's direct control as it would influence CBKs Monetary Policy regulation latitude.[400] This argument was also raised in the Boniface Oduor's case against CBK and others where CBK argued that its independence in regulating the financial sector was being interfered with by the National Assembly's direct control of the financial sector.[401]

The banks must look inward and ask the one question; how did matters get to where the people through the National Assembly, are seeking to control a supposedly fully liberalized sector of the economy? It is a question that clearly shows something is amiss in the good corporate governance practices of banks in an effort to create desired beneficial outcomes for borrowers, the economy and the shareholders. It is the argument of this study that when banks seek to more directly lend to the government and thus starve the borrowers it is a of poor corporate governance that does not take care of the other stakeholders.[402] The embrace of the CIS mechanism is long overdue in a mature financial sector like Kenya's and the approach through Prudential Guidelines or regulations alone may not work. Banks need to do more in their internal processes in order to give

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[397] Ibid
[398] Supra Note 32
[399] Supra Note 351
[400] The Impact of Interest Rate Capping on the Kenyan Economy, March 2018 available at https://www.centralbank.go.ke/wp-content/uploads/2018/03/Interest-Rate-Caps_-March-2018final.pdf accessed on 2nd Sept 2019
[401] Supra Note 91
[402] Supra Note 45

full effect to the CIS mechanism. Failure of banks management to have robust processes that are able to identify and rectify applications of the CIS mechanism can only lead to frustrations among borrowers. In the case of Alice Njeri Maina v Kenya Commercial Bank (KCB),[403] the bank listed a customer through mistaken identity, believing her to be another customer who had defaulted with a similar name. When the customer applied for a loan at her Sacco she was informed that she was listed and denied the facility. The erroneous listing had stayed at CRB records for three years without being discovered. The court found KCB culpable for negligence and recklessness in handling the customer data, it was also found not to have written to the customer informing her of her intended listing in 2012. Similarly, in the case of Namalwa Christine Masinde -vs- National Bank of Kenya[404] the plaintiff was listed with CRB without notification. She only discovered her negative listing after her loan application at another bank was denied. The court found that the bank had acted negligently and failed to observe principles of good banking practice in not notifying the customer of the intended adverse listing. The customer was awarded KShs. 200,000.00 as damages.

Also in the case Co-operative Bank of Kenya Limited v Peter Ochieng[405] the High Court found that Cooperative bank, had no reason to forward the customer's name to a CRB. In fact, in the suit, the bank could not even produce a statement to support that the contention that the customer was in arrears or in default at the time of listing. Although the court said the supply of borrower credit information to CRBs is under qualified privilege, it was shocking that the bank failed to show that the customer had a non-performing loan at the time of sending his default information to the CRB. This suit took two years to conclude in favour of the borrower. It is instructive to note that the reason the customer took the court route in resolving the issues just like theAlice Njeri Maina case above,[406] is because he had been denied a loan by Equity Bank. This shows the borrower had no prior notice of his intended listing. This is clearly reckless on the part of the bank as against the borrower, denoting poor corporate governance. "Who is the director of credit in the bank? Is he or she carrying out qualitative analysis of the processes in place to ensure no prejudice on the

[403] Supra Note 258
[404] [2016] eKLR
[405] [2018] eKLR http://kenyalaw.org/caselaw/cases/view/162209/
[406] Supra Note 258

borrowers' part or he or she is just implementing the regulations mechanically thus contributing to the erroneous data of borrowers held at CRBs?"

In the case of Mwatech Enterprises Limited v Equatorial Commercial Bank (ECB)[407] even after consent was entered with the borrower and the borrower complied on its part, the defendant bank failed to send a notification to CRB to delist the customer to enable them look for funds to repay ECB's loan. The court had to give the parties another 45 days to enable them negotiate further or enter into another consent. It is clear from the foregoing that the matters touching on CRBs and borrowers is causing considerable hardships to the borrowers on a macro level that is starving the borrowers of credit[408] and on individual levels banks are content with the application of the CIS mechanism in a manner that favour the banks or in a reckless manner thereby hurting borrowers. Borrowers have to seek court intervention for relief. This procedure is length and costly and sometimes does not help the borrowers get the help they need as quick as the borrowers would had the banks applied good corporate practices that give regard to the borrowers as part of the key stakeholders in the CIS mechanism.

It can be argued that the CRB Regulations, 2013 though they were thought to improve on the 2008 ones, they have had little to offer in terms of relief to the borrowers. One of the flaws that has been identified within the CIS mechanism was in the case of Gervase Maina Ndonga v AAR Credit Services Limited & another.[409] In this case the court found that the supposed Alternative dispute resolution (ADR) mechanism as found in regulations 35 was non-binding and did not offer any relief to the borrower upon finding of breach on the part of the financial institution, thus the borrower cannot be forced to go through this process as it did not have any award of damages, costs or interests. In this case the financiers listed the customer with Metropol Credit Reference Bureau (Metropol CRB) and upon filing suit for wrongful listing, the AAR and Metropol sought to raise a preliminary objection to the effect that the borrower had not exhausted the mechanism existing within the CIS platform. The court found otherwise stating that the mechanism espoused in the 2013 CRB regulations were not exhaustive as they provided for not real remedy to a borrower who has been affected by the wrongful application of the CIS mechanism. This kind of

[407] [2018] eKLR available at http://kenyalaw.org/caselaw/cases/view/160595/
[408] Supra Note 45
[409] Supra note 75

finding would have triggered bank-wide review of this CIS mechanism and ADR mechanism but it did not. This also points out to the nature of the inward centric view that the banks take.

To show the extent to which financial institutions are willing to use the CIS mechanism against the borrowers, the case of Erdeman Property Ltd v Credit Bank Limited [410] is instructive. In this case the High Court found that the threat to list the borrower was actuated by malice after a disagreement on the release of award monies the borrower had received from Nairobi City County upon winning a suit against the county. The bank had wanted the borrower to apply the monies towards a reduction of an overdraft facility that the borrower had with the bank. This is in disregard to the borrower's financial arrangements and commitments within itself and with third parties including completion of houses belonging to expectant home owners. Appropriation of the funds in the manner demanded by the bank would have put the borrower in financial difficulty. The customer had to go to court to get an order stopping this arm twisting and use of CRB listing as a "stick." This is a clear failure of application of good corporate governance practices by this financial institution. The demand to apply the funds for another purpose other than what the customer had planned and using threats to "damage" the borrower's reputation by forwarding its name to a CRB showed that although the bank new the seriousness of negatively listing a borrower, it was willing to go that route if it helped it achieve its means.

In the case of Amson Njoka Mwenda & another v CFC Stanbic Bank Limited & another,[411] the plaintiff was awarded Kenya Shillings One Million against CfC Stanbic bank (now Stanbic Bank) for wrongful listing. The facts were that the bank issued the customer with a listing notice, the customer repaid the loan in full, however, the bank proceeded to list the customer with Credit Reference Bureau Africa (CRB Africa-now trading as TransUnion CRB) three months after he had repaid his loan in full. The customer came to learn of the wrongful listing after his application for a loan facility had been declined by another bank. When the customer filed suit against both the bank and CRB, the bank instead of admitting liability proceeded to defend the suit while knowing very well it was culpable, while CRB Africa, claimed that its duty to the customer did not exist as its role is to receive and share borrowers information with subscribers of the CIS platform. This

[410] [2018] eKLR http://kenyalaw.org/caselaw/cases/view/161208/:

[411] Supra Note 259

goes to show that banks are still not willing to side with customers and this is a clear failure of proper corporate governance, the director of credit and his team are not keen on listening to the customer. The customer had to wait five years before he could get relief, meanwhile he had failed to complete a purchase he had started.

These cases demonstrates the manner in which banks treat the information the borrowers entrust them with, that is in a casual manner, reckless and without regard to the harm that erroneous CRB information might do to the borrowers.. Why would the bank omit such an important step in the CRB listing process? A casual glance at the customer's history would have reveal that the bank was about to list a wrong customer, but it ignored this duty. The plaintiff was awarded Kenya Shillings Two Hundred Thousand as damages. The time between filing suit and determination is surely an inconvenience to the borrower.

The media has widely publicised the issues affecting borrowers under the CIS platform and this has "caught on" the National Assembly. A business columnist has argued that commercial banks are using the CIS mechanism as a yes or no checklist, so that where there is a yes, the applicant is immediately denied credit. This is the wrong application of the CIS mechanism, that is, its use as a predictor is probability of default by a borrower based on his records accessible at CRBs.[412] Further, the non-notification of intention to adversely list borrowers with CRBs also rampant as evidenced by case law.[413] The CBK governor has noted that the use of credit scoring in pricing is minimal and the credit scoring is used primarily to adversely select borrowers to deny credit. He has now through the Banking Charter 2019 sought to carry out physical site visits to enforce individual credit scoring for each applicant.[414]

Due to the unreliability of the data held at the CRBs under the CIS mechanism and failure by financial institutions to accurately report borrowers' information, some firms have decided to advance credit to borrowers whether they are listed at the CRBs or not.[415] While some legislators

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[412] Watima Tony, *Business Daily* (Nairobi) 9th July 2018 https://www.businessdailyafrica.com/analysis/columnists/CRB-mechanism-should-be-reviewed/4259356-4654538-15gxmjr/index.html

[413] Supra Note 91, 258, 259

[414] Supra Note 351

[415] Omusolo Moses, *The Standard* (Nairobi) 21st April 2019 https://www.standardmedia.co.ke/business/article/2001321913/listed-by-crb-firm-offers-you-a-chance

want the CIS mechanism to be abolished altogether.[416] Whereas the regulator, CBK, has tried all the tricks in the book including enhancing penalties for breach of its regulations on CRBs,[417] the true focus should lie elsewhere. The buck should stop at the corporate governance within the banks' door steps.

4.6 Conclusion

The research question that this chapter sought to answer was whether there were corporate challenges when it comes to the application of the CIS mechanism and if so, whether the same has had negative impact on the borrowers. From the foregoing, it is clear that banks have corporate governance challenges when it comes to the application of the CIS mechanism. The Prudential Guidelines expect banks to have robust internal management that is able to rise to the challenges posed by the CIS. What is clear is that the banks are after the 'bottom line' and administrative actions like CIS application and implementation comes second. This has seen banks use the CIS mechanism as tools to not appraise customers risk profiles but tools to deny customers loans. Where disputes have arisen the banks have been slow and unenthusiastic in finding solutions. This has forced borrowers to seek recourse through the courts causing them to endure long waits before their disputes are resolved by the courts. This has led to damaged borrowers' financial reputations and sometimes denial of credit at the hands of banks. In a properly working bank management it is not possible that an erroneous customer data can be held for more than three years yet there exists mechanisms to submit CRB data on a monthly basis.

To conclude, poor corporate governance in the banking sector is also depicted during the interest rate capping regime where unjustifiably the banks denied credit (starvation of credit) to a segment of the borrowers and where the banks lent money, they charged even higher interest rates through exploitation of legal loopholes to introduce charges such as "appraisal fees" which charges had the effect of taking the annual interest rates charged higher than the maximum allowed. Further Mobile lending which is touted as enhancing financial inclusion, though partly true has also seen

[416] Matara Eric, *Daily Nation* (Nairobi) 23rd May 2019 https://www.nation.co.ke/business/MP-now-wants-credit-bureau-law-abolished/996-5129016-649b1xz/index.html

[417] Ngugi Brian, Business Daily (Nairobi) 1st May 2017 https://www.businessdailyafrica.com/markets/news/Banks-warned-inaccurate-borrowers-data/3815534-3910130-qr5t7g/index.html

borrowers suffering high interest rates on mobile loans, as high interest as 90% per annum.[418] This is no doubt a high burden on the borrowers, making these loans not only unaffordable but also a costly lending leading to impoverishing the borrowers.

The borrowers have been forced to seek court interventions to protect themselves against the banks malpractice regarding the CIS mechanism, although the banks and CRBs dig in, in such suits, most have gone the customers' way clearly showing that there is a problem.[419] The impact on the borrowers is that ultimately the cost of the loan becomes expensive when looked at in totality of loan costs, litigation costs, time foregone and the loss of intended benefits from the borrowing. The failure to address the challenges in the CIS mechanism, as seen in Chapter three and four, is a corporate governance challenge which has negatively impacted on borrowers.

It is also now clear that the banks and other stakeholders need to move and ensure that the ADR mechanisms within the CRB Regulations 2013 is properly structured in order to cater for disputes that may be referred to the processes therein. This is because there are recent authorities[420] that tend to suggest that the remedies available therein are not sufficient a departure from the decision in Kennedy Odhiambo Nyagudi v Central Bank Of Kenya & 3 Others[421] where the court took the view that the remedies as contained in the CRB Regulations 2013 were sufficient and the plaintiff had not exhausted the same.

The borrowers have suffered and continue to suffer a credit starvation,[422] submission of inaccurate information to CRBs by banks and when challenged the banks try to hide behind the regulations. The borrowers also are forced to seek court's intervention to protect themselves against banks and CRBs; this is often a long wait for justice as these cases take upwards to two year to conclude these leads to failure to conclude business transactions[423] among other undesirable consequences. Perhaps the case of Erdeman Property Ltd v Credit Bank Limited[424] should serve as an example of the attitude with which the commercial banks view the CIS mechanism, precisely as a tool to

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[418] Supra note 3Supra Note 9,18,23
[419] See generally Part 4.5 above
[420] Supra Note 75
[421] [2013] eKLR
[422] Supra Note 45
[423] Supra Note 40
[424] [2018] eKLR

threaten and to be applied whimsically. CBK's continued push for a fair playing field between the banks and the borrowers[425] that is, restating the Prudential Guidelines in mandatory terms with threats of onsite inspections[426] will inevitably lead to higher costs of compliance and further push banks to shun lending to this segment. This is a further negative outcome for the consumers. The directors of credit or heads of consumer lending or whatever their designation, persons charged with leading the lending arm of the bank should be as of necessity undergo training on CIS and a form of certification granted. This will be a direct way of ensuring bank boards are aware of this important mechanism in the financial sector.

[425] Supra Note 351
[426] ibid

CHAPTER FIVE
SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.0 Introduction

This study sought to examine the interplay between the corporate governance in the Kenyan banking sector and the credit information sharing mechanism and its impact on borrowers who are the banking sector's key stakeholders. The study more specifically sought to examine whether the advent of the CIS mechanism, the regulatory, statutory or legal interventions in that regard in the banking sector have benefited the key stakeholders in banking sector that is the borrowers, and if not analyze the challenges relating to failure in corporate governance that may have led to this status and suggested interventions that can be undertaken. The study sought to 'unearth' corporate governance practices from the law, regulations, circulars, and case law.

The study's boundary of investigation is the financial sector which includes banking sub-sector, Micro Finance sub-sector and the Sacco sub-sector. These subsectors are regulated by diverse laws and regulations.[427] As the financial services expand and become more instantaneous, decisions have to be made quickly whether to lend or not and this calls for the banks to have more than just what the client presents as his banking history. There needs to be less information asymmetry in the market since lenders price perceived risk higher where the information is scanty.[428] Thus the more the information available the more true the pricing of the risk.

The study hypothesized that Kenyan borrowers as key stakeholders in the financial sectors, have not benefitted from the CIS mechanism and still continue to suffer high interest rates yet they have submitted their credit history and information that should help in differentiating good payers from defaulters. This may be attributed to poor corporate governance in banks and the financial sector in general.

The study examined several laws, regulations, case law, CBK circulars, journal reports, reports theses and media reports to come up with its conclusions and recommendations. The use of this

[427] Supra Note 106 to Note 112
[428] Supra Note 54

method was suitable because CIS has been around for few years and the literature available especially locally is from the laws, courts, journals, theses and media reports.

5.1 Summary

Chapter one introduced the topic and set out the conceptual background. It also reviewed extensive literature on the topic. It was clear that even though there was a lot of literature on the benefits of the CIS mechanism, the investigations wore the lenses of the banks and did not have a look at the view point of the borrowers. Thus this set the stage for this study.

Chapter Two delved into the regulatory framework of the financial sector. It was found that there are many legislations dealing with the financial sector. These included the Micro Finance sector, Sacco sector and more recently the digital mobile lending. Other peripheral but important legislation dealt with retirement benefits, insurance among others. There was an attempt to bring financial sector regulation under one regulatory authority but this has been shelved for the time being. Banks are also meant to adhere to other legislations like the Companies Act and the Capital Markets Act when they are listed at the Nairobi Stock Exchange (NSE). It was concluded that CBK is the main regulator of the financial sector and that regulation of the financial sector is important to ensure a level playing field and for ensuring good corporate governance is practiced. However direct regulation by the National Assembly for example in setting the interest rate spread is to be avoided, however this was seen as a reaction to imperfect corporate governance practices by the sector.

Chapter three investigated the advent of the CIS framework in Kenya tracing its history to 2008 to date. From there, there have been various amendments and modifications to the CIS framework to make it more responsive to the needs of key stakeholders that is the borrowers. However, it was found that, there is generally low regard for the CIS mechanism even among borrowers and this could be traced to its advent,[429] where only negative information was shared and used by banks against borrowers. Thus the CIS framework's footing was never anchored as a partnership between the borrowers and the banks. Instead it focused on the philosophical mindset of protecting the banks and investors against the borrowers. The other weakness of the CIS mechanism is the

[429] Supra Note 11

fact that it is pushed by legislation but the implementation on the ground is done by voluntary organizations for example Tatua Center and other external bodies that have strong affiliations to the banks through KBA.[430] This bias obviously diminishes the interests of the borrowers and responsibilities that may negatively impact the banks are not given prominence or thought through an example is the ADR mechanism which has no compensation to the borrowers who might be harmed by the application of the CIS mechanism.[431] It was concluded that other consumer protection groups for example COFEC and Consumer Protection Advisory Authority need to have a say in the development and application of the CIS framework in order to balance the scales between the lenders and the borrowers.

Chapter four looked at corporate governance practices by banks as regards the CIS mechanism and the effect on the borrowers. To investigate this, the chapter relied on the principles of corporate governance generally and more specifically as laid down by the Prudential Guidelines. It was found that the top twenty banks are listed at the Nairobi Stock Exchange and as such they are subject to the disclosure rules set by the Prudential Guidelines and CMA Regulations.[432] Case law was also analyzed and the inevitable conclusion was that as relates to CIS mechanism, banks need to improve on corporate governance in order to ensure the benefits of CIS flow to their key stakeholders who are the borrowers. The rise in litigation[433] regarding CIS mechanism indicated that something is not right, CBK has come out strongly through the Banking Charter 2019[434] to try and enforce what would ideally be done voluntarily should bank boards' wish to have win-win outcomes with their stakeholders. The chapter concluded with a view that banks should in their annual reports indicate how many cases they had as a result of the CIS mechanism and also how they have implemented the CIS mechanism within the organization to ensure a stable organization that minds its stakeholders. It concludes that directors of credit or Head of consumer banking be trained on the CIS mechanism

5.2 Findings

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[430] Supra Note 247
[431] Supra Note 75
[432] Supra Note 111 and Code of Corporate Governance for the Issuers of Securities to the Public, 2015
[433] Such as in Note 75, 258, 259
[434] Supra Note 351

The research proceeded on three main hypotheses; one that the key stakeholders in the financial sector, the ordinary borrowers have not and may not benefit from the current legal and regulatory regime specifically the Credit Information Sharing(CIS) framework, and two that the challenges faced by borrowers from enjoying the intended benefits of the CIS mechanism is as a result of poor corporate governance by banks that focus inwardly as opposed to embracing the borrowers as well for a mutually beneficial relationship and third that once these challenges of lack of benefits under the CIS mechanism by borrowers is addressed, the borrowers and the financial sector as a whole would greatly benefit.

To test the hypotheses the study sought to answer four questions one, what is the regulatory regime governing the financial sector and specifically the banking sector in Kenya? Two, is the corporate governance practice in the banking sector adequate to offer borrowers as key stakeholders intended benefits of the CIS mechanism? Three, can the CIS mechanism be utilized to not only improve the performance of the credit market but also benefit borrowers? And lastly, what are the possible interventions, if any, are necessary to achieve the benefits of the CIS mechanism for the borrowers? The research questions have been answered as follows.

On whether regulatory regime governing the financial sector, Chapter Two dealt extensively this question and found out that there are several laws, regulations, guidelines and circulars in place. There is still development in this area with many amendments expected in terms of laws and regulations.[435]

To debunk the issue of corporate governance and its effect on borrowers, the study looked at legislations for example Banking Act,[436] the CRB Regulations, Prudential Guidelines, CBK circulars, case law, and among others. From the analysis, the banks have to do more to incorporate the CIS mechanism in their lending decisions; they should not wait for CBK to issue circulars and mandatory directions such as the Banking Charter.[437] Case law also answered the question in the negative through its various pronunciations for example the Ederman case where the court found that the application of the CRB was malicious.[438] The fact that a corporate organization can be

[435] One of the key regulations that is in the pipeline is the Credit Reference Bureau Regulations, 2019.
[436] Supra Note 10
[437] Supra Note 351
[438] Supra Note 410

found to be malicious points to its corporate practices. The fact that the National Assembly saw it fit to directly regulate the interest spread in the pricing of credit facilities is a clear indictment that banks have not passed on the benefit of the CIS mechanism and this speaks directly to the corporate governance where agency leadership takes precedence over stakeholders interests in an unprecedented manner. The question to be asked here is what are the directors of credit and consumer lending doing to give effect to the CIS mechanism? The answer can be emphatically said to be nothing at best unless cajoled by CBK or it favors the shareholders.

On whether the CIS mechanism can be improved to give more benefits to the borrowers, this question was answered in the affirmative. It is clear that the CIS mechanism is just catching on in Kenya. It needs support of many other sectors for example service industry, utility providers and many others in order to truly have an all-round view of the borrowers. There are efforts ongoing for example to include cross border listing[439] and eventually even international listing. Thus there is a lot of room for improvement.

Finally, on the possible interventions if any, that would lead to the increase in benefits to the borrowers. The study found that there are lots of interventions that would be needed. For example regulations need amendment to obligate banks to offer some form of token compensation under the ADR framework. As it stands, there is no obligation to use this route to resolve disputes and even where this is required, there are no remedies for borrowers under the ADR framework. This makes it a mock exercise for the borrowers. There is also need for amendment of the ADR framework so that it calls for creation of a dispute resolution tribunal that incorporates consumer protection bodies for example COFEK and Consumer Protection Advisory Committee. This would be more representative and be more robust than the current structure where a voluntary institution like Tatua Center is working amorphously on donor funding thus putting its operations and sustenance in question. Further financial service providers should be obligated as part of corporate governance practice to disclose in their annual reports, cases filed, resolved or pending against the banks. Also, they should be obligated in their lending decisions disclose how they have applied the borrower's CRB score in factoring in the applicable interest rate.

[439] Supra Note 435

5.3 Recommendations

5.3.1 Short term recommendation

5.3.2 CBK Circulars

The main purpose of the CIS Kenya is to bring credit providers together and enabling them to share borrowers financial information safely. The use of the word 'safely' here means the institutions can share customer financial transactions data history without breaching customer banker confidentiality which is implied in a contract between a banker and a customer. [440]

The research recommends that as short term measure, CBK to issue circulars to address the shortcomings noted in the CIS framework for example the ADR mechanism, CBK should ask banks to give monthly reports of the disputes they have and resolved under the ADR mechanism. This will help draw banks to this means of dispute resolution thus reducing borrowers' pain at the courts.

CBK should issue a circular asking banks to disclose to borrowers how they have applied the borrowers' credit scores in coming up with the interest rate spread they have charged a borrower. This will complement the total cost of credit initiative currently in place. This recommendation will also give borrowers and opportunity to dispute the application, seek rectification of their information and thus when they finally take the credit; they have a full buy-in and hence improved chances of repaying the facility.

5.4 Medium term recommendations

5.4.1 Training of banks' staff on CIS mechanism.

From the foregoing discussion, the study recommends that CBK and KBA and other stakeholders such as COFEK, Tatua Centre among others undertake come up with a CIS training module for bank directors in charge of consumer lending and undertake to train all bank staff dealing with consumer lending from the management level to the ordinary staff on the importance the CIS mechanism and the potential impact it can have on the borrower and the banks. CBK should also

[440] Supra Note 13

outline measures that should be taken against specific managers who bear the most responsibility for the application of the CIS mechanism.

5.5 Long term recommendations

5.5.1 Legislation

CBK should embark on revamping the ADR mechanism within the CIS framework by inviting all stakeholders that is banks, CRBs, consumer protection bodies, and voluntary organizations to come up with a clear dispute resolution mechanism. This may involve formation of non-partisan CIS Dispute Resolution Tribunal that shall adjudicate CIS related disputes, its awards or finding be enforceable in court in a similar fashion as the arbitration awards.

CBK should seek to enrich the data available at CRBs by incorporating a wider network of information providers beyond the current traditional providers. The additional information providers should be social platforms, mobile lenders, convenience stores that offer credit facilities for example 'lay-by purchases' in supermarkets. This will further reduce the information asymmetry in the financial services sector.

CBK should revise the Prudential Guideline on corporate governance to require that the directors of credit or heads of consumer lending in banks, micro finance institutions and SACCOs be trained on CIS mechanism and a form of certification issued.

Further, CBK should work closely with CMA to require inclusion of additional disclosure items in the banks, MFIs and SACCOs annual returns is the number of CIS cases handled, resolved or pending and how CIS has been implemented within the institutions.

5.6 Conclusion

The Kenyan banking sector has undergone tremendous challenges in the recent past. Most of these challenges have mainly affected bank customers or stakeholders in the broader sense. There are now several legislations regulating the financial sector. The study firmly concerned itself on whether there are benefits accruing to the borrowers from these legislations since the borrowers are key stakeholders in the financial sector.

The study concludes that there are still inadequacies in the legislations and also in corporate governance within banks thus occasioning little or no intended benefits under the CIS mechanism. The inadequacies can be addressed in the interim using CBK's supervisory powers under the Banking Act through circulars and in the long term through legislative amendments that seek to firmly entrench the culture of CIS mechanism in the financial sector.

5.7 Further Areas of Research

The study recommends a comparative study be done between the current obtaining CIS mechanism, its application and other jurisdictions. This will help enrich the legislation currently in place, import good practices and improve the benefits the borrowers derive from the CIS mechanism. It is the firm belief of the researcher that if the borrowers benefit, the benefits will flow to the financial institutions as well as the entire economy.

The research also recommends further study on use of ''social capital'' of borrowers as one of the factors in the application of the CIS mechanism. This is important since the advent of social media, digital lending and other instantaneous lending platforms, there should be a research on how the borrowers' digital "foot prints" can be used to assess the borrowers' character in predicting repayment of a loan facility.

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