

**TOWARDS INCREASED CONSUMER
PROTECTION: A STUDY OF LENDING BY BANKS
IN KENYA**

**Maureen Nyambura Ngigi Warui
Registration Number: G62/76287/09**

**This thesis is submitted in partial fulfillment for
the award of the degree of Masters in Law (LL.M)
of the University of Nai:**


June 2012

Nairobi



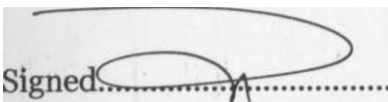
L DECLARATION

I, the undersigned, do declare that this thesis is my original work and that it has not been submitted for a degree in any other university or institution.

Signed/  Date: .M1Q.1)2.Q).2 ^_

Maureen Nyambura Ngigi Warui

This thesis has been submitted for examination with my approval as the University's supervisor.

Signed 

Date.

Steven Gatembu Kairu

The opinions and conclusions expressed herein are those of the student author and do not necessarily represent the views of the School of Law (UoN).

Reference to this study should include the foregoing statement.

II. DEDICATION

To my parents, Mr. and Mrs. Warui, who have toiled tirelessly to see me through thus far and for their unyielding love and support.

To my husband, brother and sister for their boundless encouragement through the years.

III. ACKNOWLEDGEMENT

My gratitude goes to all who assisted in one way or the other in the preparation of this research. Special thanks go to my supervisor Mr. Steven Gatembu Kairu for his guidance, patience and constructive criticism.

I wish to thank the University of Nairobi for allowing me to use their library and study facilities.

IV. ABSTRACT

Consumer protection within any sector is not only important but necessary. The mode of achieving this protection and the extent to which a consumer ought to be protected has been a matter of academic debate and discourse for years. Some academics argue that intervention in the market place by the government and players within any sector should be kept at a minimum to allow the market to operate at an optimum. On the other hand, there are academics who argue that a level of government and player intervention through enactment of policy, codes of conduct and legislation is both necessary and unavoidable because the market is unable to correct existing imbalances purely on its own.

This research was based on the premise that that some level of intervention is necessary in order to achieve an adequate level of consumer protection. The overall objective of the research was to undertake extensive study into the laws, regulations and institutions governing lending by banks in Kenya. Further, the research sought to look into the practical conduct of bank employees, in particular, credit officers when processing applications made by prospective borrowers, with a view of specifically assessing the information disseminated to such prospective borrowers at the initial stages of their application (disclosure). Further, the primary research sought, albeit to a lesser extent to establish the extent of standardization of the bank's procedures, the level of discretion left to the bank's employees and the bank employees' awareness of the legal provisions governing lending by banks in Kenya. After collating the evidence on a practical level, this research sought to identify existing shortcomings, loopholes and weaknesses with the bank's application and processing procedures having regard to the governing legal and institutional framework. The research instruments used were interviews and focus group discussions. The research acknowledges the importance of the prospective borrowers making an informed decision, which ought to be respected.

The assessment of the laws, regulations and institutions governing lending by banks in Kenya was conducted by comparing the level of consumer protection

legal provisions and institutions operating within the Kenyan jurisdiction provide against those available in other jurisdictions such as the United Kingdom, Canada and Australia. It was not the intention of this research to suggest or prove that these alternative jurisdictions are wholly 'better' or somewhat more superior to the Kenyan jurisdiction but merely to compare the extent of the consumer protection provided for in the legal provisions. It is arguable that this approach provided a more wholesome picture of lending practices and procedures of banks. Further, it was recognized that the findings of the primary research may not necessarily be reflective of the conduct of *all* banks in Kenya as only representatives from a few banks were interviewed.

Finally, following this comprehensive assessment of the legal, institutional and practical framework governing lending by banks in Kenya, this research aimed to provide recommendations, where appropriate, for implementing changes that would arguably increase consumer protection within the lending sector by banks in Kenya. Given the promulgation of the Constitution of the Republic of Kenya in 2010 and its subsequent implementation, all legal provisions, including banking ones ought to be reviewed to align them to the new constitutional dispensation. It is hoped that the contents of this research will provide valuable insight into the review and/or amendment of the legal provisions governing lending by banks in Kenya.

| Heading | Page Number |
|--|--------------------|
| j. Declaration | 2 |
| II. Dedication | 3 |
| HI. Acknowledgement | 4 |
| IV. Abstract | 5-6 |
| V. Table of Contents | 7-9 |
| 1. Chapter One: Introduction | 10-12 |
| 1.1 Statement of Problem | 12-14 |
| 1.2 Justification for the Research | 14-16 |
| 1.3 Assumptions and Limitations | 16-17 |
| 1.4 Research Objectives | 17-18 |
| 1.5 Theoretical Framework | 18-29 |
| 1.6 Literature Review | 29-39 |
| 1.7 Hypothesis | 39 |
| 1.8 Research Methodology | 39"4i |
| 1.9 Research questions | 41-42 |
| 1.10 Chapter breakdown | 42-43 |
| | |
| 2. Chapter Two: The Legal Framework Governing lending by banks in Kenya | |
| An overview of the legal framework governing banks in Kenya | 44-46 |
| The definition of Banking and Banking Business | 47-50 |
| The Banker-Customer Relationship | 50-53 |
| An assessment of the articles of the Constitution of Kenya | 53-55 |
| An assessment of the provisions of the Banking Act | 55-69 |
| An assessment of the provisions of the Central Bank of Kenya Act | 69-71 |
| An assessment of the provisions of the prudential guidelines and banking regulations | 72-82 |

| | |
|---|---------|
| An assessment of the provisions of the Consumer Protection Bill 2011 | 82-85 |
| An overview of the Consumer Protection provisions governing the lending industry in the United Kingdom | 85-89 |
| An assessment of the provisions of the Banking (Amendment) Bill 2011 and the Kenya Deposit Insurance Bill 2011 | 89-91 |
| Chapter two conclusion | 92-93 |
| | |
| 3. Chapter Three: The institutional Framework governing lending by banks in Kenya | |
| Outline of the institutional framework governing the Banking and financial sector in Kenya | 94-96 |
| An assessment of the role and mandate of the Central Bank of Kenya | 96-106 |
| An assessment of the role and mandate of Credit Reference Bureaus and the Consumer Federation of Kenya | 106-111 |
| An evaluation of the institutional framework of alternative jurisdictions | 111-114 |
| An evaluation of the institutional framework in the Consumer Protection Bill 2011 | 115-116 |
| An assessment of the provisions of the Kenya Deposit Insurance Bill 2011 and the Banking (Amendment) Bill 2011. | 116-117 |
| Chapter Three Conclusion | 117-118 |
| | |
| 4- Chapter Four: Presentation and analysis of Primary Research Findings | |
| 4-1 Introduction | 119 |
| 4-2 Research Method | 119-120 |
| 4-3 Discussion and analysis of Research findings | 120-129 |
| 4-4 Summary of Research findings | 129-131 |

Chapter Five: Research Conclusion and Recommendations

| | | |
|-----|---------------------|---------|
| 5.1 | Research Conclusion | 132-136 |
| 5.2 | Recommendations | 136-140 |

| | | |
|-----------|---------------------|----------------|
| 6. | Bibliography | 141-147 |
|-----------|---------------------|----------------|

t **CHAPTER ONE: INTRODUCTION**

The 'Consumer Society' is often portrayed as a phenomenon of the 20th and 21st Centuries.¹ Over the years, there has been regulation in respect of essential items such as bread, ale and fuel². It is arguable that much of the earlier legislations was directed at achieving 'fair trading' as opposed to 'consumer protection' and that key attempts at protecting the consumer developed following World War II, as society became more affluent.*

Both the consumers and credit products⁶ are key components of economic growth?. Laws, rules and regulations on consumer protection are specifically

¹ The 'Consumer Society' is described as a marketplace or society that is driven by 'consumer' requirements and needs, Chuah J and Furmston M (2010), *Commercial and Consumer Law*, Harlow: Pearson Education Limited at page 376.

² For example Acts within the United Kingdom Jurisdiction such as the Merchandise Marks Acts 1887-1953 which preceded the Trade Descriptions Act 1968, which was in turn replaced by the Consumer Protection from Unfair Trading Regulations 2008. All these were aimed at protecting consumers from unfair trading practices.

³ Such as the Trade Descriptions Act 1968 and the Unfair Trading Regulations 2008. In Kenya, there exists the Sale of Goods Act, Chapter 31 of the Laws of Kenya which governs the Contract for Sale and Transfer of Goods to a buyer. The provisions deal with *inter alia* the sellers obligations, performance of the contract by the parties and remedies available in the event of breach of contract. Having reviewed Chapter 31, it is my considered view that the provisions within the Act are more geared to restricting the seller from engaging in unfair practices when entering the Contract of Sale of the goods and/or transferring title to the buyer as opposed to consumer protection. Notably, there is no similar act governing the provision of services in Kenya.

⁴ A Offer (2007) , *The Challenge of Affluence: Self Control and Well-Being in the United States and Britain since 1950*, Oxford University Press: Oxford at page 1 cited in Chuah J and Furmston M (2010), *Commercial and Consumer Law*, Harlow: Pearson Education Limited at page 377.

⁵ Reference is made to the dictionary definition provided in note 1. Legally, there is no single definition for the term 'consumer' but in general terms, legislation is concerned with those who buy goods and services for private purposes and not business purposes (Chuah J and Furmston M (2010)), *Supra note 1* at page 376. For purposes of this thesis the term 'consumer' means an individual who has borrowed money from a bank by way of a personal loan, overdraft and/or business loan for their private consumption even if such consumption entails the pursuit of a business venture.

⁶ The research conducted is largely limited to three types of loans being personal loans, overdrafts and business loans borrowed from banks. These are also termed as credit products. However, it is recognized that there are other types of loan products provided by banks such as mortgages, which are excluded from the research because the laws and regulations governing banking such as the Banking Act, Cap 488 of the Laws of Kenya appears to treat Mortgages and Mortgage Finance Companies differently. Given this, it is my considered view that separate research ought to be conducted on the mortgage finance industry, which arguably faces its own unique challenges, which are outside the scope of this research. Chapter two further elaborates and assesses the legal provisions governing lending by banks, pointing out in brief how mortgages and mortgage finance companies are distinguished.

[^]On the week commencing August 1, 2011, banks such as Barclays Bank Kenya Limited, Kenya Commercial Bank Limited and Co-operative Bank Limited reported significant growth in half year profits and attributed the growth to increased earnings from loans (recorded in

concerned with persons who can be defined as 'consumers'.⁸ Regulation 3(1) of the Unfair Terms in Consumer Contract Regulations 1999 provides that a consumer is one who buys goods and services for private use. The Molony Committee on consumer protection defined a consumer as one who purchases (or hire purchases) goods for private use or consumption. More recently, the definition of a consumer has been broadened to include *anyone* who consumes goods or services at the end of the chain of production, whether they have procured it or not.¹⁰ In the financial sector, a consumer may therefore be defined as a person who purchases financial services¹¹ for their own personal use in line with the Molony Committee definition.

It is arguable that individuals as well as businesses increasingly use and offer credit to trade and purchase goods and services that they require. Richard Etemesi¹², then Chairman of the Kenya Bankers Association, expressed a view that the banking sector in Kenya had made tremendous contribution to the growth of the credit market¹³. Media reports indicate that the credit industry in Kenya has gradually, over the years, opened up to the middle class earners.¹⁴ The role, increased importance of lending by banks or other lending institutions and potential growth of the lending industry in Kenya is

the Daily Nation of August 2 and 3, 2011 at the Business News Section). Although the measure of economic growth is not solely dependent on the increase of lending, it is arguable that such increase in lending increases the spending power of borrowers in that they are empowered to purchase goods and services that they perhaps were unable to afford without financing through loans. This in turn stimulates the economy because demand for goods and services increases and supply in turn increases to respond to such demand in the process affecting other economic growth indicators such as level of employment. This thesis merely highlights the general importance of lending in society however, its specific effects and its role as an indicator of economic growth is outside the scope of this thesis.

⁸ Chuah J and Furmston M (2010), *Supra note 1* at page 383.

⁹ Diamond A (1963), *The Molony Committee Final Report of the Committee on Consumer Protection*, *The Modern Law Review*, Vol 26 No 1 at page 66-75 at paragraph 2. This was a committee appointed to consider measures 'desirable for the further protection of the consuming public'.

¹⁰ Harvey B and Parry D (2000, 6th edition), *The Law on Consumer Protection and Fair Trading*, London: Lexus Nexus UK at page 8.

¹¹ Financial services in general refer to services provided by the larger finance industry, which encompasses a broad range of organizations that deal with the management of money. Among these organizations are banks, credit card companies, insurance companies, consumer finance companies, stock brokerages, investment funds and some government sponsored enterprises. This Thesis is limited to personal loans, business loans and/or overdraft lending offered by banks.

¹² Advertising Feature of the Daily Nation, September 2 2010 at page 1

¹³ *Ibid*

¹⁴ Recorded in the Daily Nation of August 2 and 3, 2011 at the Business News Section, *Supra*

recognized and appreciated, more so following the licensing of Credit Reference Bureau Africa and other Credit Reference Bureaus¹⁵, which are mandated to make consumer information more accessible to subscribing third parties such as lending institutions. The specific economic effects and measure of economic growth attributed to increased lending is outside the scope of this research. Given the recent developments and potential within the lending sector, there is increased need for effective regulation. However, this research is limited to consumers of credit products offered by banks as hereinbefore defined.

1.i Statement of Problem

The reasons put forward for the special treatment of consumers include *inter alia* the fact that laws, rules and regulations promoting consumer protection prevent (or at least reduce) unfair trading practices by suppliers therefore serving as preventative tools.¹⁶ It is argued that these laws, rules and regulations make it possible for consumers to pursue enforcement action against suppliers of services for loss suffered as a result of that supplier's unfair practices¹⁷. Perhaps the most important reason for protecting consumers is to redress some of the imbalances contained within the market such as information asymmetry and lack of a variety of products and services¹⁸, all of which usually work in favour of the suppliers leaving the consumer disadvantaged. ^

This research asserts that consumer protection is typically achieved through laws, regulations, codes of ethics and actions usually involving the intervention of governments and/or players in the industry designed to ensure that the consumers obtain what they would want *if* they were fully informed

¹⁵ Regulation 3 of the Banking (Credit Reference Bureau) Regulations, 2008 establishes and licenses the Credit Reference Bureaus to operate bureau business in Kenya. The bureaus activities in Kenya include, obtaining customer information; the storage, management, evaluation, update and dissemination of customer information to subscribers; the compiling and maintaining of a database to generate a report from customer information therefrom; the assessment of a customer's credit worthiness amongst others.

¹⁷ *Ibid*¹⁷ J and Furmston M (2010) > *Supra* note 1, at page 384

Ibid at page 384 and 385

¹⁹ *Ibid* at pages 384 to 387

but subject to limitations on their income²⁰. It is arguable that an Act of Parliament effecting consumer protection²¹ is one of the most important socio-economic legislations for the protection of consumers because it is compensatory in nature²². Lakshminath and Sridhar²³ assert that this is because the objective of the Act would be to provide simple, speedy and inexpensive redressal to the aggrieved consumers, reliefs of a specific nature and award of compensation wherever appropriate. It is proposed that any consumer protection Act should seek to protect the consumer's rights to *inter alia* accurate marketing, sufficient and adequate information, acceptable quality, fair trading practices, competition, consumer protection and limiting consumer exploitation.^{24*}

Given the foregoing, the statement of problem that this research seeks to address is that the current laws and regulations governing lending by banks in Kenya do not adequately protect the rights of borrowers of bank credit products²⁵ in Kenya. It considers and argues that some of the real issues experienced by borrowers of bank credit products in Kenya which are not addressed by the current laws, rules and regulations include banks engaging in misleading advertising and marketing of their credit products; bank representatives providing inaccurate information on the credit products sought; non disclosure of material terms and conditions; bank representatives failing to provide borrowers with information that is material to the credit agreement; bank representatives engaging in unfair practices to include providing misleading or deceptive information to borrowers; banks arbitrarily increasing their interest rates and lack of borrower education. This research views these loopholes contained within the existing legal framework to be of

²⁰ This assertion is supported by Harry B and Parry D (2000, 6th edition), *Supra* note 10

Such as the United Kingdom Consumer Protection Act 1987. In Kenya, there is a move towards attaining a single Consumer Protection Act. The Consumer Protection Bills dated 2007 and 2011 have however not yet been enacted into law.

²¹ Ukshminath A and Sridhar M (2007, 10th edition) *Ramaswamy Iyer's: The Law of Torts* New Delhi: Lexis Nexus at page 1005.

²³ *Ibid*

²⁴ *Ibid* at page 1006.

²⁵ These credit products as described before are limited, for the purposes of this research to personal loans, business loans and overdrafts offered by banks. The borrowers of these credit products for the purposes of this research are also referred to as consumers of credit products offered by banks.

great concern particularly given the increased role of credit in Kenya today.²⁶ Further, this research considers and views as a problem the ineffectiveness and inefficiency of institutions governing lending by banks in Kenya which is as a result of inadequate legal provisions. It is argued that because the laws, rules and regulations governing lending by banks are fraught with regulatory gaps and shortcomings, it is questionable to what extent the institutions that are required to enforce such provisions to protect borrowers are empowered to effectively and efficiently do so.

This research argues that the provisions dealing with the protection of the borrower of credit products and institutions enforcing such provisions ought to be reviewed. Through the conduct of primary research, this research investigates the issues experienced by borrowers with a view of highlighting the inadequacies of the existing legal and institutional framework. A study by the Central Bank of Kenya in 2007²⁷ on bank charges and lending rates revealed that there was mistrust and low level of awareness by consumers, lack of clear information being disseminated to consumers at the initial stages, perceived high bank charges, lack of transparency in costs and a product driven approach by banks rather than a market or consumer driven one. This research asserts that the position remains the same four years later and considers this to be a problem.

1.2 Justification for the Research

This research is based on the premise that that some level of consumer protection in any industry is not only important but is also necessary. It is debatable that one of the primary reasons for legislative intervention in favour of the consumers is that there may be information deficiencies that result in

²⁶ Research conducted by Financial Sector Deepening (FSD)- Kenya in 2009 and titled Chapter 1: Financial Inclusion: Recent Developments and Lessons from Kenya by David Ndihi highlight that access to banks by the adult population had increased from 26 to 41% between 2006 and 2009. Further, the study found that access to bank credit increased from 1.7% to 12% of the banking population (12%). [accessed on 21, 2012] http://www.centralbankofkenya.org/finaccess/documents/finaccess_results_analysis.pdf

²⁷ The study by Central Bank of Kenya and titled Survey on Bank Charges and Lending Rates conducted in December 2007 and can be found on http://www.centralbankofkenya.org/pdfs/documents/08-03-20_Survey_on_bank_charges.pdf

inefficient markets. Further, it may be argued that for a consumer to make an informed decision, they should be in possession of all the information necessary for them to make a rational choice. In order to achieve this, the law requires that suppliers and traders behave in a certain manner and provide consumers with certain information before any contract is entered into.²⁸

In Kenya, there exist laws such as the Sale of Goods Act²⁹, which require sellers or buyers of goods to act in a certain manner and provides for their rights in the event of breach of a contract for the sale and transfer of goods. 30 There also exist laws governing banks such as the Banking Acts³¹ which contain provisions that seek to protect banking customers in general by putting in place minimum standards which the banks ought to comply with failing which they risk revocation of their licenses and/or fines imposed by their regulator, the Central Bank of Kenya. This thesis argues that such laws, in particular banking ones which are the subject matter of the research, are inadequate in protecting the consumers of bank credit products or borrowers against issues that may adversely affect the consumers such as information asymmetry (disclosure), lack of transparency in bank and interest charges and unfair practices and ought to be reviewed accordingly.

The Constitution of Kenya was promulgated in August 2010 and is now in the process of being implemented. Article 2 of the Constitution stipulates that it is the supreme law in Kenya and that any law that is inconsistent with it is void to the extent of the inconsistency. Given this, all legal provisions, including banking ones ought to be reviewed to align them to the new constitutional dispensation. Further, article 46 entrenches consumer rights and requires that parliament enact legislation to provide for consumer protection and for fair, honest and decent advertising. The entrenchment of consumer rights signifies the importance of the concept. This research makes recommendations that ought to be considered when reviewing laws and regulations governing

* Chuah J and Furmston M (2010), *Supra* note 1, at page 378.

³⁰ Section 31 of the Laws of Kenya

³¹ The Banking Act also elaborates on what is to be considered a contract for the sale of the services of services (as opposed to goods) to act in a similar manner. Chapter 488 of the Laws of Kenya

lending by banks in order to achieve increased consumer protection in line with the provisions of the new dispensation. Having regard to the statement of problem that this research seeks to address and the process of implementing the provisions of the Constitution to include the review and enactment of laws, it is arguable that this research is relevant, timely and justifiable.

j« Assumptions and Limitations

I have made a number of assumptions whilst undertaking this research, some of which are fundamental. These assumptions have largely emanated from constraints associated with the conduct of the research to include available timescales, geographical location, budget and word limitation amongst others. It is not practicably possible within these constraints to conduct one research on consumer protection in all geographical settings and on consumers of all types of products and services worldwide. The research is therefore limited to consumers or borrowers of credit products offered by banks in Kenya.

Some of the fundamental assumptions I have made include firstly, that the income levels of the participants of the focus groups, being one of the vehicles through which primary research was conducted, are largely similar within the selected age brackets and that their borrowing preferences and risk appetite are also largely similar within that age bracket irrespective of the individual's social background. Secondly, I have assumed that the views of the focus group representatives are representative to the views of all borrowers nationally irrespective of their circumstances or location. Thirdly, I have assumed that there are no fundamental differences between the composition of loans and overdrafts offered by different banks. Fourthly, I have assumed that bank credit products are accessible in the rural areas in the same nature, extent and consistency as in the main cities.

Further, in addition to the limitations on geographical scope, budget, timescales and word count, this research has other limitations which include the fact that the participants of the focus groups were working and living in Nairobi and its outskirts only. Further, insider information on the credit Procedures followed by the banks proved difficult to obtain from the

employees of the banks because they feared losing their jobs for breaching their duty of confidentiality to their employer. The banks' employees were guarded when providing this information or sought anonymity. In addition, at the time of conducting the research and writing the thesis, there is ongoing parliamentary debate on proposed bills such as the Banking (Amendment) Bill 2011, the Kenya Deposit Insurance Bill 2011 and the Consumer Protection Bill 2011 which have not been concluded. This thesis therefore analyses the contents of these bills in as far as they provide for the protection of borrowers of bank credit products and does not take into consideration the views and opinions surrounding the ongoing parliamentary debate.

1.4 Research Objectives

The main research objective is to extensively review the existing legal and institutional framework governing lending by banks in order to identify and highlight any existing shortcomings in the protection of the rights of borrowers of bank credit products and recommending relevant changes.

The specific objectives of the research are to;

- a) Identify and conduct a review of the current legal and institutional framework governing lending by banks in Kenya³².
- b) Establish existing regulatory gaps, overlaps and shortcomings that exist within the existing legal and institutional framework in so far as they deal with and provide for the protection of borrowers or consumers of bank credit products³³.
- c) Conduct primary research into how bank representatives deal with and process credit applications submitted by prospective borrowers, in

³² review include the review of existing Statutes, Bills and instruments forming and mandating institutions governing the banking sector

This is done through identifying key aspects of lending that remain largely unregulated for example the issue of banks increasing interest rates; capping of charges or fees imposed by mandatory information that ought to be provided to a borrower prior to signing the framework. I name a few. For comparative purposes, I will compare the Kenyan legal provisions dealing with the protection of borrowers against other jurisdictions such as the United Kingdom, Canada and Australia.

particular, the information provided to such borrowers from the outset.³⁴

- d) Contribute towards the ongoing deliberations on consumer protection given the entrenchment of consumer rights in the new constitutional dispensation and subsequent review of the existing statutes and enactment of new laws in compliance with the provisions of the Constitution.

1.5 **Theoretical Framework**

1.5.1 Historical Background

The law of contract plays some role in the protection of consumers through providing legal redress on issues that may adversely affect the consumer such as misrepresentation, implied terms of contract and exclusion clauses to name a few. The law of contract is based on the concept of equal bargaining power where it is assumed that parties to a contract are deemed to be capable of negotiating terms that are fair to themselves.³⁵ It is arguable that this assumption is untenable because in the case of many products and services the sellers and suppliers can easily dictate the terms to the consumers and they assume the attitude of 'take it or leave it' thereby placing the consumer in

³⁴ This is done through focus groups and personal interviews using questionnaires as the research instrument. The objective of the primary research is to observe and highlight how bank representatives deal with the applications submitted by prospective borrowers for loans and overdrafts. Of particular concern to this research is the information disseminated to the prospective borrowers before they execute the contract. The reason for this is that this research acknowledges that adequate and accurate information ought to be provided to prospective borrowers at the outset to enable them make an informed decision, which ought to be respected.

³⁵ In the decided case of *Kyangavo -v- KCB Ltd and Another* HCC No 428 of 2001 the courts held that contracts are between parties and the courts construe them and arbitrate disputes touching and concerning such contracts. Further, it was held that the courts do not make contracts for parties and the parties are at liberty to negotiate whatever conditions they like. Where a party found a condition to be harsh or unfair, that party was at liberty to reject it. The court confirmed that once terms are agreed upon between the parties, it was unfair for one party to claim that condition is unfair. From this, it is debatable that the court presumes equality in bargaining power in as far as negotiation and entering into a contractual agreement. This position is however untenable because in many cases, a consumer is not a

owed to negotiate contract terms and has to accept the terms set out by the supplier because they need to goods and services on supply notwithstanding that such terms may not always be in their best interests. Other cases where the courts have made similar rulings are *Muiruri, Margaret Njeri -v- Bank of Baroda* Civil appeal No 9 of 2001 to name a few.

a very difficult position and in a disadvantaged bargaining position given that they require those goods and services and they may not be able to do without them. Further, within the law of contract, there applies the doctrine of *privity of contract*. This doctrine provides that a contract cannot confer or impose rights or obligations arising under it to any person who is not a party to it. Under strict application of this doctrine, only parties to the contract can benefit from the contract. This limited application of the contractual relationship leaves persons who are not party to a contracts⁶ outside the doctrine. This being the case, consumer protection, in particular where the ultimate user or consumer of a good or service is not the one who procured it or is not party to the contract for sale, is outside the doctrine. As a result of these glitches with the law of contract, tort law and other types of law besides contractual law have over time been developed to protect a consumer.³⁷

A tort is defined as a civil wrong which gives rise to an action at common law for unliquidated damages.³⁸ An example of such a civil wrong relevant to this research is negligence. A consumer (for purposes of this research read a consumer or borrower of bank credit products) affected by an act of negligence of the bank or its representatives may seek redress if they can prove that given the facts available, the bank at the time of transacting owed them a duty of care to ensure that they did not suffer loss or damage, secondly, that this duty was breached and thirdly, as a result of the breach, the consumer or borrower of bank credit products suffered a loss. This provides for another cause of action in addition to breach of contract in which the aggrieved consumer may seek remedy. The right of an action in tort springs from breach of a duty which a person owes to another.³⁹ The remedies in tort therefore are wider than those in contract because although there may be no privity of contract between the consumer and the supplier of services or seller of goods, such supplier or seller may still be held liable for negligence.

or example persons who ultimately use a product even if they have not procured it and are not Party to a Purchase agreement
 f j TM W J > Maher L, Mckeough J and Pearson G (1997, 5th edition), Consumer Protection
 3*Ja v Federation Press -
 192^o
 39^o *Ibid* ¹ (2005, 3rd edition), *The Law of Kenya*, Nairobi: Kenya Literature Bureau at page

It is arguable that consumer protection solely under the law of tort is also not adequate and poses challenges to the aggrieved consumer because for the consumer to succeed in such action, they have to prove the essential elements of tort⁴⁰. These essential elements are that there was an existing duty at the time a breach of that duty occurred and that *that breach* resulted in a loss to the consumer. The onus of proof under the law of tort is on the consumer. Further, as part of private law, the consumer themselves have to take on the action which may be prohibitive to the consumer in terms of costs and time. In addition, an action by the consumer under tort could fail because of a number of defences⁴¹ available to the seller or supplier of the goods or services.

The concept of consumer protection has now developed beyond the confines of the laws of contract, tort and the doctrine of privity of contract. In some jurisdictions there are statutes designed to specifically protect the consumer such as the Consumer Protection Act 1987 and the Consumer Credit Act 1977 (as amended in 2006) in the United Kingdom. These outline the statutory rights of the consumers in general with the latter statute specifically addressing the rights and protection of borrowers. In Kenya, certain statutes have been enacted which indirectly protect the consumers or regulate products or services such as the Trade Description Act which controls business activities at large in so far as they involve descriptions of goods or services, the Standards Act in which the Kenya Bureau of Standards is set up to promote standardization, inspect goods and ensure that they comply with certain specifications to name a few. Subject to draftsmanship, it may be argued that statutes that specifically address consumer protection are likely to provide for a higher level of protection because they are prescriptive, prohibitive and protective in nature and they carry sanctions which are to be enforced as penalties against non-conformers. Such statutes are public law measures and the state places positive duties on providers or sellers of certain services and

41 ^{Jane*} Furmston M (2010), *Supra* note 1, at pages 384 to 386.

nese defences insofar as credit services may include *volenti non fit injuria* being that the consumer or plaintiff in the cause of action both knew of the risk they were undertaking and ungly consented to undertake such risk or where the consumer is alleging deceit, the P viaer or supplier of credit services may allege that they made a genuine mistake when they Performed the alleged action.

goods and it uses a machinery to detect non-confirmers and proceeds to prosecute culprits.

Notably, in Kenya, there is no single Act dealing with consumer protection. There however exists the Consumer Protection Bill 2011, which was drafted following the failed attempt to enact the Consumer Protection Bill 2007. The 2011 Bill is yet to be enacted into law⁴². Consumer rights are also now entrenched in article 46 of the recently promulgated Constitution of the Republic of Kenya which states that *inter alia* goods and services are required to be of reasonable quality and suppliers are required to provide information that is necessary for the consumers to gain full benefit from the goods and services. This signifies the increased importance and necessity of consumer protection in today's world.

1.5.2 Theoretical and philosophical framework of consumer protection.

There are several theories and philosophical frameworks that underpin consumer protection and this research. These include;

a) The Theories of Consumer Sovereignty and Consumerism

Consumer protection is premised *in part* on firstly, the theory of consumer sovereignty. The lead economist, Adam Smith, cited by Brian Harvey and Deborah Parry⁴³ stated that 'the interest of the producer ought to be attended to only so far as it may be necessary for promoting that of the consumer.' This is the essence of consumer sovereignty and even if these sentiments were aired by Adam Smith in the 18th Century, they still ring true to some extent. On a number of occasions in today's free market economy, producers of goods and services have often had to adjust to changing consumer preferences. To propounders of the theory of consumer sovereignty, the consumer is *at all times* sovereign to the producer and should be protected. Consumer

² In particular, section VII of the Bill specifically deals with consumer credit. The Bill, *inter alia* seeks to make it an offence to provide false, misleading or deceptive representation in documentation explaining the benefits of the goods or services provided, including credit. It also provides for standard disclosure in that the financial providers, disclosure of brokerage to charges amongst other things within the consumer lending regime. The Bill seeks to prescribe procedures for consumer remedies under Part IX.

⁴³ Parry B and Parry D (2000, 6th edition), *Supra* note 10 at page 11

sovereignty dictates that in an ideal free market, the consumers should ultimately dictate what is to be produced or provided. For the purposes of this research based on the theory of consumer sovereignty, the consumer's financial preferences ought to dictate the type of credit products that are offered by banks. Through their spending decisions, individual consumers arguably control both the allocation and distribution of financial services. 44

There are dissenting views articulated by some theorists such as Galbraith, also cited by Brian Harvey and Deborah Parry⁴⁵ who state that the control which the consumers exercise is not absolute as expressed by the agitators of the consumer sovereignty theory. The dissenting theorists argue that consumer sovereignty is *a matter of degree* because the state even in a mixed economy can greatly affect the spending behaviour of consumers by its own spending for example in the increase of excise duties on products such as tobacco, alcohol, public health amongst others. These actions in turn inevitably impact on prices and demand, which affects supply. This is known as the economic context of consumerism.

Consumerism encompasses the economic theory of consumer behaviour, which largely supports the dissenting views on consumer sovereignty. The economic theory of consumer behaviour stipulates that consumer spending behaviour is drawn on a much larger canvas, negating the assertions that the consumer is *at all* times superior to the producer, which is the theory of consumer sovereignty. Pursuant to the economic theory of consumer behaviour or consumerism, it is argued that the nature of a household's demand can be explained on the basis of three hypotheses⁴⁶. Firstly, it is supposed that the demand is influenced by the price of that commodity and

⁴⁴ Saving J.L, Consumer Sovereignty in the Modern Global Era. Journal of Private Enterprise, Fall 2006.

⁴⁵ Harvey B and Parry D (2000, 6th edition), *Supra* note 10 at page 12

⁴⁶ *Ibid* at page 8 outlines that there are unrealistic assumptions made about the households when constituting the economic theory on consumer behaviour resulting in major flaws in the theory. Households are defined as comprising of a group of consumers. It is assumed that these households are consistent in decision making (which is not always the case), that they know what they want, they act rationally, that they desire their wellbeing or 'satisfaction' or utility' (that is the best value for money or the best return for their expenditure), that they operate in a competitive market where there is a diversity of sellers that is, not a monopoly or oligopoly as is sometimes the case and that buyers prevent any one of them being able to greatly influence price.

the price of other alternative goods assuming that such alternative goods are available and that income and preferences are kept constant. Secondly, there is a presumption that the rise in income and the rise in demand are inextricably linked in that a rise in income is associated *normally* with a rise in demand.*? Thirdly, it is assumed that the demand for a commodity is dependent on the preferences and taste of the household, which is a very real factor insofar as marketing and advertising of goods and services.

A further objection to the idea of consumer sovereignty is the argument that there is an artificial want created by the marketing and advertising media which manipulates the preferences and tastes of households. The responsive legal control on marketing to include a requirement for the provision of accurate information is therefore necessary. This ensures that the consumer's knowledge on the products and services is apt facilitating them with the necessary information to make an informed decision on whether to purchase the goods and services being advertised. This objection to the idea of consumer sovereignty therefore inadvertently supports the notion of consumer protection. It is arguable that consumers are sovereign so long as they know what they want and are able to act upon their desires without limitation or external influences. If consumers are tricked into making purchases that do not satisfy their requirements through false advertising or deceitful business practices, then the consumers might not be the rulers of the economic realm.⁴⁸

To ensure consumer sovereignty, the consumers should be assured of their rights including a right to be informed or educated, safety, choice, an avenue where the consumer's grievances can be heard, a right to seek redress on grievances to name a few. Regulators and players within the financial sector should ensure that there exist laws, policies, regulations, practices and codes of ethics to ensure the protection of a consumer. Consumer protection is a

in ' Create exceptions to this where say a household is very well off and therefore an increase in income does not affect their spending habits or demand as they were already enjoying the goods and services on offer prior to the increase.
48 w^oiHf ^ro^ucts and services
q^ ato8el» Joel, Does consumer irrationality Trump Consumer Sovereignty? Evidence from Own Purchases (October 2002). Available at SSRN: <http://www.ssrn.com/abstract=337261> or doi:io.2i39/ssrn.337261.

public good which will not be available in optimal quantities without government intervention where there is inequality in bargaining power, poor information dissemination, a lot of externalities and lack of quality assurances⁴⁹

The theories of Consumerism and Consumer Sovereignty are applicable and relevant to this research because they, like the underlying supposition of this research, are based on the premise that consumers in general *ought* to be protected. The starting point in the conduct of this research is that the borrower or consumer of bank credit products ought to be protected because of amongst other inefficiencies in the market, their vulnerable or disadvantaged bargaining position when compared to banks. Further, this research acknowledges that it is necessary for the government to step in or intervene to deal with or correct market imbalances such as information asymmetry because the market is unable to do this on its own. That notwithstanding, this research recognizes that the consumer is not sovereign at all times and that only selected issues on consumer credit should be addressed within the legal framework. It acknowledges that consumer sovereignty is a matter of degree however, a consumer who is well informed as a result of mandatory statutory obligations imposed on the bank requiring them to provide amongst other things, accurate and adequate information on a particular credit product will be better protected and better placed to make an informed decision which *ought* to be respected.

Insofar as consumerism and the economic analysis of consumer behaviour, this research acknowledges that external factors beyond legislation affect consumer behaviour. Many of these external factors which include preferences, income and geographical location to name a few have been kept constant during the conduct of the research and are cited as assumptions and/or limitations of the research.

⁴⁹Sylvia Lane, (2005), The Rationale For Government Intervention In Seller-Consumer Relationships, Review Of Policy Research. Volume **2** Issue **3**. Pages 419 - 428.

y The Economic analysis of the law and Utilitarianism

Justice Oliver Wendell Holmes Jr. cited in Bix⁵⁰ stated that '*for the rational study of law the black letter man may be the man of the present, but the man of the future is the man of statistics and the master of economics*'. The economic analysis of laws¹ stipulates that there is a sense in which the law correlates with economics thereby presenting a vital practical approach which should be used to evaluate a legal instrument or provision. When conducting a review or analysis of laws, one should ask whether a proposed change will reduce the evil in question or whether there might be adverse long term effects that may harm the group one is trying to protect. For the purposes of this research, it is crucial that when assessing whether the existing laws and regulations are adequate in achieving their purpose of protecting the consumer or borrower of bank credit products, the theory of the economic analysis of law is appropriately considered.

The economic analysis of law is grounded in part on utilitarianisms². 'The greatest happiness for the greatest number' is a maxim⁵³ that was adopted by Bentham to popularize this philosophy which argued that the happiness of a community is increased if the total of all the pleasures of all its members is amplified to a greater extent than their pains. Bentham listed fourteen pleasures and twelve pains as a comprehensive account of 'happiness-relevant consequences.'⁵⁴ Bentham however recognized that a measure which greatly increases happiness of a few even though it marginally diminishes the

⁵⁰ Bix B (2006, 4th edition), *Jurisprudence: Theory and Context*, London: Sweet and Maxwell at page 189.

⁵¹ Some of those who propounded the economic analysis of law include amongst others Ronald Coase (1910) with the Coase theorem which stipulates that the efficient distribution of goods depends on a free market where activities respond to prices and costs without the distortion of subsidies which reduce the cost of production resulting in more of the goods being supplied than would otherwise have been the case. Other theorists include Richard Posner.

⁵² This theory was propounded and popularized by Bentham. The theory holds that morality requires doing whatever would maximize the sum total of pleasure, that is utility but minimize the sum total of pain.

Cited in Harris J.W. (2nd Edition, 2004), *Legal Philosophies*, Oxford: Oxford University Press at pages 40 to 45.

⁵³ Bentham argued that the measure of value of each pleasure or pain was to be referred to seven criteria being intensity, duration, certainty, propinquity (nearness or Proximity), fecundity (richness or productiveness), purity and extent. He advanced the principle of utility as the proper basis for both morality and legislation.

piness of many and contrary to the maxim adopted, may have been
itifiable by the principle of utility.

In addition, there are other objections that arose from the theory of utilitarianism⁵⁵ being that firstly, no-one is in a position to know all the consequences of their actions. The moral objections and opinions after one has committed an action provide more practical guides to that particular action. In such a case, the consequence or moral judgments/effects on the community are known following the action. Secondly, the pleasures and pains of different people are not commensurate or matching in nature. Balancing these different effects in order to achieve 'the greatest happiness for the greatest number' may prove to be a challenge. Thirdly, it is arguable that the satisfaction of all human desires including those that are unethical, gross or cause suffering should not be the aim of our morality. Fourthly, human desires and satisfactions are capable of manipulation through means such as advertising or education posing doubt on the extent to which desires can be determined by the principle of utility. Lastly, it is not easily determined whose interests are in question. There may be various utilitarian solutions to a need depending on who is counted as being part of the so-called community whose pleasures and pains are being considered. As a result of these, in my considered view, justified objections to utilitarianism, it is not prudent for law makers to base their legal analysis or assessment of the adequacy or efficiency of an existing legal framework entirely on the principle of utility.

The economic analysis of the law attempts to deal with some of the aforementioned objections. Whilst Bentham spoke of the greatest happiness of the greatest number, the economic analysis of law looks for the most economically efficient solution to society's needs. The economic analysis of law tries to maintain the advantages of utilitarianism by looking at the practical and economical side of law (as opposed to providing value judgments on Pleasures and pains) while losing the disadvantages of being unworkable^r social reasons. The economic analysis of law defines desires by actions of

⁵⁵ *Ibid*

the members of a community and it defines levels of desires by how much one is willing to pay.*6

Richard Postner (1939 -) was one of the most influential figures in the law and economics movements?. He argued that the underlying rationale of common law adjudication is economic in nature⁸. The true basis of legal prohibition according to Postner is economic efficiency.⁵⁹ The important issue according to Postner's argument is that legislation and rules produced should be efficient. Therefore, a review or analysis of any laws including those in consumer protection according to Postner must be based on the principle of efficiency, that is, consideration of the effect such review or analysis will have on the economic forces of the market.

The theory on the economic analysis of the law is not without flaws. For example, it is often difficult to adopt an efficient and/or economical approach to law in more sensitive areas of social interaction. Postner appears to equate justice with wealth maximization for the community and overall supply and demand⁶⁰. Increasing wealth for the society is not always a moral good and it is often difficult to justify the sacrifice and suffering of some members of society on the basis of an increase of wealth for others. Layton and Holmes⁶¹ argue in support of Postner in that where legislation is concerned, more is not necessarily better because of implementing and transaction cost implications⁶².

⁵⁶ Bix B (2006, 4th edition), *Supra* note 50 at page 192.

⁵⁷ *Ibid* at page 200.

⁵⁸ Harris J.W. (2nd Edition, 2004), *Supra* note 53 at page 48.

⁵⁹ For example, Postner explained that laws penalize a thief not because the theft is morally or in some non-economic sense wrong but because it wishes to persuade such a thief to use the market. Further, he argued that whether the law penalizes through tortious liability or criminal sanction is a question of technique.

⁶⁰ Harris J.W. (2nd Edition, 2004), *Supra* note 53

⁶¹ Cited in Harvey B and Parry D (2000, 6th edition), *The Law on Consumer Protection and* London: Lexus Nexus UK at page 26.

ney argue that the total cost of corrective action within society is made up of at least three elements namely, the transaction costs the consumer incurs in terms of inconvenience, risk and changing time all of which are presumed to increase with the extension of legislation, the net benefit of the legislation and the actual cost incurred by the business in complying with the legislation. Further, they argue that these additional costs are ultimately borne by the consumer one is trying to ultimately protect.

This research aims to review the laws, regulations, policies and practices within the lending industry by banks in and thereafter make recommendations or proposals for variation or changes to such laws, where it is deemed necessary in order to achieve increased consumer protection. The economic analysis of the law, which is grounded in part on the theory of utilitarianism, is therefore an appropriate and relevant theory for the conduct of this exercise because as highlighted by Layton and Homes⁶³, when assessing any legal provision on consumer protection, one must consider the overall *cost implications* of regulation and seek to establish a balance between reducing exploitation of the consumer by suppliers and overprotecting them, which yields the *minimum social cost* to the community.

Overprotection of the consumer has repercussions in that the prudent and economically or legally aware consumer would spend much time and energy trying to establish the relevant laws, regulations and provisions governing and affecting their protection. This effort according to the economic analysis of law amounts to a cost to society. On the other hand, it is arguable that the consumer who is not economically or legally aware may be unbothered about the numerous enacted provisions making them unworthy or lacking in economic benefit. Further, relevant to this research, banks and other institutions within the lending sector would be required to incur heightened implementation and compliance costs of overprotective laws, which may prove uneconomical.

This research when looking into the adequacy of the provisions relating to the protection of the borrower or consumer of bank credit products will consider whether it is effective to add additional legal provisions to the existing consumer protection laws within the banking sector. It will also look into whether there is a need to consolidate consumer protection laws in general in order to avoid regulatory overlaps, which may prove time consuming and therefore costly to the consumers when they are trying to establish their rights and the banks when they are attempting to comply with and apply the numerous provisions. This research project will also look into whether the

⁶³ted m Harris J.W. (2nd Edition, 2004), *Supra* note 53.

existing laws, regulations, institutions and practice provide the most adequate protection to borrowers and consumers of bank credit products or if there are regulatory gaps that require control.

! 6 Literature Review

During the conduct of this research, it was noted that there is scanty literature available on the specific topic of research, which is the level of protection afforded to borrowers or consumers of credit products provided by banks in Kenya. The term consumer and borrower for the purposes of this research are used interchangeably. As explained previously, the credit products provided by banks for the purposes of this research are limited to personal and business loans and overdrafts supplied by banks in Kenya for the ultimate use by such consumers or borrowers. In order to circumvent the issue of sparse writing on the specific research area, I opted to look into text centered generally on consumer protection within the financial services sector (as opposed to the lending arm of financial services, which was also somewhat limited and spanned law and economics.

In keeping with the theories of the economic theory of consumer behaviour, consumerism and the theory of consumer sovereignty some of the available literature derives from behavioural economics, which has been used to examine consumer behaviour and the reasons behind certain consumer choices. This literature recognizes that beyond the economic concepts of rationality and competitive markets, consumer behaviour may be attributed to other factors and behavioural biases or preferences. In the financial sector specifically, some studies^{6*} have argued that factors such as marketing and advertising or their vulnerability may affect the consumer's choices in that the consumer may choose what they are drawn to or what they understand as a result of these factors. These studies argue that where a consumer may not be

Benartzi S and Thaler R.H. (2002), *How Much is Investor Autonomy Worth?*, Journal of Finance 57 (4) at pages 1593 to 1616; Bertrand *et al* (2004), *A Behavioural Economics View of Overly*, American Economic Review 94 (2) at pages 419 to 423, ; Agarwal *et al* (2006), *Do Consumers Choose the Right Credit Contract*, Working Paper Number 2006-11, Federal Reserve Bank of Chicago, Chicago IL; Campbell (2006), *Household Finance*, Journal of Finance 61 (4) at pages 1553 to 1604 and Harvey B and Parry D (2000, 6th edition), *The Law and Economics of Consumer Protection and Fair Trading*, London: Lexus Nexus UK.

existing laws, regulations, institutions and practice provide the most adequate protection to borrowers and consumers of bank credit products or if there are regulatory gaps that require control.

1.6 Mature Review

During the conduct of this research, it was noted that there is scanty literature available on the specific topic of research, which is the level of protection afforded to borrowers or consumers of credit products provided by banks in Kenya. The term consumer and borrower for the purposes of this research are used interchangeably. As explained previously, the credit products provided by banks for the purposes of this research are limited to personal and business loans and overdrafts supplied by banks in Kenya for the ultimate use by such consumers or borrowers. In order to circumvent the issue of sparse writing on the specific research area, I opted to look into text centered generally on consumer protection within the financial services sector (as opposed to the lending arm of financial services, which was also somewhat limited and spanned law and economics).

In keeping with the theories of the economic theory of consumer behaviour, consumerism and the theory of consumer sovereignty some of the available literature derives from behavioural economics, which has been used to examine consumer behaviour and the reasons behind certain consumer choices. This literature recognizes that beyond the economic concepts of rationality and competitive markets, consumer behaviour may be attributed to other factors and behavioural biases or preferences. In the financial sector specifically, some studies⁶⁴ have argued that factors such as marketing and advertising or their vulnerability may affect the consumer's choices in that the consumer may choose what they are drawn to or what they understand as a result of these factors. These studies argue that where a consumer may not be

Carrianna Pennington and Thaler R.H. (2002), *How Much is Investor Autonomy Worth?*, Journal of Consumer Research 29 (4) at pages 1593 to 1616; Bertrand et al (2004), *A Behavioural Economics View of Consumer Choice*, Economic Review 94 (2) at pages 419 to 423, ; Agarwal et al (2006), *Do Consumers Choose the Right Credit Contract*, Working Paper Number 2006-11, Federal Reserve Bank of Chicago, Chicago IL; Campbell (2006), *Household Finance*, Journal of Consumer Research 33 (4) at pages 1553 to 1604 and Harvey B and Parry D (2000, 6th edition), *The Law of Consumer Protection and Fair Trading*, London: Lexus Nexus UK.

ell informed, they can act out of confusion when they are presented with any alternatives and can be exploited by sellers or suppliers of goods and services. In this regard, authors such as Barr⁶⁵ note that even well established and efficient disclosure requirements in statutes may not be sufficient in protecting the consumer because such disclosure would only be effective only to the extent that it is concise and comprehensible to that consumer. These academics suggest developing financial market laws and regulations based on behavioural models as opposed to solely on the economic concept of a rational consumer and ensuring that the market remains competitive, correcting any inefficiencies with minimal interference from the government and market players⁶⁶. They suggest the use of financial literacy as an avenue of remedying low levels of consumer protection within financial services in addition to well drafted and designed financial consumer protection laws and regulations.

Authors such as Elliehausen⁶⁷ argue that the results of behavioural research or applied research could be useful in designing effective regulations particularly in the credit market. Brix and McKee⁶⁸ argue that the challenge in applying behavioural research going forward is to identify effective forms of disclosure because despite its importance, there is no universally accepted set of disclosure requirements in terms of which terms and conditions are to be disclosed, when to disclose and how such disclosure is to be presented amongst other issues. Brix and McKee⁶⁹ suggest that financial consumer protection laws and regulations in environments where access to financial services is low, should make sure that information is presented in a

⁶⁵ Barr et al. (2008), *Behaviourally informed Financial Services Regulation*, Report, New America Foundation.

⁶⁶ ⁶⁷ Elliehausen (2010), *Supra note 64*.

⁶⁸ Elliehausen G (2010), *Implication of Behavioural Research for the Use and Regulation of Consumer Credit Products*, Finance and Economics discussion No 2010-25, Federal Reserve Board

⁶⁹ Brix L and McKee K (2010), *Consumer Protection Regulations in Low Access Environments: Opportunities to Promote Responsible Finance*, CGAP Focus Note 60, Washington DC; CGAP. Some authors such as Ebers (2004), *Information and Advising Financial Services Sector: Principles and Peculiarities in EC Law*, *Comparative Law*, Volume 8.2 found at <http://www.ejcl.org> [accessed 11th April 2012],

⁶⁷ Studies such as Collins et. al (2009), *Portfolios of the Poor: How the Poor Live*, Princeton New Jersey, Princeton University Press and FSD-Kenya (2009), *Nairobi Standard Measure for Consumer Interest Rates in Kenya: A Scoping Study*, found on <http://www.fsdkenya.org> [accessed on April 21, 2012] support this

standardized format in plain language and the use of complex formulas and calculations should be avoided. The studies however acknowledge that some credit products may be more complex and will require more information to be disclosed though in environments where the citizenry has low financial literacy, it is likely that such complex information will not be understood by the consumer. Studies like the one conducted by the United States Government Accountability Office in 2006⁷⁰ acknowledge that disclosure in all its forms may be complicated and may contain conflicting information such as confusing disclaimers.

In addition to the above views on the use of behavioural research to develop laws and regulations improving consumer protection in the financial sector in general, the level of intervention by the government and industry players for purposes of enacting these laws and regulations has been a subject for debate over the years. Many authors such as Harvey and Parry⁷¹, Meynes⁷², Layton and Holmes⁷³, Lakshminath and Sridhar⁷⁴, Chuah and Furnston⁷⁵, Megrah and Ryder⁷⁶ concede and advocate for a level of consumer protection in any sector noting that this protection is both necessary and unavoidable in order to protect consumers of any goods and services against unfair trading practices engaged in by sellers and suppliers of such goods and services. Further, these authors agree that consumer protection is essential in order to promote and protect consumer rights and achieve set mandatory performance standards for the sellers or suppliers of goods and services to adhere to thereby effectively controlling or regulating their actions. Scholarly

⁷⁰ V G-A.O (2006), *Credit Reporting Literacy: Increased Complexity in Rates and Fees Heightens Need for More Effective Disclosures to Consumers*, United States Government accountability Office, Report to the Ranking Minority Member, Permanent Sub Committee on investigations and U.S Senate, GAO-06-929, Washington D.C

⁷¹ Warr V 6y B and Parry D (2000, 6th edition), *Supra* note 64.

⁷² Meynes R (1979), Consumer protection: The issues, *Journal of Consumer Policy*, Volume

⁷³ Layton J and Holmes P (2000, 6th edition), *Supra* note 64

⁷⁴ Lakshminath A and Sridhar M (2007, 10th edition) *Ramaswamy Iyer's: The Law of Torts*

⁷⁵ Chuah H Uxis Nexus

⁷⁶ Megrah M and Furnston M (2010), *Commercial and Consumer Law*, Harlow: Pearson Education Limited

⁷⁷ Butt J M and Ryder F.R. (8th edition, 1972), *Paget's Law of Banking*, London: Norton & Co Publishers Ltd.

committees such as the Molony Committee⁸⁰, the Crowther Committee and organizations such as Kenya Bureau of Standards (KEBS)⁸¹, Consumer Federation of Kenya (COFEK)⁸², office of Fair Trading in the United Kingdom⁸³ also concede that a level of consumer protection is both necessary and unavoidable for the same reasons.

Furthermore, these scholarly committees, organizations and academics alike concede that a level of government intervention in the form of Acts of Parliament, policy and regulations is the preferred course of action to put special measures to protect the consumer. Opinions on the reasons of such government intervention is varied with authors such as Harvey and Parry⁸⁴, Maynes⁸⁵, Lakshminath and Sridhar⁸⁶ and Chuah and Frumston⁸⁷ citing the attainment of consumer protection as the key justification of regulation whilst others such as Breyer⁸⁸ citing the correction of imbalances in the market such as information asymmetry and lack of competition as the main justifications for regulation with consumer protection being cited as being a consequence of such correction. The degree of intervention is a matter of debate amongst the authors and committees.

The Molony Committee⁸⁹ argues that special measures should be put in place to protect the consumer so long as such measures do not affect the general workings of the market place. On the other hand, there are authors⁹⁰ who argue that special measures should be put in place without regard to the market forces or the search of 'perfect competition.' They argue that the key objectives should be to protect the consumer against unscrupulous and at

⁸⁰ Diamond A (1963), *The Molony Committee Final Report of the Committee on Consumer Protection*, The Modern Law Review, Vol 26 No 1 at page 66-75.

⁸¹ www.kebs.org [accessed January 25, 2011]

⁸² www.cofek.co.ke/ [accessed November 10, 2010]

⁸³ www.offt.gov.uk/ [accessed March 4, 2011]

⁸⁴ Harvey J and Parry M (2000, 6th edition), *Supra* note 64 at pages 3 to 15

⁸⁵ Maynes E (1979), *Supra* note 72

⁸⁶ Chuah M (2007, 10th edition), *Supra* note 74 at page 1001 to 1009

⁸⁷ Breve Q and Frumston M (2010), *Supra* note 75 at page 381 to 390.

⁸⁸ Cambridge University Press *Regulation and its Reform: Typical Justifications for Regulation*,

⁸⁹ Diamond H and University Press at Chapter 1.

⁹⁰ *Protection of Consumers: The Molony Committee Final Report of the Committee on Consumer*

⁹¹ Such as T V Modern Law Review* Vol 26 No 1 at page 69-72.

Lakshminath and Sridhar and Harvey and Parry *Supra* note 74 and 64.

times fraudulent business practices, the existence of natural monopolies and information asymmetry.⁸⁸ Authors such as Layton and Holmes⁸⁹ argue that consumer protection through government intervention is acceptable *so long as* the transaction costs of such regulation are kept at a minimum thereby ensuring that there is no overregulation resulting in disproportionate compliance costs and/or ineffective (unnecessary) regulation contrary to the theory of economic analysis of the law.

Further, the Molony Committee grouped the general proposals that ought to be contained within the legal framework governing consumer protection in order to ensure effective protection of the consumer in any sector as follows. The Committee proposed that there should exist:

1. Arrangements to give the consumer a positive assurance that the goods or services on offer are safe (if safety is relevant) and of sound quality. This, the committee termed as the setting of performance standards which are essential in order to achieve heightened consumer protection.
2. Adequate and sufficient information annexed to the goods or services which will assist the consumer to judge whether or not the goods or services will satisfy their particular requirements. This, the committee termed as informative labeling, which they considered to be one of the essential elements of achieving increased consumer protection.
3. An assessment of merits of the goods (and services) on offer by independent agencies in the form of comparative testing or 'seals of approval'. The committee proposed that products being compared should be similar in nature and the matters or items being compared should be standardized to enable the consumer compare and choose the product that was better suited for their needs. The committee argued that products should have seals of approval by the nominated independent agent engaged in conducting the comparative testing in order to provide the consumer added comfort and/or redress in the event of misrepresentation.

⁸⁸ Goodhart C.A.E, (1989, 2nd edition) *Money, Information and Uncertainty: The Economic Regulation*, Pelgrave Macmillan at part 9.

⁸⁹ *See* **Harvey and Parry, *Supra* note 64 at page 12.**

⁹⁰ Diamond A (1963), *The Molony Committee Final Report of the Committee on Consumer Protection*, *The Modern Law Review*, Vol 26 No 1 at **paragraph 40.**

An adequate means whereby the justifiably aggrieved consumer may obtain fair and quick redress in a manner that is not costly and one that is easily accessible to the consumer.

- 5 Restraint of misdescription of the significant characteristics of the goods (or services) on offer so as to ensure that accurate and adequate information that is relevant to the consumer in their decision making is readily available.
6. Restraint of objectionable sales promotion methods whether in the form of advertisements or otherwise, which are calculated to divert the consumer from making a proper judgment that is in their best interests.

In keeping with the general views of the Molony Committee as advocates of consumer protection, authors such as John Goldring et al¹ explain that consumer protection measures within the financial services sector should seek to safeguard the interests and rights of consumers of financial services, which include lending services (read: borrowers or consumers of credit products) against several key factors in the very least. Firstly, the authors suggest that consumer protection measures should seek to protect the consumers of financial services against unscrupulous sellers and uncaring service providers who engage in activities intended to defraud the public. Secondly the authors propose that these measures should guard against a lack of competition thereby limiting the consumer's choice in products, market failures and the collapse of some financial service providers all of which may result in losses being incurred by the consumers. Thirdly, the authors put forward that the consumer protection measures should safeguard against false, biased or incomplete information regarding the prices and quality of financial services thereby misleading the consumer who then makes a decision based on incorrect or incomplete information. Lastly, the authors suggest that consumer protection measures should guard against laws, regulations and regulatory agencies that favour producers or providers of services as opposed to consumers particularly given the typical position where the

¹ Waller L, Mckeough J and Pearson G (1997, 5th edition), Consumer Protection
Sydney: Federation Press.

consumer is at a disadvantaged bargaining position as compared to the producers or providers of financial services. This research supports the views and opinion of John Goldring et al.⁹² and agrees that the issues identified are real issues experienced by consumers in the financial services and banking sectors, who include borrowers and ought to be safeguarded against to ensure that a heightened level of consumer protection is achieved.

This research suggests that the factors proposed by the Molony Committee are essential elements of consumer protection and ought to be present in any sector whether by way of statute or otherwise. Further, this research proposes that the most efficient and effective way of ensuring that the essential elements of consumer protection are contained within any legal and institutional framework, including the one governing lending by banks in Kenya, is through a comprehensive Act of Parliament and supplementary legislation to such an Act. Moreover, this research acknowledges that choices made by consumers are influenced by several factors in line with the theory of the economic theory of consumer behaviour and accordingly, one cannot entirely disregard behavioural research when developing laws and regulations aimed at achieving increased consumer protection. That notwithstanding, this research asserts that behavioural research should be used together with other economic models which are more objective for example the idea of a rational consumer because it is arguably more difficult to measure behaviour which may be influenced by matters which are specific to a particular consumer therefore making the research subjective.

Notwithstanding the aforementioned recommendations of the various pro-consumer protection committees and authors, some committees such as the US Special Committee on Retail Installment Sales, Consumer Credit, Small Loans and Usury⁹³ have expressed concerns relating to consumer protection. They argue that it represents, to a large extent, undue 'mollycoddling' of the consumer. In particular, the US Special Committee highlights that some of the ^ that should be considered prior to effecting legislation and/or policy

⁹² *Ibid*

⁹³ In Harvey and Parry, *Supra* note 64 at pg 13.

protecting the consumer should include the determination of what one is protecting the consumer from and whether it is justified to protect them from their own lack of knowledge or discipline which leads the consumer to take advantage of easy credit. The Special Committee however concedes that where there is fraudulent business practice, the consumer should be protected.

The Office of Fair Trading (hereinafter called OFT), which is a UK based consumer and competition authority that works across the whole of the UK economy comprises of the Consumer Credit Group which is responsible for regulating the consumer lending industry which is comprised of all businesses that lend money, offer goods or services on credit, introduce individuals to credit or engage in debt collection and debt advice⁹⁷. It advocates for the *effective and proportionate* regulation⁹⁸ of consumer credit business, therefore recognizing that the cost of regulation may be disproportionate to the benefits sought thereby aligning itself with advocates for consideration of transaction costs incurred in regulating a sector in accordance with the theory of economic analysis of the law such as Justice Oliver Wendell Holmes Jr cited in *Bix*⁹⁹ and Richard Postner. The OFT issues periodic newsletters, which give consumers an overview of the consumer protection work being conducted by the group. Further, it seeks enforcement against companies that do not adhere to the set standards to the detriment of the consumer and persistently pursues higher levels of proportionate consumer protection in the credit sector in the UK.⁹⁸

Further, the OFT has conducted research⁹⁹ into the use of self regulation as a way of solving consumer protection issues in the market. In their research the OFT concluded that there is a good case for the greater use of self regulation in

www.fsa.gov.uk/pages/Library/Communication/PR/2Qio/042.shtml [accessed

⁹⁷ www.fsa.gov.uk/pages/Library/Communication/PR/2Qio/042.shtml [accessed February 28, 2011].

⁹⁸ *4th* edition), *Supra* note 50 at page 189.

⁹⁹ *Q* (2004), *Supra* note 53 at page 200.

⁹⁹ *Q* (2011) mpft.gov.iik/nFTwork/credit/ [accessed February 28,2011]

doCurri ^S Polished research, *Business leadership in consumer protection: A discussion* *Www J?i* ⁰⁷⁷ *self regulation and industry-led compliance* (OFT, March 2009) found on "www.fsa.gov.uk" [accessed February 28,2011].

living consumer protection issues. In addition, the OFT noted that in its experience, where consumer problems have been identified, the industry welcomes the opportunity to put things right and where possible avoid the need for statutory and/or government regulation or enforcement action which can prove to be costly. The OFT acknowledges a need for flexibility in dealing with consumer problems and the benefits of self regulation however, it notes that not all self regulation works effectively.¹⁰⁰ To this end, whilst acknowledging the role and importance of consumer protection, the OFT, a major promoter of consumer protection and consumer rights concedes that government intervention may in some cases prove to be disproportionately costly and that there are alternative forms of regulation such as self regulation, that may prove to be effective in certain circumstances.

The World Bank in January 2011 conducted research into the Consumer Protection Laws and Regulations available in several countries in the deposit and loan services (financial services).¹⁰¹ The paper, written by the Financial Access Team aimed to assist what they termed as poor financial sector development. It was found that consumer protection and financial literacy can contribute to improved efficiency, transparency, competition and access in retail financial markets by reducing information asymmetries and power imbalances between providers and users of financial services.¹⁰² The paper presented the results of a survey on consumer protection laws and regulations in 142 countries with findings indicating that although consumer protection legislation is in place in majority of the countries, these did not necessarily address the issues specific to financial services.

The research conducted by the World Bank highlights that there was evidence that enforcement powers and monitoring capacity were limited in many countries obstructing the effective implementation of existing laws and

¹⁰⁰ *Ibid* at Page 36.
¹⁰¹ Conte

Protect™ Policy Research Working Paper numbered 5536 and titled 'Consumer Regulations in deposit and loan services: A cross-country analysis with a focus on the role of consumer protection' at <http://econ.worldbank.org> [accessed April 21, 2012].
¹⁰² *Ibid* at Page 2.

regulations. In addition, the study found that independent third party dispute resolution mechanisms were not widespread.^{1^} The research noted that in Kenya, there was no specific consumer protection statute with or without reference to financial services but that there were consumer protection regulations within the financial services sector, namely the regulations within the Banking Act, Chapter 488 of the Laws of Kenya with respect to bank charges, disclosure, credit reference bureaus and interest on non performing loans.¹⁰⁴ These are discussed in detail in chapter 2 of this research which assesses the existing laws and regulations governing lending by banks in Kenya. This research concurs with the findings of the research conducted by the World Bank that the most effective and efficient way of attaining adequate consumer protection is through the enactment of statute with supporting subsidiary regulations and policies being complementary to such statutes. Further, this research concurs with the findings of the World Bank that enforcement is paramount to attaining consumer protection even where there are elaborate consumer protection laws.


Furthermore, the research conducted by the World Bank highlighted that policy papers focusing on the review of consumer protection and financial literacy indicate that there is no one-size-fits all approach when it comes to designing consumer protection and financial literacy policy. It noted that many studies in developing countries such as Miller^{lc:5} indicate that financial literacy is low among the poor especially in developing countries like Kenya meaning that individuals lack even the understanding of interest rates¹⁰⁶ creating a large asymmetry between borrowers and lenders in terms of awareness of the financial product or service in question arising from illiteracy and inexperience on the part of the borrowers and differences in language and ethnicity. In this respect, the World Bank research proposed financial

^{^^} at pages 6 to 16.

^{'bid} at page 34. Interestingly, it was found that there were no other consumer protection tions save for the ones contained in the financial services sector.

[^] Miller *et. al* (2010), *The Case For Financial Literacy in Developing Countries: Promoting ORrr? to finance by Empowering Consumers*, Joint Research by the World Bank, DFID, CGAP, Washington DC: World Bank found at ^{^j^}<http://dataoecd.org/q^/^2/4.q24f:.q^Q.pdf> [accessed April 21, 2012].

Kenya (2009), *Supra note 69*.



education to the poor to raise their financial capability with a view of establishing better consumer financial protection laws and regulations. This research supports this recommendation from the World Bank and suggests that laws enacted should contain mandatory provisions that the supplier disclose, explain and educate borrowers or consumers of credit products prior to execution of the contract to ensure that they are aware of their obligations and the implications of their decisions.


j 7 Hypothesis

This research seeks to discuss the problem that the current laws, regulations, institutions and practices governing lending by banks in Kenya are inadequate in protecting consumers or borrowers of bank credit products. Further, it seeks to assess to what extent such laws, regulations, institutions and practices are inadequate highlighting any shortcomings, anomalies and regulatory gaps that exist in as far as the protection of consumers or borrowers of bank credit products. Finally, the research makes proposals for correcting such inadequacies where appropriate.

Given the above, the hypothesis that this research seeks to prove or disprove is that the inadequacies that exist in the current laws, regulations, institutions and practices governing lending by banks in Kenya result in low levels of protection being afforded to consumers or borrowers of bank credit products in Kenya.

Research Methodology

The main objective of conducting primary or field research was to assess the level and nature of information that was disseminated on a practical level when bank employees were processing credit applications submitted by prospective borrowers or consumers of bank credit products. This is the element of disclosure at the outset, which this research considered to be an important aspect of consumer protection. Further, the primary research sought, albeit to a lesser extent to establish the extent of standardization of the bank's procedures, the level of discretion left to the bank's employees and the bank employees' awareness of the legal provisions governing lending by banks



After collating the evidence on a practical level, this research sought in Kenya-

identify existing shortcomings, loopholes and weaknesses with the bank's application and processing procedures having regard to the governing legal and institutional framework. This approach in my considered view provided a more wholesome picture of lending practices and procedures of banks. It was recognized during the conduct of the primary research that the findings thereof may not necessarily be reflective of the conduct of *all* banks in Kenya because only representatives from a few banks were interviewed.

The research data from the respondents who were borrowers or consumers of bank credit products was collected from three (3) focus groups. Each group contained between 6-12 respondents who were in formal employment and had obtained different types of bank credit products over the past two (2) years. The composition of the groups included both males and females in the age bracket of 30 to 55 years. I engaged the services of Synovate in the conduct of the research through the focus groups and agreed that due to time and financial constraints, the respondents were to be from Nairobi and its outskirts.

The reason I chose respondents in formal employment was that they were more likely to prove attractive to lending institutions because they had a regular income as compared to applicants from the informal employment sector without a regular or steady source of income. Selecting the lower age limit of 30 years and the upper age limit of 55 years was premised on the assumption that at age 30 a person was likely to have been in employment for a years and had an earning history that facilitated them to apply for and attain credit. They were also likely to have previously obtained credit by this age. At the official retirement age of 55 years, it was assumed that the retiring candidate's source of income diminished and obtaining credit appeared to be less attractive both for them and the bank. For these reasons, my considered as that the age bracket of 30 to 55 years was best placed as a target group.

Further, it was assumed that the age brackets, which the respondents were divided into shared similar experiences, sought credit for similar reasons and shared comparable exposure to the process of lending by banks. The groups were divided as follows:

- a. Group 1 comprising of age group 30 to 35 years;
- b. Group 2 comprised of age group 36 to 45 years;
- c. Group 3 shall comprise of age group 46 to 55 years;

In order to aid the focus group discussions, I prepared a questionnaire. I then engaged the services of Synovate to conduct the focus group discussions and collate the results, which I analyzed for the purposes of presentation in this thesis. In addition, I personally conducted interviews with the bank employees from different banks who had been engaged in the services of processing and/or approving credit applications by their employer. I prepared a different questionnaire for the bank employees.

1.9 Research questions

The questions I have sought to answer in this research are as follows;

- 1.9.1 What is the current legal and institutional framework governing lending by banks in Kenya?
- 1-9-2 Are there regulatory gaps, overlaps and shortcomings that exist within the existing legal and institutional framework in so far as they deal with and provide for protection of borrowers or consumers of bank credit products?
- 1-9-3 What are the recommended changes, if any, to the laws, regulations, institutions and practice governing lending by banks in Kenya that may be effected so as to achieve an adequate or higher level of protection of the borrower or consumer of bank credit products?
- 1-9-4 HOW do banks and their representatives deal with and process credit applications submitted by prospective borrowers and in particular, what is the nature and extent of information provided to such borrowers at the outset?

- 1.9-5 What changes to the laws, regulations, institutions and practice may be recommended in order to increase the protection afforded to borrowers or consumers of bank credit products?

For the purposes of this research bills proposed in order to amend or review the existing laws in line with the new constitutional dispensation were considered as part of the legal framework

L10 chapter Breakdown

Chapter one (this chapter) contains the introduction, statement of problem, objectives, research questions, hypothesis, justification of the study, literature review and theoretical framework, methodology and chapter breakdown.

Chapter two assesses the legal provisions (statute, rules, guidelines and regulations) that govern the bank lending industry in Kenya against recommendations made by pro-consumer protection authors and committees such as the Molony Committee. This chapter highlights any inadequacies, inconsistencies, shortcomings and loopholes within such legal provisions when compared with other jurisdictions and international standards.

Chapter three assesses the institutional framework that governs the bank lending industry in Kenya. It highlights any inadequacies or shortcomings in the framework when compared with other jurisdictions.

Chapter four discusses the practical aspect of the bank credit industry as presented in the data collated from primary research. An analysis of the research findings is presented in this chapter and a summary of the analysis is provided.

Chapter five provides a conclusion to the research and outlines recommendations aimed at addressing any inadequacies highlighted in Previous chapters.

In the next chapter, I will proceed to assess and evaluate the laws and regulations governing lending by banks in Kenya. I will seek to analyze the extent to which such laws and regulations protect the consumers of bank products. Where there are shortcomings or loopholes, I will discuss



them and propose amendments and/or variations aimed at increasing consumer protection within the sector. Finally, I will go on to briefly discuss the provisions of the proposed Bills currently undergoing parliamentary debate that are tailored to increase consumer protection in compliance with the letter and spirit of the new constitutional dispensation. I will comment on whether in my considered view such provisions adequately address the issues, anomalies and loopholes that exist within the current legal framework.



PJAPTKR TWO: THE LEGAL FRAMEWORK GOVERNING IJJJOING BY BANKS IN KENYA

^ OVERVIEW OF THE LEGAL FRAMEWORK GOVERNING BANKS INJCENYA

There are several laws, rules and regulations that govern the banking industry in Kenya. This research seeks to assess these legal provisions in order to determine whether they adequately protect the borrower or consumer of bank credit products. Where it is found that the said laws, rules and regulations contain anomalies or shortcomings which compromise the protection of borrowers or consumers of bank credit products, this research aims to point out such inadequacies and make recommendations for change aimed at achieving increased consumer protection.

The relevant laws enacted to govern the banking industry include the Banking Act¹⁰⁷, the Central Bank of Kenya Act¹⁰⁸, Companies Act¹⁰⁹ and various prudential guidelines issued by the Central Bank of Kenya (hereinafter referred to as the 'CBK')^{no} from time to time. It is significant to note that there exists the Microfinance Act¹¹¹, which governs every deposit taking microfinance business. Section 3 of the Microfinance Act however specifically exempts banks, financial institutions or mortgage finance companies licensed under the Banking Act¹¹² from its application.

For the avoidance of doubt, this research is limited to licensed banks under the Banking Act. The Microfinance Act is merely introduced herein to give the reader a more comprehensive overview of the complexities that exist within the structure of governance of finance institutions and the finance sector in Kenya¹¹³. By way of example, the definition of 'banking business' provided for

¹⁰⁷ s. 488 of the Laws of Kenya
¹⁰⁸ s. 491 of the Laws of Kenya
¹⁰⁹ s. 3 of the Laws of Kenya
June 15 2016 on Central Bank of Kenya website <http://www.centralbank.go.ke> [accessed

¹⁰⁹ s. 2 of 2006
The Microfinance Act does not also apply to a building society registered under the Post Office Societies Act* the Kenya Post Office Savings Bank established under the Kenya Post Office Savings Bank Act.
¹¹⁰ s. 3 of the Savings Bank Act.
and the Microfinance Act definition of banking business as contained in section 2 of the Banking Act and the definition of microfinance business as contained in section 2 of the Microfinance Act

in both Acts causes confusion to both types of institutions (banks and microfinance institutions) and the public in general in terms of the application and extent of the acts and may result in protracted court cases against the CBK¹¹⁴. This research will only assess the provisions applicable to banks, in particular, relating to the protection of borrowers or consumers of bank credit products. An assessment of these provisions will be conducted having regard to laws contained within other comparable jurisdictions such as the United Kingdom (hereinafter referred to as the 'UK'), Australia and Canada. The reason why these jurisdictions have been selective as comparables is because they are commonwealth in nature, as is the Kenyan jurisdiction with the legal practice being heavily weighted on common law, precedents and case law therefore making them akin to a large extent.

CBK is the main regulator within the financial sector in Kenya, which is composed of several players such as financial institutions, banks, microfinance businesses, mortgage finance companies, securities exchanges, investment brokers and advisers amongst others. However, there are other independent regulators that play a complementary role to CBK by regulating their designated sub-sectors such as the Sacco Societies Regulatory Authority (SASRA) which regulates Sacco societies and the Capital Markets Authority (CMA) which regulates securities exchanges and investment advisors to name a few. This set up affirms that Kenya has a fragmented financial and legal regulatory framework. CBK falls under the Ministry of Finance docket and is responsible for formulating and implementing monetary policy and developing, nurturing and promoting solvency, liquidity and the proper functioning of the financial system in Kenya¹¹⁵. As at January 2012, there were forty three licensed commercial banks and one mortgage finance company.¹¹⁶

some respects overlap and may result in institutions providing microfinance business being
114¹¹⁴ provided by CBK to be providing banking business without an appropriate banking license.
w, case in point is the closure of companies such as Kenya Aldba Micro-Finance Limited
the KTS closed down by CBK six years ago for allegedly taking deposits from members of
public and providing banking business without a valid license. The company has since
initiated legal proceedings, which are yet to be determined, and is claiming Kenya Shillings
Fifty and Thirty Million from CBK in damages as reported in the Daily Nation,
June 17¹¹⁵ 2011 at Page 30, Business News.
116¹¹⁶ Central Bank of Kenya website <http://www.centralbank.go.ke> [accessed

In the eighties, some twenty years or so after independence, Kenya experienced a banking crisis when several indigenous banks developed liquidity problems. In spite of the efforts of Treasury and the CBK to bail out ailing institutions then, some institutions were closed¹¹⁷. This crisis exposed the inadequacy of the safety provisions existing at the time and resulted in significant amendments to the then Banking Act 1989. The current Banking Act, which is the main Act dealing with the relationship between the customer and their licensed banks first came into force in October 1995. In enacting this statute, Parliament sought, amongst other objectives, to address a crisis in the banking industry that was precipitated by the collapse of a number of financial institutions. The Banking Act 1995 was therefore geared towards addressing deposits protection with the intention of controlling the banking industry in order to avert other crises¹¹⁸. Section 56 of the current Banking Act repealed the Banking Act 1989. The Banking Act 1995 has been reviewed over the years with changes being inserted therein. This research looks at the Banking Act 2011 which incorporates changes until January 1, 2011.

Consequently, the Central Bank of Kenya Act, which mainly deals with the relationship between banks themselves and banks with CBK, was also reviewed. The CBK continuously produces various prudential guidelines governing the banking industry.⁹ With the promulgation of the Constitution of the Republic of Kenya¹²⁰, it is anticipated that various statutes and laws will be reviewed and/or amended accordingly to ensure that their provisions do not contravene the requirements of the Constitution¹²¹ with the laws governing the banking industry not being an exception¹²².

¹¹⁷ *ibid*

¹¹⁸ *ibid*

⁹ To include guidelines on the enforcement of Banking Laws and Regulations, the conduct of banking, risk classification of assets and provisioning, liquidity management, amongst others.

August 27, 2010

Article 2 (4) states that any law, including customary law, that is inconsistent with the Constitution is void to the extent of the inconsistency, and any act or omission in contravention of the Constitution is invalid.

Acts have been amended to align them with the Constitution such as the Banking Act 1995. However, such Acts may require further review during the course of implementing all the provisions

Constitution for example to incorporate article 46 which provides for merger protection. New Acts of Parliament are also likely to be enacted.

2 THE DEFINITION OF BANKING AND BANKING BUSINESS

The Central Bank of Kenya Act¹²³ defines a bank as a 'body corporate or other body of persons, carrying on, whether on their own behalf or as agent for another, banking business within the meaning of the Banking Act, whether in Kenya or elsewhere.' The Banking Act¹²⁴ further defines a bank as 'a company which carries on, or purposes to carry on, banking business in Kenya.'¹²⁵

Banking Business was traditionally considered to be notoriously ambiguous and subject to judicial interpretation as evidenced by cases such as *Woods v Martins Bank Ltd (1959)*¹²⁶ where a question arose as to whether investment advice constituted banking business. In his ruling, Justice Salmon held that the limits of a banker's business cannot be laid down as a matter of law and that the nature of such business must in each case be a matter of fact. Further, in other instances¹²⁷, the sitting judges Honourable Diplock, Denning and Herman failed to agree on the proper interpretation of banking business. In order to deal with similar anomalies within the Kenyan jurisdiction, the Banking Act expressly defines both a bank¹²⁸ and what constitutes banking business. Banking business under section 2 of the Banking Act is defined as meaning;

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

¹²³ Cap 491 of the Laws of Kenya, *Supra* note 108 Part I at page 5

¹²⁵ 488 of the Laws of Kenya, *Supra* note 107 section 2

Bodies corporate and companies are also governed by and should be constituted and operated in accordance with the provisions of the Companies Act. This research aims to examine the laws governing lending in the banking industry only with the provisions of the

¹²⁶ *Woods v Martins Bank Ltd (1959)* where the question was whether investment advice was banking business outside its scope.

¹²⁷ *See e.g. Diplock, Denning and Herman* in the case of *United Dominions Trust v Kirkwood (1966) 2 QB 431; 1 All 968* of the Banking Act, Cap 488 of the Laws of Kenya.

Notwithstanding this statutory definition of banking business, it is often
ed that it is too wide and general and in many ways causes confusion¹²⁹.

This somewhat unclear state of affairs has led to institutions being determined
by the CBK as providing banking business illegally contrary to the Banking

This is in spite of such institutions being registered, licensed and/or
governed by other Acts of Parliament such as the Microfinance Act.¹³⁰

Pursuant to section 3(1) of the Banking Act, only a licensed institution or duly
approved agent acting on behalf of a validly licensed institution may provide
banking business. The conduct of any banking business by any person in
Kenya without holding a valid license is prohibited¹³¹. A contravention of the
provisions of section 2 attracts a fine not exceeding one hundred thousand
shillings or imprisonment for a term not exceeding three years or both¹³².

It is apparent from the aforementioned definition of banking business that
lending money received from the public and held on deposit or on current
account by the holder of such monies (read: bank) constitutes banking
business. Notably, the Banking Act stipulates that such money is repayable *on*
demand or upon expiry of a fixed period or *on notice* from the depositor;
meaning that at the appropriate time, the money should be readily available
for withdrawal by the depositor should they so wish. It is therefore inferred

¹²⁹ For example in the case of *First National Finance Ltd -v- Kutus Auto Hardware Ltd and
2 others [2006] eKLR* where the court was required to determine whether the recovery of
ponies constituted banking business therefore was requiring a valid license or it was financial
business thereby not requiring one. It was held that the business conducted was not banking
business. On the other hand, in the case of *Kenya Akiba Microfinance -v- Central Bank of
V[^]ny^Q> the Attorney General and Commissioner of Police, HCCCNo 644 of 2005* it was held
, at Kenya Akiba Microfinance's lending business was banking business and required a
•cense pursuant to the Banking Act, which it did not have. This is inspite of Kenya Akiba
icrofinance being a microfinance institution governed by the Microfinance Act. CBK
,3[^]tructed the closure of Kenya Akiba Microfinance.

, A situation apparent in the *Kenya Akiba Microfinance -v- Central Bank of Kenya, the
y[^]omey General and Commissioner of Police, HCCC No 644 of 2005* highlighted above,
thfou • Akiba Microfinance has sought the court's determination on whether it is governed by
^ Microfinance Act, which it alleges or the Banking Act. Further, in *Samuel Bosire v Gladys
"yangi Omosa & another [2010] eKLR* it was held that the appellant, a self help group was
131 J[?]ucting an illegal business by providing banking business without a valid license to do so.
th[^] U^{er} the use of the word 'bank' or 'any of its derivatives' or 'any other word indicating
of 'action of banking business' or the use of the word 'finance' without the prior consent
132 p^e Central Bank of Kenya is also prohibited.

ar[^] ursuaⁿt to section 3(2) of the same Act. It is debatable whether this penalty clause and the
r[?]is herein provide adequate deterrence. Section 4 further provides that any institution
C, mⁿ 8 to transact banking or financial or mortgage finance business must apply to the
| Sank of Kenya for a license and be vetted in the process.

that the bank ought to manage carefully the amount of deposits held and the lending of such deposits, to avoid a situation where the bank is unable to repay a depositor when they require their monies back.

Moreover, it is inevitable that given the provisions of section 2 of the Banking Act, in order to conduct a wholesome assessment of the adequacy of the current laws, one should consider the provisions put in place to protect all consumers of banks products, be they depositors or borrowers. This research is based in part on the premise that adequate provisions should be put in place to protect both consumers of credit (borrowers) and depositors (the banks' creditors), which partly concurs with the theory of consumer sovereignty in that provisions ought to be put in place to protect all consumers of banking products due to their disadvantaged market position as compared to that of banks. The pivotal focus of this research is however the protection afforded to borrowers or consumers of bank credit products.

Changing political, social, economic and technological conditions force legislators to periodically review and look more closely at statutes which govern the operation of banks and banking business as the 'major purpose of most of the statutes is to safeguard the investor, depositor and the borrower.'³³ These changing conditions include the entry conditions within banking by competitors whose prime function is the financing or lending of money but not banking as is commonly understood.^{1^} It is clear that when making an assessment of the laws and determining whether to increase protection for borrowers or the consumers of bank credit products, one should have regard to the economic effect of any amendments and the possibility of over-regulation in line with the theories of the economic analysis of the law

B.IH^{Megrah} M and Ryder F.R. (8th edition, 1972), *Paget's Law of Banking*, London: [^]Ibid^{°nh} & oo Publishers Ltd at P ^ 6_

and utilitarianism. Over regulation in any sector or industry may result in negative effects or moral hazards posing additional problems.^{1^}

2 g The Banker-Customer Relationship⁶

The definition of a customer is not expressly provided for in the Banking Act hence one must look at common law, judicial interpretations and academic definitions[^] of the term. In the case of the *Commissioner of Taxation v English, Scottish and Australian Bank Ltd (1920y*⁸, it was held that the definition of a bank customer was not really a legal question but one to be resolved by what an ordinary intelligent businessperson would understand by the term 'bank customer'. Further, in cases such as *Woods v Martins Bank Ltd (1959)*¹³⁹ and *Ladbroke and Co v Todd (1914)*^{0f} it was held that there does not need to be continuity in the maintenance of an account with the bank for the banker-customer relationship to exist.

However, a course of dealing between a bank and an individual which is not distinctly related to banking business as hereinbefore defined is not sufficient for purposes of creating a banker-customer relation. In the case of *Great Railway Company v London and County Banking Co Ltd (1901y*^{*1}, the House of Lords found that there was no banker-customer relationship in existence because the courses of dealings were not distinctly related to banking business as defined within the United Kingdom jurisdiction. In addition, a banker-customer relationship does not arise where an account is opened using false documents or without an authority, as established in the case of *Robinson v Midland Bank Ltd (1925)*[^]. For the purposes of this thesis, it is assumed that

¹⁸ Financial Sector Assessment: A Handbook, The World Bank and the International Monetary Fund, Chapter 5, *Evaluating Financial Sector Supervision: Banking, Insurance and Securities Markets* at page 105.

³ Megrah M and Ryder F.R. (8th edition, 1972), *Paget's Law of Banking*, *Supra* note 133 at chapter 3.

[?] Such as the Unfair Terms in Consumer Contracts Regulations 1999 SI 2083 and the Consumer Protection from Unfair Trading Regulations 2008 SI 1277 chapter 4 section 4.9 and chapter 7 section 7.7 respectively.

¹³⁸ AC 683.

¹³⁹ 1QB 55.

¹⁴⁰ Comm
mAc
414
41TLR402

there exists an established banker-customer relationship between the bank and the consumers of bank credit interviewed for the purposes of primary research¹⁴³⁻

The relationship between the bank and its customer takes several forms^{1**} such as the debtor-creditor relations, except that the bank is not liable to pay the customer money lent or deposited in it unless and until the customer demands payment^{1^}. Such relationships give rise to duties being owed by the bank to its customer and vice versa¹⁴⁶. For example, the bank has a duty not to release confidential information, to furnish customers with information relating to their accounts amongst others and the customer on the other hand has a duty to take care in drawing cheques as established in *Lumsden and Co v London Trustee Savings Bank* [1971]J^{1*?} amongst others. Banks (and conversely customers) may therefore be found contractually or civilly liable for a breach of the terms and conditions governing their relationship¹⁴⁸. It is therefore of utmost importance that the bank manages both the relationship with its customers and regulators on one hand and the risks involved in the finance and banking business on the other hand in order to evade liability. Laws, rules and regulations should be put in place or where in existence should be reviewed periodically to manage and govern such banker-customer relations in all its forms.

¹⁴³ It follows that lending of bank deposits received from the public constitutes the conduct of banking business and it establishes a banker-customer relationship, irrespective of whether or not the debtor holds an account with that particular bank.

¹⁴⁴ It may take the form of a *bailor-bailee* relationship with the bailor (either depositor or borrower who has provided security or collateral in exchange of a loan) seeking safe custody of their goods; *principal-agent* relationship because in some instances, the bank acts as an agent of its customer; for example in the case where the bank is administering the estate of its customers or a contractual relationship to name a few.

[^] Judge S (2nd Edition, 1999), *Business Law*, Hampshire: Macmillan Press Ltd at page 463. This debtor-creditor relationship has been established over time in cases such as *Carr v Carr* 146

Foley v Hill and Others (1848) 2 HLC 88.

J v Achimson v Swiss Bank Corporation [1921] 3 KB 110; Vol 3 A.B no. Lloyd's Rep 114

For example, banks and/or their representatives may be held liable in negligence for a statement, as established in the case of *Hedley Byrne & Co Ltd v Heller & Partners Ltd* [1964] AC 465 or they may be held contractually liable. Further, in this case of *Hedley Byrne & Co Ltd*, it was held that the bank may be vicariously liable to a customer or any other person for the negligence of its agents and employees if they were acting within the scope of their apparent authority when the negligent act occurred because of the duty of care that arose as a result of the banker-customer relationship.

part of the risk associated with lending and requiring specific management thereof by the banks, is that the borrowers or consumers of the banks' credit products may take on more than they can afford, whether through impulsiveness, bad planning or lack of full understanding of the extent of their commitment¹⁴⁹. Regulation is therefore essential to manage the banks' relationship with its customers, including the bank- debtor relationship. In light of the rapid expansion in the credit industry¹⁵⁰ and aggressive marketing by banks and other lending institutions, there should be a promotion of the ideology of responsible lending and corporate social responsibility, the encouraging of information sharing between lending institutions (including banks) to ensure that they have an accurate overview of the prospective borrower's finances and the disclosure of accurate and adequate information to the prospective borrower prior to them executing the contract¹⁵¹.

The remainder of this chapter seeks to assess the relevant laws that govern lending by banks in Kenya in as far as they deal with some of the issues affecting borrowers or consumers of credit products such as mis-advertisement, mis-information, lack of disclosure, disadvantaged bargaining position as compared to banks to name a few. Such assessment is aimed at identifying what legal provisions require amending or enacting in order to achieve increased consumer protection. It is arguable that the issues affecting borrowers or consumers of bank credit products are diverse and given the limitations of this research to include time, word count and the geographical location of respondents, the assessment of the laws governing lending by

¹⁴⁹ Megrah M and Ryder F.R. (8th edition, 1972), *Paget's Law of Banking*, *Supra* note 133 at chapter 3.

¹⁵⁰ By way of example, household debt in the UK is monitored by the Department of Business, innovation and Skills (BIS) and the debt monitoring papers indicating the increase in consumer debt can be found on <http://www.berr.gov.uk/whatwedo/consumers/consumer-QflaBce/over-inHpedness/Monitoring/index.html>, where it is shown that household debt in 2008 more than tripled from 2003 to reach sterling pounds 1.4 trillion. In Kenya, the CBK tracks private sector debt separate from government debt and the findings showing a steady increase in debt for the period 2000 to 2009 can be found on <http://www.centralbank.go.ke/download>

These factors all signify a heightened need to protect the consumer more so following the recent 2008/2009 financial meltdown in developed countries or the so-called 'credit crunch' noted in Chuah J and Furmston M (2010), *Commercial and Consumer Law*, Harlow: Pearson Education Limited at page 474.

tanks in Kenya will be restricted to the evaluation of the extent to which such laws deal with the following issues;

- a Irresponsible lending by banks through for example, misleading advertising or marketing, arbitrary change of interest rates and lack of disclosure or information sharing at the initial stages of the credit application process;
5. The mandatory contents of consumer credit agreements to include the use of simple agreements, inclusion of standard clauses that ensure consumer protection such as cooling off periods and disclosure of bank charges and/or terms that may adversely affect the borrower;
- c. Unfair practices by banks such as providing false, misleading or deceptive information, non disclosure of information, imposition of extortionate and hidden default charges and interest rates;
- d. Protection of consumer rights in the event of default.

These in my considered view are real issues that affect the borrowers or consumers of bank credit products which should be managed through mandatory legal provisions contained in Acts of Parliament.

2.4 An assessment of the articles of the Constitution of the Republic of Kenya.

The Constitution of the Republic of Kenya was promulgated on August 27, 2010 and is the supreme law within the jurisdiction of the Republic.² Any law that is inconsistent with the Constitution is void to the extent of the inconsistency and any act or omission in contravention of the Constitution is invalid.³ Given the provisions of article 2 (1) read together with article 2(4),⁴ U statutes enacted before August 2010 should be reviewed at this time and Periodically thereafter and amended accordingly in line with the new institutional dispensation and the jurisprudence evolving therefrom.

² Dv Re k r.**²W which states that the Constitution is the supreme law of the 'si ? c and binds all persons and all State organs at all levels of government.
Article 2 (4)


On the issue of consumer protection, the Constitution contains several articles that entrench the rights of consumers and impose obligations on service providers, including banks, into the legal framework in Kenya. Article 10 entrenches national values and principles of governance (such as good governance, integrity, transparency and accountability) into the legal and institutional framework, therefore setting a standard that providers of goods and services are required to observe and adhere to. This results in increased consumer protection through the minimization of unfair, non transparent and misleading conduct by service providers.

Further, every citizen has a constitutional right of access to information held by the State or another person as well as a right to the correction or deletion of untrue or misleading information that affects them.¹⁵⁴ Article 10 inextricably impacts upon the current statutory provisions and regulations that deal with customer information held by third parties.¹⁵⁵ Banks and Credit Reference Bureaus should therefore constantly review and update their information so as to comply with the provisions of the Constitution and so as not to be accused and possibly sued for violating and/or infringing upon the consumer's constitutional rights. Consumer protection is further augmented by the fact that the Constitution necessitates that consumer information is at least in theory, recorded accurately to aid the consumer and the bank alike when making the purchase/lending decision.

Article 46 of the Constitution deals more explicitly with consumer protection by enumerating the rights to which all consumers, to include those of bank credit products or borrowers, are entitled. These include; the right to goods and services of reasonable quality, the right to information necessary for the consumer to gain full benefit from such goods and services, the right to Protection of the consumer's economic interests, compensation for loss or InJury arising from defective goods and services, amongst others. This article

¹⁵⁴ Article 40,
50,

such as the information held pursuant to the Banking (Credit Reference Bureau) Stations 2008 provisions that will be assessed later in this research.



further provides that Parliament is required to enact legislation to provide for consumer protection as well as for fair, honest and decent advertising.⁶ The impact of Article 46 on existing laws and regulations governing lending by banks in Kenya is potentially huge. Banks and other lending institutions are constitutionally bound to conduct fair, honest and decent advertising thereby empowering consumers in that they have recourse through the filing of constitutional petitions or references in court should an institution fail to observe their rights⁸. It is apparent that the statute/s to be enacted by Parliament in compliance with the contents of Article 46, will be a gargantuan step towards increasing consumer protection.

2.5 An assessment of the provisions of the Banking Act

The business of banking involves the taking and managing of risks. When the bank on the one hand lends money, there is a risk that the borrower will be unable to meet their repayments. Further, when the bank accepts deposits, the depositor expects that they will receive their money back on demand usually with interest. The concept of consumer protection should seek to minimize the risks borne by the consumer such as the loss of deposited funds or the overcharging by banks for credit.

It is arguable that for a bank to effectively provide services and make a profit as a business, the lending arm of the bank should complement the deposit taking arm of the bank. This means that the bank should hold, as deposits, enough money to be able to pay its liabilities as and when they are due as well as to lend in order to generate more income and so forth. Regulations and laws affecting the deposit taking arm of the banking industry may therefore inadvertently affect the credit arm. In all cases, this research aims to show that

¹⁵⁶ Article 46 (3) states that the article is applicable to goods and services offered by both Public and private persons.

⁷ By virtue of the constitutional provisions herein, the rights of the consumers are fundamentally entrenched into the legal and institutional framework in the country. Article 46 read together with Article 2 make it imperative for legislators to review all laws relating to goods and services provided by public and private bodies to ensure that the rights of the consumers are not violated and that they are protected.

⁸ Article 47 provides that every person has the right to administrative action that is expeditious, efficient, lawful, reasonable and procedurally fair.

regulations and laws should be put in place to protect or safeguard both the deposit arm (depositors) and the credit arm (borrowers) of the banking sector. Notably, the then existing Banking Act 1989 was reviewed following the post independence banking crises when financial institutions were failing due to a lack of liquidity¹⁶⁰. Given the circumstances within which the Banking Act was enacted, it can be said that a synopsis of the statute and the subsequent amendments thereto reveals that the common thread that runs through the provisions is that of protecting the depositor, although there are some provisions that inadvertently spill over and protect borrowers or consumers of bank credit products.

Notably, responsible lending was described by the European Union Market Commissioner, Charlie McCreevy as cited in Chuah and Fumston¹⁶⁰ as involving a situation '*where the credit products sold are appropriate for consumers' needs and are tailored to their ability to repay*', and responsible borrowing as involving '*where consumers provide relevant, complete and accurate information on their financial conditions*'. It is desirable that both these ingredients of 'responsible lending' and 'responsible borrowing' be considered essential for the good governance of any banking industry. This should be evident from the statutory and legal framework governing the banking industry which should seek to promote both ingredients. There are many provisions within the current Banking Act that are aimed at protecting all bank customers (read: both borrowers and depositors). Some of these provisions include the inspection and control of banks through the licensing provisions contained within part II of the Banking Act. Under this part, the transacting of banking or financial business without a valid license is prohibited, the use of the term bank or any of its derivatives without the consent of CBK is also prohibited¹⁶¹, detailed licensing guidelines on what is to be considered when determining whether to license an institution or not are provided for¹⁶², minimum capital requirements that banks are to hold at CBK

¹⁶⁰ <http://www.centralbank.go.ke> [accessed June 15, 2011]

¹⁶¹ Chuah J and Fumston M (2010), *Commercial and Consumer Law*, Harlow: Pearson Education Limited at page 475

¹⁶² section 3(i)a and 3(i)b

to ensure liquidity are detailed¹⁶³, situations that may result in the bank's license being revoked by CBK^{16*} are outlined, to name a few.

Taking into account the Molony Committee^{1^} recommendations on consumer protection discussed in chapter one, the provisions of the Banking Act, which seek to protect all customers of the bank promote consumer protection by ensuring that the entrants and participators within the banking industry are continuously vetted and a certain standard of service is maintained. The licensing requirements weed out rogue providers of financial services and unscrupulous lenders who may seek to take advantage of the bank's customers. Such service providers are likely to be widespread in a sector which is not adequately regulated and/or governed through an effective legal and institutional framework. Within the credit industry, the presence of rogue and unscrupulous traders may result in increased misrepresentation and/or arbitrary alteration of interest rates, misconduct by lenders where the borrower is in default of their obligations, false advertising and marketing, fraud to name a few evils. CBK in its role as a regulator and supervisor within the financial sector is stringent in ensuring that the provisions in the Banking Act are adhered to and is quick to step in where there is indication that they are not.¹⁶⁶

Notwithstanding the above, it is arguable that the penalties imposed for breaching some of the provisions of the Banking Act; for example licensing do not serve as sufficient deterrents. Section 3(2) states that any person who contravenes section 3(1), which deals with the use of the term 'bank' or its derivatives without the consent of CBK or transacting in banking or financial business without a license, shall be guilty of an offence and liable to a fine not

⁶³ Section 7
Section 6

¹⁶³ Anderson A (1963), *The Molony Committee Final Report of the Committee on Consumer Protection*, The Modern Law Review, Vol 26 No 1 at paragraph 48.

^{16*} The case in point is the closure of companies such as Kenya Akiba Micro-Finance Limited which was closed down by CBK six years ago for allegedly taking deposits from members of the public and providing banking business without a valid license. The company has since discontinued proceedings, which at the time of writing are yet to be determined, and is currently owing Kenya Shillings Nine Hundred and Thirty Million from CBK in damages as reported by Daily Nation, Friday June 17 2011 at page 30, Business News.

exceeding one hundred thousand shillings or to imprisonment for a term not exceeding three years or both. It is debatable that these enforcement terms provided for within the Banking Act are not commensurate to the crime because the defaulting institution is likely to have benefited in excess of the set penalty and can easily afford to pay it off. These minimalist penalties weaken the protection afforded to all the consumers of banking products.

Furthermore, an overview of the Banking Act indicates that most provisions are aimed at specifically protecting the depositors with comparably fewer provisions geared towards the protection of borrowers or consumers of bank credit products. The whole of Part VIII of the Banking Act deals with the Deposit Protection Fund (hereinafter referred to as 'the Fund') and establishes the Deposit Protection Fund Board (hereinafter referred to as 'the Board'), which has a mandate of providing a deposit insurance scheme for 'customers of member institutions and liquidate and wind up the operations of any institutions'¹⁶⁷. Part VIII also deals with the establishment of mandatory contributions to be made by each institution licensed to carry on financial business in Kenya to the Fund¹⁶⁸, steps to be undertaken by the Board where it appears that the affairs of a licensed institution are being conducted to the detriment of its depositors amongst others. It is clear that these provisions are tailored, with great emphasis being made, on the protection of depositors.

Part III of the Banking Act deals with the issue of prohibited business and contains provisions which limit or place restrictions on issuing of credit, advances and the granting of guarantees, all of which seek to promote responsible lending by restricting the amount of credit, advances or level of Suarantee that may be provided to a single person¹⁶⁹. There is a provision that an institution in Kenya shall not *grant to any person or permit to be outstanding any advance, credit facility or give any financial guarantee or*

and .e does not define 'person' but makes reference to 'individuals', 'associates' 'nf'l'vid'I°° which read in light of the provisions, may include both corporates and ^ats being legal persons as opposed to individuals only.

•,cur any other liability on behalf of any person, so that the total value of Ranees, credit facilities and financial guarantees in respect of that person I any time exceeds twenty five percent of its core capital.¹⁷⁰The extent of Qjy advances, credit facilities or financial guarantees to a particular person is capped at no more than 25% of the bank's or institutions' core capital. It is debatable that 25% represents a substantial amount given that the capital of n institution is defined within the Banking Act as meaning the paid up share capital¹⁷¹ and in many cases, with regards to banks, the paid up share capital may run into billions¹⁷². In view of this, it is desirable that the per centum of 25% be reviewed and/or reduced.

Moreover, there is an exemption provided for on the limitation of advances, credit or issuing of guarantees in that the CBK may authorize a mortgage finance company to permit the total value of the advances, credit facilities and financial guarantees in respect of a particular person^{1^} to exceed 25% of the institution or bank's core capital^{2*}. As a result of this, one may argue that the protection afforded to consumers of credit under section 10 (1) is somewhat reduced where the person is borrowing from a mortgage finance company. In spite of the shortcomings of section, it seeks to manage the risk appetite of banks and minimize the likelihood and existence of irresponsible lending and unfair practices aimed at securing a larger consumer base thereby protecting the bank's customers in general. Management of risk also guards against the collapse of the institution thereby further protecting the bank's customers, in particular, investors and depositors.

¹⁷³II H ^ iss^{11^} <http://www.kcbbankgroup.com> [accessed June 15, 2011].
 an J? . section 10 (3) of the Banking Act, reference to a person includes reference to of (Jclate, which is defined in section 2 insofar as an individual as including any member by the**1*0118 family' any company or other body corporate controlled directly or indirectly Person whether alone or with their associates and any associate of the person's

¹⁷⁴Alan⁶ stated within section 10 (1)

Section 11 of the Banking Act provides that an institution in Kenya shall not ' (c) grant* or permit to be outstanding any unsecured advances in respect of any of employees or their associates or...(d) grant or permit to be outstanding any advances, loans or credit facilities which are unsecured or advances, loans or credit facilities which are not fully secured (i) to **any of its officers** or significant shareholders or their associates or (ii) to any person of whom or of which any of its officers or significant shareholders has an interest as an agent, director, manager or shareholder or (iii) to any person of whom or of which any of its officers or significant shareholders is a guarantor....' This section aims to prohibit any advancement of unsecured credit to employees of the institution or bank or their associates and the significant shareholders of the banks. Further, section 11 (e) states that no institution shall 'grant or permit to be outstanding any advance, loan or credit facility to any of its directors or other person participating in the general management of the institution **unless** such advance, loan or credit facility (i) is approved by the full board of directors of the institution upon being satisfied that it is viable (ii) is made in the normal course of business and on terms similar to those offered to ordinary customers of the institution.' This section goes on to stipulate that the institution should notify CBK of every approval of the board given within seven days of such approval. It is obvious that section 11 (e) seeks to place restrictions on any loans (secured or not) advanced to directors or persons involved in the management of the bank.

The Banking Act however, does not provide a description of what is considered to be 'management of the institution' leaving room for debate. The provisions of section 11 aim to promote responsible lending by banks to their employees and shareholders, limits (in theory) the conduct of unfair practices by the banks such as issuing of loans or advances to employees and shareholders on the grounds of nepotism or commercial interests, reduces fraudulent practices such as instances of issuing unrestricted loans to associates of employees who may then ultimately have a back hand benefit the loan or advance at the expense of the institution and its customers, to

name a few. By virtue of section 11, the employees and shareholders of the bank, may also consider being consumers of the bank's credit products or borrowers, are at least in theory protected from some of the ills that are prevalent within the lending industry by banks in Kenya. However, the enforceability of section 11 and the practice within the banking sector portray a different picture as is highlighted by case precedents.

It is apparent from the provisions of section 11 of the Banking Act that the granting of an unsecured loan to an employee (or permitting one to be outstanding) contravenes the provisions of the Banking Act. In the case of *Peter Kinyanjui Nyaga -v- Kenya Commercial Bank*TM*, the plaintiff was an employee of the bank and was offered four unsecured loans at staff rates. He then sought employment with a different bank, upon which his previous employers sought to revise the rates of the loans. It was held that the court does not have jurisdiction to regulate the interest rates of a commercial agreement such as a loan agreement as this was a matter between the parties in question. Further, it was noted that the issue of contravention of the provisions of section 11 was not pleaded and therefore could not be addressed resulting in an inconclusive outcome with respect to section 11. On the face of it, the provisions of section 11 were contravened leaving the employee exposed to exploitation from their unscrupulous employer, who may not have advised them of the repercussions of changing employment when advancing the loan. There are several decided cases which indicate that banks are regularly found to be culpable of violating the provisions of section 11.^{1?6}

^{1?5} [2011] HCC No 517 of 2010

^{1 *} In the case of *Catherine Njuguni Kanya -v- Commercial Bank of Africa [2001] HCC No 1661 of 2001* the plaintiff, who was an employee of the bank had taken a secured loan from her employer and was therefore not in contravention of section 11 (c). The employee however took part in a strike and was dismissed from employment. The interest rates on the secured loans were recalculated by the bank at the commercial rates. It was decided by the court that this course of action by the bank was unlawful and it was held that the applicable rate should be the initial rate of the loan. Further, in the case of *Trust Bank Ltd -v- Paramount Universal Ltd, Ajay Shah and Praful Shah [2001] HCC No 1243 of 2001* it was held that the bank acted in contravention of section 11 by granting and permitting to be outstanding an unsecured loan to their employee.

Section 177(i) (h) of the Banking Act prohibits an institution from granting any loan or credit facility or conducting its business or part thereof in a fraudulent or reckless manner. Fraudulent conduct is described in the Banking Act as including intentional deception, false and material misrepresentation, concealment or non disclosure of material facts or misleading conduct that results in loss or injury to the consumer of the institution¹⁷⁷. Notably, there is no description within the Act of what is considered to be 'material' or what amounts to 'concealment' and therefore it is arguable that one is required to seek guidance from common law and precedents¹⁷⁸, which have varied descriptions on a case to case basis. The issue of materiality is often put down to the facts of the case in question and the significance of the course of action having regard to the facts as highlighted by Lord Justice Ralph Gibson who stated that;^{17*}

Whether the fact not disclosed is of sufficient materiality to justify or require immediate discharge of the order without examination of the merits depend on the importance of the fact to issues which were decided by reason of the duty on the applicant to make all proper inquiries and to give careful consideration to the case being presented.'

In addition, the threshold of proving conduct amounting to fraudulent or reckless behaviour is questionably high. The onus of proving the case lies on the claimant who is typically the consumer of the goods and services in dispute. As highlighted by Justice Kneller in the case of *Brinksmat Ltd -v- Elcombe*¹⁸⁰, allegations of fraud must be proved to a high standard of proof and beyond reasonable doubt. There is a higher degree of probability required which is over and above a mere balance of probabilities¹⁸¹. There are also a

Section 177(iA)

Such as Brinksmat Ltd -v- Elcombe (1988) 3 ALL ER 188; Tiwi Beach Hotel Ltd -v- Court of Appeal Mbsa, Civil Case No 63 of 1990; Bao Investment and Office Management Services Ltd -v- Housing Finance Ltd Nbi Court of Appeal Case No 171 of

* the case of *Brinksmat Ltd -v- Elcombe (1988) 3 ALL ER 188 at page 192*

¹⁷⁷ *3 ALL ER 188*

¹⁷⁸ *Case of Mutsongar -v- Nyati (1984) KLR 425*

wide range of defences¹⁸² that are available to the defendant who is usually the bank making it an uphill task for the claimant to prove the case albeit not impossible^{1^}.

In view of this, whilst the provisions of section 11 (1) (h) go a long way in protecting the consumer in general, the corresponding burden and onus of proving fraudulent or reckless conduct on the part of the bank placed on the claimant raises questions as to whether the enforceability of such protection is effective in increasing consumer protection. It is arguable that a more effective way of promoting consumer protection would be to have stronger provisions within the Banking Act, such as those that control or prohibit certain conduct or unfair practices, including misleading advertisements¹⁸⁴, prescribing minimum contents and terms of the credit agreement, minimum disclosure standards, protecting the borrower's rights both at the initial contractual stage or in time of default to name a few. This will ensure that there is a bare minimum standard set governing lending by banks in Kenya as well as minimum obligations to be satisfied by the banks and their representatives when dealing with or processing applications made by prospective borrowers or consumers of bank credit products, failing which there should be punitive action and/or mandatory fines imposed. Such fines should be commensurate with the benefit to the bank and serve as adequate deterrents.¹⁸⁵

¹⁸² Such as stating that all reasonable precaution and due diligence was undertaken as decided in the case of *Berkshire County Council -v- Olympic Holdings Ltd* [1994] Crim LR 277 or that it was an innocent mistake

¹⁸⁴ In the case of *Trust Bank Ltd -v- Paramount Universal Bank Ltd and 2 Others* [2009] 2 KLR 1000, the plaintiffs successfully proved their case that the defendants were fraudulent and reckless by engaging in acts of intentional deception against the plaintiff, misleading the Plaintiff to issue cheques, engaging in devices that led to loss to the plaintiff and cheating them out of their monies.

Section 51 of the Banking Act prohibits misleading or false advertisements inviting any person to make a deposit. Notably, this section is limited to deposits and not credit facilities or other banking products in general.

Section 8 of the Consumer Credit Act 1974 (as amended in 2006) of the Consumer Credit Act contains provisions defining what a consumer credit agreement governed by the Act is. Section 16 details the types of credit agreements that are exempt from the provisions of the Act. Part IV of the act deals with the conduct of businesses when seeking business in Kenya. Section 17(1) of the Consumer Credit Act 1974 (as amended in 2006) provides for the following: (a) Positive disclosure, circulars and credit information being distributed to consumers; (b) Pre-contract disclosure to name a few.

part X of the Banking Act contains miscellaneous provisions, some of which seek to restrict the conduct of banks, with regards to increasing bank charges, and limiting the interest recovered by the bank on defaulted loans. Section 44 provides that no institution shall increase its rate of banking or other charges except with the prior approval of the Minister. This seeks to set a procedure and put in place checks and balances for banks wishing to increase their bank charges, which ideally should include interest charges. Practically however, this provision has not stopped banks from increasing their lending rates arbitrarily and notably, the CBK has had to step in, albeit unsuccessfully, on several occasions and persuade banks to reduce their lending rates and thus pass on the benefit of low central bank rates (the rate which commercial banks borrow from the CBK) to the consumers. Notably, section 16A of the Banking Act restricts imposition of charges on savings accounts and compels banks to pay accrued interest to their customers on such savings accounts. There is no similar provision restricting or controlling increases of interest rates on bank credit products including loans, mortgages or overdrafts¹⁸⁶.

Over the years, the lending sector has proved to be volatile. Banks have often justified their increases in lending rates by stating that the Central Bank Rate has been increased and accordingly, they are unable to absorb the cost of such an increment and have to pass it to the consumers¹⁸⁷. To add to the existing

¹⁸⁶ The Banking Act 2001 (referred to as the Donde Act) was introduced by MP Joe Donde who sought to reduce the difference between savings deposit rates and lending rates to 6% on the upper side thereby restricting the banks' discretion to escalate interest rates. The commercial banks proceeded to court to fight the provision which was repealed through the Central Bank of Kenya (Amendment) Act 2004 without having been fully implemented. There is currently a fresh attempt by Rangwe MP, Martin Ogindo to control maximum chargeable interest rates by banks. The Banking (Amendment) Bill 2011 seeks to fix the minimum saving deposit interest rate at 70% of the Central Bank Rate and to restrict interest rates on loans to a maximum of 4% above the Central Bank Rate (*Investment News Kenya: How the Courts have frustrated efforts to control rising bank lending interest rates in Kenya*, found in [WKilZ3www.investmentnewskenya.com/how-courts-h](http://www.investmentnewskenya.com/how-courts-h)

¹⁸⁷ <http://www.investmentnewskenya.com/how-courts-h> [accessed November 11, 2011] To date, as was the case in *Donde v. Commercial Bank of Africa*,²⁰⁰¹ the commercial banks are fiercely fighting the introduction of such provisions even when the interest rates charged threaten to go through the roof with disastrous effects to the economy. At the time of writing parliamentary debate on the Banking (Amendment) Bill 2011 is ongoing.

¹⁸⁸ The CBK has kept a keen eye on the lending or interest rate set by banks to their customers and continues to use the Central Bank Rate to control the bank interest rate. However, their role as a backstop of banking legislation has been reduced to that of a toothless dog. For example, the CBK raised the Central Bank Rate from 6.25% to 8% with the knock on effect of such as Commercial Bank of Africa, Equity and I & M Bank raising their interest rates

legislative shortcomings, there is difficulty posed to both CBK and the banks to balance the requirements of the different stakeholders of the banking industry to include employees, customers, shareholders, government to name few. An increment of lending rates may prove beneficial to the bank's shareholders in terms of profit earned but on the other hand it may prove detrimental to the borrowers or consumers of bank credit products through increased borrowing charges on existing loans.

Further, to compound to the predicament faced by borrowers or consumers of bank credit products, the courts have on many an occasion held that their role is to construe contract terms made between parties to a contract and not to negotiate such terms or conditions¹⁸⁸. The courts have confirmed that each party to the contract is at liberty to reject any unfair term and negotiate more favourable ones thereby presuming equal bargaining power between the banks and the borrowers or consumers of bank credit products, a presumption which is arguably untenable because often, such borrower is in dire need of financing and is forced to accept the terms and conditions proposed by the bank. The courts have however intervened in instances where the agreement between the bank and the borrower does not specify the interest rate chargeable. In such instances, the court has relied on powers conferred to it under section 26 of the Civil Procedure Act which states that;

'(1) Where and in so far as a decree is for the payment of interest of money, the court may, in the decree, order interest at such rate as the court deems reasonable to be paid on the principal sum adjudged from the date of the suit to the date of the decree in addition to any interest adjudged on such principal sum for any period before the institution of the suit, with further interest at such rate as the court deems reasonable on the aggregate sum so adjudged from the date of the decree to the date of payment or to such earlier date as the court thinks fit.....(2) where such a decree is silent with respect to the

1? credit to an average of 23-25% (reported in the Daily Nation, June 30, 2011, page 25 Business Section).

^{Tmsnf^{8aV0} -v- KCB and Another HCC No 428 of 2001; Simiyu -v- HFCK [2001] 2 EA 540; Bank Ltd -v- Eros Chemists Ltd and Another Civil Appeal No 133 of 1999.}

payment of further interest on such aggregate sum as aforesaid from the date of the decree to the date of payment or other earlier date, the court shall be deemed to have ordered interest at 6 per cent per annum.'

In the several decided cases the courts have held that banks which failed to stipulate rates of interest in lending agreements run the risk that the courts will fall back on the provisions of section 26 of the Civil Procedure Act and exercise their discretion in awarding interest.¹⁸⁹ The court in this case confirmed that banks ought to specify in the lending agreement what interest rate is payable. Notably, the court in this case also pointed out that where by agreement the parties have fixed the interest payable, the court had no discretion in the matter and had to enforce the agreed rate unless it was shown that it was either illegal or fraudulent. It is arguable that the courts application of section 26 of the Civil Procedure Act affords some protection to borrowers where the lending agreement does not state the interest payable. However, this protection is subject to the courts discretion in setting a favourable interest rate and is therefore not consistent or certain. Further, where parties have agreed on an interest rate, the court has clearly stated it has no discretion to interfere even if a party considers such interest rate to be extortionate. The only instance where the court has declared it may intervene is where the rate of interest is successfully shown to be unconscionable, illegal or fraudulent with the onus of proof being on the claimant and the standard of proof being above that of a balance of probabilities. Again, the court presumes equal bargaining power between the bank and the borrower, a scenario which is seldom the case.

Having regard to the aforesaid, it is arguable that enactment of a statute dealing with real issues experienced by the borrowers or consumers of bank credit products or lending in general may be beneficial in setting a ceiling on permissible interest rates and providing a definition or description of what is considered to be extortionate rates. A capped per centum such as say 4%

Shah -v- Guilders International Bank Limited Court of Appeal case no 135 of 2001 and
^N **Ambro** Bank NV -v- Ee Monde Foods Ltd Civil Application No 15 of 2002.

bove the Central Bank of Kenya rate as was attempted by the Banking Act
ool Act) anc* is currently proposed by the Banking (Amendment) Bill
qii Such a provision would compel the courts to declare a credit agreement
ntaining interest rates over and above the prescribed rate as being
xtortionate and in violation of the consumer's constitutional and legal rights.
Further, such as statute would compel the court to provide a suitable remedy
to claimants and/or consumers who have suffered loss as a result of the banks'
default. It would also compel banks to set their interest rates below the
prescribed rate to avoid contravening the law and facing hefty penalties. It is
desirous that such a statutory provision, if effectively and comprehensively
drafted would on the one hand provide flexibility and certainty for the banks
to operate in the open market within minimum set standards while on the
other hand protecting the consumer from extortionate and somewhat
arbitrary lending rates. At the time of writing this thesis the trend is that once
CBK announces an increase in the Central Bank Rate, the banks inadvertently
follow by announcing an increase in their commercial lending rate, justified or
not.^{1^}

Section 44 (A) of the Banking Act provides limitations on the interest
recoverable by banks and other financial institutions upon *defaulted or non
performing loans*. This provision does not however extend to performing or
non defaulted loans. The bank is only permitted to recover from the debtor,
with respect to a non performing loan, the maximum amount comprising of
the principal owing when the loan became non performing plus interest in
accordance with the contract between the debtor and the bank (which shall
not exceed the principal amount owing when the loan becomes non
Performing) and expenses incurred in the recovery of any amounts owed by
the debtor. There is no definition within the body of the Banking Act of what is
considered to be a non performing loan. However, it provides that non
Performing loans are considered to be so pursuant to guidelines stipulated

By way of example, as advertised in the Daily Nation, July 6 2011, page 10 where NIC bank
"increased its lending rate from July 15, 2011. Banks such as Commercial Bank of Africa
d KCB have also done the same. The increment has occurred after CBK increased their
ntial bank rate as highlighted in note 187 above.

time to time by CBK.^{1?1} It is arguable that the definition of non performing loans should be incorporated within the body of the Banking Act, for purposes of completeness and clarity. Furthermore, the legal binding effect of guidelines generally has been a topic of debate over the years, in particular the issue of whether practice guidelines are merely provided for purposes of administrative guidance as opposed to them having a legally binding effect on contracting parties^{1?2}. Notwithstanding this, it is arguable that prudential guidelines obtain their binding effect by virtue of section 55 of the Banking Act which states that the Minister for Finance (by extension through the CBK, which falls under their docket) may make regulations for carrying out the purposes and provisions of the Banking Act and in those provisions, may prescribe penalties to be paid by institutions or credit reference bureaus which fail to comply with the directions.

The provisions contained within section 44 (A) aim to protect the consumer from exploitation by banks and financial institutions during times when they are unable to meet their obligations under the credit agreement. It is however desirable that the Banking Act should contain more provisions protecting the borrower or consumer of bank credit products from exploitation at their time of need. It should also contain mandatory requirements that lenders provide clear warnings that missing payments could have severe consequences on the borrowers' circumstances, including their credit rating. It is worthwhile noting that there is no provision in the Banking Act governing the conduct of enforcement proceedings and it is commonplace to see banks harassing borrowers who fall into arrears and in many cases failing to assist borrowers even in cases of genuine hardship, which may only be short lived, for example by providing a moratorium during which the borrower may make reduced

¹ For instance prudential guidelines, in particular guideline 4, which defines non performing **as loans** that are no longer generating income or when it comes to the institutions knowledge at a credit facility will no longer generate income. The guideline continues to state that loans **non** performing when the principal or interest due is unpaid for 90 days or more or 90 days has been rolled over into a new loan or refinanced. ^{19a} ^{ve} ^{Port} dated April 8, 2003 prepared by the International Bureau for the World Intellectual Property Organization conference held at Geneva on May 12 to 16, 2003. The report is titled *dis* ^S *practice guidelines under the draft Substantive Patent Law Treaty: Options for* Kliff¹⁰⁰ and can be found on ^{^B^!} [Qfly.wipo.int/edocs/mdocs/scp/en/scp_Q/scp_Q_6.doc](http://qfly.wipo.int/edocs/mdocs/scp/en/scp_Q/scp_Q_6.doc) [accessed July 7, 2011].

payments, lengthening the term of the agreement to facilitate reduced payments to name a few. This indicates that section 44 is incomplete in dealing with the protection of the rights of a defaulting borrower. It deals with the interest element arising from non-performing loans but not the other elements of default such as the conduct of enforcement proceedings, the enforceability of agreements, recovery procedures amongst other issues.

From the above, this research suggests that the Banking Act contains anomalies and/or shortcomings that require addressing. There is a need to review its provisions in order to make the Banking Act more comprehensive and incontrovertible. In the alternative, it may be prudent to have an entirely separate comprehensive Act dealing with credit agreements through banks or other lending institutions where the institution and the borrower do not have equal bargaining rights in terms of their economic or financial clout. Such a comprehensive Act may prove to be more cost effective in terms of compliance and implementation costs pursuant to the theory of economic analysis of the law. A separate comprehensive act governing lending in general may also prove to be less fragmented and therefore less confusing in its application as compared to inserting provisions in the existing separate Acts governing the different types of institutions⁹³ in a piecemeal fashion.

2.6 An assessment of the provisions of the Central Bank of Kenya Act

The Central Bank of Kenya Act, Cap 491 of the Laws of Kenya, establishes the Central Bank of Kenya (hereinafter CBK) and mandates it to conduct its role as regulator of the finance sector. The principal object of CBK is described as being to 'formulate and implement monetary policy directed to achieving and maintaining stability in the general level of prices'.⁹⁴ CBK is also required

⁹³ For example, Microfinance Institutions governed under the Microfinance Act, Banks governed under the Banking Act, SACCOs governed under the Sacco Societies Act, Building Societies governed under the Buildings Society Act, Post Office Savings Bank governed under the Kenya Post Office Savings Bank Act to name a few.

⁹⁴ This assessment is conducted on the Central Bank of Kenya Act incorporating changes up to February 21st 2011.

to foster the liquidity, solvency and proper functioning of a stable *market-based* financial system. Section 4(3) requires CBK to support the government's economic policy, including its objectives for growth and employment¹⁹⁷. It is clear from the provisions in the statute that CBK's main role is as regulator of the financial market and its players, which includes banks. CBK is also designated as the fiscal agent for government transactions pursuant to section 32 of the Central Bank of Kenya Act.

An overview of the Central Bank of Kenya Act indicates that the provisions put in place are largely tailored towards legitimization of CBK as an institution and its overall objectives. The provisions contained within the statute regulate the relationship between the CBK and the financial institutions conducting banking business. The provisions also govern the relationship between the financial institutions with each other. It is arguable that it was not contemplated by law makers that the statute should regulate the relationship between financial institutions, including banks and their customers. By way of example, the statute contains several provisions geared towards regulating the relationship between banks and that between CBK and banks. Part VII regulating the relationship between the CBK and banks depositing and borrowing from it¹⁹⁸. In addition, the Central Bank of Kenya Act permits and makes provision for the CBK, acting as the government's fiscal agent, to 'administer *public debt*¹⁹⁹ including the issuance of, payment of interest on and redemption of bonds and other securities of the government.'²⁰⁰ Further, section 46 permits CBK to direct advances to the government for the purposes

¹⁹⁷ This puts into question CBK's independence and objectivity as a regulator in circumstances whereby the considered view of the Monetary Policy Committee (set up under the Central Bank Act to formulate Monetary Policy) is inconsistent with the government's proposed Policy. It is doubtful in such circumstances whether the CBK would effect its policy at the expense of the government's objectives given that the CBK is under the Ministry of Finance **docket**.

CBK acts as a lender of last resort for banks by granting loans and advances for fixed periods to specified banks at whatever rate it determines and announces,

where Public entity is defined in the Central Bank of Kenya Act to include the government, local authority or any public body specified by the Minister on the recommendation of the CBK as a public entity for the purposes of effecting the provisions of the Central Bank of Kenya Act.

~ Action 45 (c). CBK acts not only as a fiscal agent and banker to the government but also as a fiscal agent and banker for public entities in accordance with and within the scope agreed between the public entity and CBK. This role as a fiscal agent and banker of the government and public entities again puts into question CBK's objectivity and independence as effecting their monetary policy.

of offsetting differences between receipts on revenues and payments. CBK is however prohibited from guaranteeing *any* loan, advance or investment²⁰¹ and any advances made to the government must bear interest at market rate, be secured through securities issued by the government and must be made purely on a temporary basis.²⁰²

It is apparent from the issues highlighted above and the contents of the Central Bank of Kenya Act as a whole including its preamble that it was not the intention of the legislators to include provisions governing the relationship between the consumer and the bank within the statute. In view of this, the Central Bank of Kenya Act should not and does not contain provisions dealing with the issues experienced by borrowers or consumers of bank credit products and the fundamental elements of lending to individual borrowers. It is desirable that the Central Bank of Kenya Act should contain provisions empowering CBK to directly regulate banks and/or intervene in issues related to the conduct and governance of lending agreements, in particular, the control of lending rates of commercial banks in line with the Central Bank of Kenya base rate and their credit policy. Further, it was not projected and indeed the statute does not deal with the protection of individual consumers as opposed to banks borrowing from CBK. Notwithstanding this, CBK is required to advise the Minister of Finance on any matter which in its opinion is likely to affect achievement of its objectives or that is of concern to it, which includes commercial lending rates, an issue that CBK has been outspoken on particularly recently.²⁰³

Section 52.

Section 46 (2) puts limitations on the lending capacity of CBK to the government and also puts in place a procedure and controls lending to the government (which is widely defined in the Central Bank of Kenya Act).

with- [^] arSuably however reduced to being a persuasive one due to a lack of provisions [^]unn the Central Bank of Kenya Act mandating CBK unequivocally to have an active role in [^] Sovernance of commercial lending rates and commercial banks' credit policy. *Supra* note

- An assessment of the provisions of the Prudential Guidelines and Ranking Regulations

prudential Guidelines

The CBK is mandated, within the Banking Act,^{20*} to advise and direct the business of institutions for the general carrying out of the purposes and provisions of the Banking Act. CBK issues directions, being the Banking Regulations (discussed later in this section), that all licensed banks should comply with and guidelines, termed as Prudential Guidelines, which are to be adhered to by all institutions in order to maintain 'a stable and efficient banking and financial system.'²⁰⁵ There are thirteen guidelines issued by CBK to date²⁰⁶. The regulations and guidelines issued by CBK complement the Banking Act and are enforceable and binding on financial institutions by virtue of sections 33(5) and 55 which state that a failure to comply with directions and regulations provided by CBK will attract a penalty^{20?}.

Prudential guidelines are provided by CBK to institutions governed under the Banking Act. In issuing these guidelines CBK attempts to adopt international standards of banking such as the Basel Accord²⁰⁸; for example guideline 3 is based on the Basel capital adequacy measures. Relevant to this research,

²⁰⁴ Section 33(i)(b)

²⁰⁵ Section 33(4)(b)

²⁰⁶ These include guidelines on licensing of new institutions (CBK/PG/01); corporate governance (CBK/PG/02); capital adequacy (CBK/PG/03); risk classification of assets and provisioning (CBK/PG/04); liquidity management (CBK/PG/05); foreign exchange exposure limits (CBK/PG/06); prohibited business (CBK/PG/07); proceeds of crime and money laundering (prevention) (CBK/PG/08); appointment duties and responsibilities of external auditors (CBK/PG/09); publication of financial statements and other disclosures (CBK/PG/10); opening of new place of business, closing existing place of business or changing location of place of business (CBK/PG/11); mergers, amalgamations, transfer of assets, liabilities (CBK/PG/12) and enforcement of banking laws and regulations (CBK/PG/13).

By virtue of section 55 (2), the Minister of Finance may, within regulations, prescribe Penalties to be paid by institutions (including banks) or credit reference bureaus which fail to comply with the directions of CBK. Such penalties shall not exceed one million shillings in the case of an institution or the credit reference bureau and one hundred thousand shillings in the case of an individual.

A set of agreements set by the Basel Committee on Bank Supervision (BCBS), which provides recommendations on banking regulations for issues such as capital risk, market risk, Operational risk. The main purpose of the accords, which are three in number, is to ensure that financial institutions have enough capital to meet obligations and absorb unexpected

See http://www.investopedia.com/terms/b/basel_accord.asp [accessed, July 13, 2011].
in,²³ in the process of implementing the provisions of the Basel Accords and is currently implementing those contained in Basel II.

guideline 4 touches on and concerns the issue of credit and lending by banks²⁰⁹ and its purpose, as outlined therein, is to ensure that 'all assets are regularly evaluated using an objective internal grading system which is consistent with the guideline and that timely and appropriate provisions and write offs are made to the provisions (or loan) accounts in order to reflect the true condition and operating results of the institutions'²¹⁰. This guideline ultimately ensures that the risk appetite of the institution is constantly reviewed and managed in accordance with set principles to maintain the stability of the financial sector.

Guideline 4 also provides a definition of non performing loans pursuant to section 44 (a) of the Banking Act. Loans²¹¹ are described as being non performing when they are no longer generating income or when it comes to the institution's knowledge that a credit facility will no longer generate income,²¹² therefore ensuring that the institution is periodically re-evaluating their debtors and payments received.²¹³ Current accounts and other credit extensions are deemed to be non performing if the balance exceeds the customer's approved limit for more than 90 consecutive days or if the interest is due and unpaid for more than 90 days.²¹⁴

The aforementioned provisions provide clarity insofar as section 44 (a) of the Banking Act and aim to provide consistency within the application of the said Act. If well utilized, the provisions of guideline 4 may be used to increase consumer protection by ensuring that banks conduct periodical reviews of loans and that they obtain an explanation from the borrower, where a loan has

²⁰⁹ CBK/PG/04 which is titled Risk Classification of Assets and Provisioning.

Ibid section 2.1 at page 65 of the Prudential Guidelines 2006.

Described within the guideline to include any loan, discount, advance, overdraft, export Wis purchased, customer liability on off-balance sheet items and any credit extended to customers of an institution. This definition is all encompassing therefore leaving little room
^{Or} **debate on whether any type of advance is a loan or not. The guideline also states that the terms loans and advances may be used interchangeably.**

[^] **Guideline 1.4 of CBK/PG/04.**

^{.3} **The guideline continues to state that loans are non performing when the principal or Merest due is unpaid for 90 days or more or interest payments for 90 days or more have been polled over into a new loan or refinanced.**

^H **Guideline 1.4.2 of CBK/PG/04.**

been classified as non performing in order to seek an appropriate solution^{2^}. This review if effectively conducted may result in an appropriate solution being agreed upon within the stipulated 90 days, resulting in the status of the loan remaining as a performing loan, which is more advantageous to both the bank and the credit rating history of the borrower. This research, through the conduct of primary research aims to find out whether such proposed solutions, amongst others are being offered by bank representatives in practice in order to assist defaulting consumers when they are experiencing genuine temporary hardship or whether in the alternative, banks quickly seek enforcement action against the borrower without recourse.

Guideline 2.3 of CBK/PG/04 states that the Board of Directors of every institution shall prescribe, in writing, their credit policy specifying the criteria and procedures in *evaluation, processing, approval, documentation and disbursements of credit*. Such procedure should include procedures for loan administration and recovery. This clause seeks to standardize the credit lending process within banks thus ultimately protecting the borrower from exploitation and/or unfair practice that results from a lack of procedure, with each bank representative exercising their uncapped and unguided discretion in decision making. Standardization notwithstanding, this research asserts that bank representatives are still left with too wide a discretion on credit matters, which should be further controlled. It is clear from guideline 2.3 that it is up to the bank to initiate and enact internal policies and ensure adherence to such policies by all members of staff. There is also no detailed guidance on the extent, contents and nature of such policies that ought to be developed by the bank. This weakens the consumer protection provided for because the provisions do not compel banks to utilize approved standards or policies nor do they oblige banks to deal with some of the evils or real issues experienced by borrowers or consumers of bank credit products such as non-disclosure, false or misleading information, false or misleading advertisement to name a few. This research seeks, albeit not as a main objective of the primary

JL ^Xamples of such solutions include the bank proposing the restructuring of the loan, ttering a moratorium to the debtor, extending the term of the agreements with the net effect educating the monthly payments, to name a few.

research, to establish whether banks have effected an internal and/or standardized credit policy and if so, if such policies are being utilized in practice. Guideline 3.1 states that each institution shall have a loan review function so that amongst other issues, the problem accounts are identified in a timely and proper manner and dealt with accordingly. This regulation, if adhered to may assist in identifying consumers who are experiencing financial difficulties and are unable to meet their repayment obligations. The bank may then seek to address the problem accordingly, thereby protecting both the bank and the borrower from the effects of a defaulted account that has been left unnoticed and unmanaged²¹⁶.

Notwithstanding the protection afforded within the guidelines, it is arguable that more comprehensive statutory provisions should be put in place to deal with issues affecting borrowers or consumers of bank credit products and lending in general. These issues include the governance of enforcement action when the borrower is in default, disclosure, mandatory contents of credit agreements, false or misleading advertising and marketing to name a few thereby increasing consumer protection by reducing arbitrary action by the bank or its representatives. Notably, CBK/PG/04²¹⁷ provides for the suspension of interest rates on non performing loans and advances and guideline 3.7 also provides guidance on the treatment of collateral pledged by the borrower. These provisions seek to protect the consumer from exploitation by way of freezing cumulative interest during the time of default. Given that a loan or advance is considered to be non performing after 90 days of non payment of the sums due or interest,²¹⁸ then it infers that a bank may not charge interest after 90 days or 3 months of non performance. This seeks to control exploitation and unfair practices conducted by banks against the consumer.

Clause 3.2 also sets guidelines on the classification of loans based on the capability of the **borrower** to make payments.

Guideline 3.6 provides that all interest on non performing loans and advances will be pended in accordance with the criteria set out in this guideline and should not be treated the bank as income

²¹⁸ Guideline 1.4 of CBK/PG/04. *Supra* note 212.

overview of the Prudential Guidelines relating to consumer credit, in particular, CBK/PG/04 indicates that, although its provisions seek to protect borrowers by capping and/or controlling the interest chargeable during default, prescribing the treatment of collateral, recommending the classification of loans, proposing the use of set credit policies amongst other issues, the guideline is debatably more concerned with the bank's classification and management of risk and assets. The provisions that deal with consumer protection arguably still leave a wide discretion to banks in as far as their enforcement and application is concerned, for example the contents of the banks' written lending policy, thus opening them to abuse and diluting much of the protection afforded. Further, as previously highlighted²¹⁹, whilst banks and financial institutions acknowledge that the guidelines are binding upon them pursuant to the provisions of the Banking Act, it is open to debate that the prudential guidelines are of a lower legal standing than an Act of Parliament, more so if there appears to be a conflict between the guidelines and the Act. This research proposes that although CBK/PG/04 (Risk Classification of Assets and Provisions) and the terms therein relating to lending and risk classification is an attempt to protect borrowers, it is a half hearted one. Clear, unequivocal, undisputed and all encompassing provisions should be put in place vide an Act of Parliament to deal with the prevailing issues that affect borrowers and governing lending. This research recognizes that this is an enormous and time consuming activity that will involve reviewing the current laws to ensure that there is no duplication or conflict however, it is proposed that there is no better time to review existing laws given the new constitutional dispensation. After all, it is likely that the role of lending in society will increase and not reduce in the near future and adequate legal provisions governing lending will be considered critical to the stability and efficiency of the financial sector.

²¹⁹Report dated April 8, 2003 prepared by the International Bureau for the World Intellectual Property Organization conference held at Geneva on May 12 to 16, 2003 and titled *Status of practice guidelines under the draft Substantive Patent Law Treaty: Options for discussion* and can be found on http://www.wipo.int/edocs/mdocs/scp/en/scp_Q/scp_Q_6.doc, *Supra* note 192.

y Banking Regulations

There are several Banking Regulations (hereinafter called the Regulations) which have been issued by CBK to supplement the Banking Act and expound on its provisions aimed at achieving a more comprehensive and exhaustive legal framework²²⁰. In addition, the Regulations provide more detailed guidance on the application of the statute and apply to all banks licensed under the Banking Act. For example, the Banking (Penalties) Regulations 1999 deals with penalties imposed on all banks and financial institutions that fail to meet their obligations under the Banking Act²²¹. Notably, the penalties in the 1999 regulations are the same as those imposed under section 55 of the Banking Act. It is desirable that these penalties as discussed earlier should be increased or revised upwards to make them commensurate to any benefit enjoyed by the bank as a result of the bank's violation of the regulatory and statutory provisions²²².

Notably, the Minister for Finance is empowered to prescribe additional charges.²²³ However, these additional charges imposed are capped at ten thousand shillings per day for each case of failure by the bank. Again, this capped figure is arguably set too low for it to serve as an effective deterrent, given the profit potential of the violating bank. The Banking (Penalties) Regulation at clause 3 outlines what constitutes a specific violation of the directions; for example the granting of loans and advances to any person in excess of 25% of the institutions core capital, outstanding unsecured advances

²²⁰ These include the Banking (Deposit Protection Fund) Regulations, 2003, the Banking (Liquidation of Institutions) Regulations 1992, The Banking (Penalties) (Amendment) Regulations 1999, The Banking (Increase of Rate of Banking and other charges) 2006, The Banking (Credit Reference Bureau) Regulations 2008, to name a few.

¹ Regulation 2 (a) of the Banking (Penalties) Regulations, 1999 states that any institution that fails or refuses to comply with CBK directions under the Banking Act shall be liable to a Penalty not exceeding one million in case of an institution and one hundred thousand in case of a natural person.

²²² For example, for a given type and number of identifiable breaches, the mandatory penalty within the statute and regulations may be recorded as a Percentage rate of the quantifiable benefit or provable liquidated damages to the borrower.

³ Regulation 2 (b) of the Banking (Penalties) Regulations, 1999.

to the bank's employees or the bank's directors.²²⁴ Clause 3 extends to the violations, as outlined within section 11 of the Banking Act including failure by institutions to exhibit their annual audited accounts in a conspicuous place in every office and to publish the same in a national newspaper^{2^}. Publishing and displaying of audited accounts increases consumer protection by equipping borrowers with information that may prove useful to them when making a decision on whether to procure a product or not.²²⁶ An overview of the provisions of the Banking (Penalties) Regulations, 1999 indicate that they aim to increase protection of *all* borrowers or consumers of banking services and are not tailored specifically to consumers of bank credit products.

The Banking (increase of Rate of Banking and other Charges) Regulations 2006 contain provisions that are more specific to borrowers. By way of example, they specifically stipulate that the bank is required to make an application to the Minister of Finance through the Governor of CBK before increasing their rate of banking or other charges²²⁷. The provisions of Regulation 2 are complementary to those contained within section 44 of the Banking Act²²⁸. Each institution is required to post their rates of interest and charges levied on the products offered in a conspicuous place or circular^{22*} and where the bank is seeking to introduce a new product, prior to charging, levying or imposing any rate or charge, they are required to notify the Minister

²²⁴ The specific violations within clause 3 of the Banking (Penalties) Regulations, 1999 are similar to those contained within section 11 of the Banking Act, which are discussed within the assessment of the provisions of the Banking Act (section 2.5 of this thesis). It remains the case in point of this research that the figure of 25% of the institutions core capital is too high. Further, as highlighted in section 2.5, it has been found in practice as evidenced by decided cases that banks allow unsecured loans to their employees to remain outstanding therefore being culpable to breaching the provisions of section 11 of the Banking Act.

²²⁵ Regulation 3(1) (g) of the Banking (Penalties) Regulations 1999.

²²⁶ The protection afforded is subject to the consumer's own understanding of accounts and how they impact upon their purchase decision, which is often a highly technical and complex concept.

[^] According to Regulation 2 of the Banking (Increase of Rate of Banking and other Charges) Regulations, 2006, the Governor of CBK is required to consider every application submitted
^{ln} Particular whether the proposed increase or change is in conformity with government Policy of entrenching a market-orientated economy in Kenya and whether the change or
[^]crease is above or below the underlying inflation rate prevailing over the twelve months Preceding the application.

. **By** virtue of section 44 A of the Banking Act, interest recovered on defaulted loans **is**
[^]cluded in the definition of 'banking and other charges' as similarly outlined in regulation 2.

[^] **Regulation** 6 of the Banking (Increase of Rate of Banking and other Charges) Regulation

of Finance in writing.²³⁰ It is clear that these provisions attempt to protect the borrower in that they aim to set a predetermined procedure and standard before any increases in rates of banking and other charges are imposed. This is done with a view of controlling inflation and putting checks and balances to ensure that borrowers are not charged exorbitant interest rates and defaulting charges, which may be increased arbitrarily without consultation. There is however not clear definition of what constitutes a 'bank charge' or indeed how the rates of interest are to be determined. The regulations are limited to increases of such charges and rates of interest.

The Banking (Credit Reference Bureau) Regulations, 2008 establishes and licenses the Credit Reference Bureaus to operate bureau business in Kenya.²³² Activities of the bureaus are provided for in the regulations and include the obtaining of customer information; the storage, management, evaluation, update and dissemination of customer information to subscribers; the compiling and maintaining of a database to generate a report from customer information on the database; the assessment of a customer's credit worthiness; the carrying out of market and statistical research relating to matters set out under the regulations to name a few.²³³ A bureau is prohibited from engaging in activities not specified under the Banking Act. The purpose of collating such customer information as contained in the regulations, is so that it may be exchanged or shared amongst subscribers of the Banking Act, being institutions licensed to conduct banking business in Kenya.

²³⁰ Regulation 7 of the Banking (Increase of Rate of Banking and Other Charges) Regulation 2006.

That notwithstanding, as previously discussed, banks have been quick to charge consumers increased lending rates when CBK revises their Central Bank Rate upwards indicating that banks are not willing to absorb any form of increased costs howsoever incurred. Further, in the case where CBK lowers their Central Bank Rate, banks are generally slow to pass on the benefit to their customers as is the case at the time of writing this thesis. This is an issue that as often required the intervention of CBK as highlighted in note 187. This intervention unfortunately, is merely advisory in nature (as opposed to concrete enforcement measures coupled with strong punitive steps for non-compliance) with CBK recommending a course of action in terms of the banks increasing or decreasing the lending rate, which the banks undertake at their discretion. As discussed in sections 2.4 and 2.5 there are no provisions contained within the CBK Act and the Banking Act unequivocally mandating CBK to directly control the commercial banks' lending policies.

Regulation 3 of the Banking (Credit Reference Bureau) Regulations, 2008.

Regulation 13 of the Banking (Credit Reference Bureau) Regulations, 2008. It is noteworthy that the duties, mandate and activities of the bureau are widely described within the regulations.

The regulations specify what information is to be shared,²³⁴ which includes details of loans and advances taken or outstanding, defaults in payments and action taken to recover monies. It is apparent that the information collated by virtue of the regulations is both wide and sensitive from the borrower's point of view and should therefore be treated with the good judgement, caution and confidentiality that it deserves. To this end, the regulations provide for restrictions on the use of such customer information, including the duty by subscribers to protect the confidentiality of the borrower or customer concerned and the duty to use the borrower's information solely as required by law.²³⁶ Further, the borrowers have a right of access to the information held about them and a right of correction where the information held is found to be incorrect.²³⁷ The information collated by virtue of the regulations above is required to inform the whole of the decision making process by the institution with regards to lending.²³⁸

The provisions of the Banking (Credit Reference Bureau) Regulations, 2008 are far reaching in terms of the protection of borrowers or consumers of bank credit products and aim to ensure that the information asymmetry that typically exists between the borrower and the lending bank is redressed. It is desirable that there be an exchange of information between banks, financial

²³⁴ Regulation 14 of the Banking (Credit Reference Bureau) Regulations, 2008 outlines that these include the customer's identity such as name, date of birth, national ID, driving licence number; the customer's employment, income, career, professional and business history; the customer's credit history including the nature and amounts of loans or advances and other credit facilities granted or to be granted; the nature and details of security or securities taken or proposed to be taken; details of patterns of payment of credit facility or default in payment by the customer, debt restructuring and action taken by institutions to recover unpaid amounts to name a few.

²³⁵ The bureau is also required to retain the customer information on non performing loans until the expiry of seven years from the date of final settlement of the amount in default or upon expiry of seven years from the date of the person's discharge from bankruptcy.

Regulation 15 of the Banking (Credit Reference Bureau) Regulations, 2008. Pursuant to regulation 19, bureaus are required to take necessary security and control measures to avoid **unauthorized** access to, improper use or mismanagement of customer information held.

Regulation 20(2) entitles the customer access to their credit report, which is kept in the database of the bureau. One free copy of this report should be issued to the customer at least once per year and within 30 days of receiving adverse action by a lender. A credit report is defined within the regulations as being a customer information file containing a customer's history compiled by the bureau and may include publicly available information.

Regulation 18 of the Banking (Credit Reference Bureau) Regulations, 2008.

stitutions and the borrower particularly when a lending decision is being made. This exchange, in an ideal set up and if effectively utilized, is beneficial to both the lending institution and the borrower alike because the bank on the one hand is better placed to assess the risk involved in lending to a particular person and make an informed decision whereas the prospective borrower on the other hand is discouraged from borrowing above their means by virtue of the bank conducting an assessment of their repayment capacity and explaining such an assessment thereby educating them. The enforceability and implementation of the regulations in Kenya is yet to be fully comprehended because the provisions are relatively new²³⁹.

From a theoretical standpoint, it is debatable that the protection and benefits envisaged by Credit Reference Bureau Regulations are achievable only if all parties concerned are honest in terms of the initial information provided and diligent in terms of updating the database to keep it accurate. Notwithstanding the provisions put in place, in practice, there is nothing preventing a prospective borrower or consumer of bank credit products from manipulating the system by being deceitful whilst completing the application for the initial loan²⁴⁰, which information is then captured in the credit report pursuant to the provisions of the Credit Reference Bureau Regulations 2008 thus causing the false information to be duplicated and exchanged between the subscribers thereafter. This course of action if undertaken significantly dilutes any protection afforded by the Regulations, since any subsequent decisions made by the parties in question would be made on the basis of false information. Further, the current laws on data protection are somewhat

²³⁹ A recent study written by Davel G, Serakwane T and Kimondo M (February 2012) and titled *Kenya Credit Information Sharing Initiative : A Progress Report 2008-2011 Challenges and Opportunities*, indicates that remarkable progress in information sharing has been made since the registration of the first credit reference bureau in February 2010. It however highlights that some challenges have been faced particularly with the legal provisions that are in place which impose stringent registration requirements for the credit reference bureaus and restrict the sharing of bank information with other institutions. Available at <http://www.fsdkenya.org> [accessed April 21, 2012]

²⁴⁰ A loan is defined in the regulations as meaning direct, indirect and contingent obligations incurred by an individual or entity with third parties and includes any loan, discount, advance, overdraft, export bills purchased, other bills receivable or purchased, import bills, customers' liability on off balance sheet items or any other credit facilities extended to a person or institution.

lacking in preventing the misuse of data which may result in the prospective grower being exposed to unscrupulous third parties (including banks) exploitation. Notably, the Credit Reference Bureau Regulations discourages the misuse of customer information by virtue of regulation 17 and 18 and imposes a Penalty²⁴¹ however; it is arguable that the penalty provided for is not commensurate to the potential benefit to bureaus and subscribers for mis-using or otherwise selling their databases to other third parties for example marketing and sales organizations.

2.8 An assessment of the provisions of the Consumer Protection Bill 2011²⁴².

An overview of the Consumer Protection Bill 2011 (hereinafter called 'the Bill') indicates that it is dedicated towards increased consumer protection in the provision of goods and services alike with part VII dealing with the protection afforded within Credit Agreements.[^] This research, for completeness, sets to briefly assess the provisions contained within the Bill notwithstanding that it has not been enacted. There was a previous attempt to enact a Consumer Protection Act through the bill dated 2007 however it did not go beyond the first reading. It is therefore curious the nature of the Bill which will be enacted in accordance and compliance with the provisions of the new constitutional dispensation relating to consumer protection, in particular article 46, which

²⁴¹ See regulation 30 which indicates that where a bureau is in breach of or fails to update and maintain information as required, it shall be liable to pay a penalty of five hundred thousand shillings and in the case of continued failure, it shall be liable to an additional penalty of ten thousand shillings for each day.

¹² Previously, the Consumer Protection Bill 2007 was tabled in Parliament prior to the promulgation of the current Constitution of the Republic of Kenya. This bill however did not Proceed past the first reading (www.kenyalaw.org [accessed July 12, 2011]. Following Promulgation on 27th August 2010, a further bill being the Consumer Protection Bill 2011 has been drafted in line with the new constitutional dispensation. The provisions of the two bills are largely similar in nature. The 2011 Bill is pending parliamentary debate and, if approved, enactment.

[^] Credit Agreements are defined in the Bill as meaning consumer agreements under which a lender extends credit or lends money to a borrower and includes a supplier credit agreement and prospective consumer agreement under which an extension of credit, loan of money or supplier credit agreement may occur in the future. The definition albeit wide in that it covers present credit agreements and proposed future credit agreements does not however include an agreement under which a lender extends credit or lends money on the security of a mortgage of real property.

entrenches consumer rights and compensation to consumers for default by suppliers into the legal framework

Notably, the definition of credit agreements contained within the Bill includes individual credit agreements but excludes agreements where real property is used as security for example a mortgage⁴. The memorandum of objects and reasons for the Bill is explained as the establishment of a regime of consumer protection law, *'in order to provide comprehensive consumer protection and appropriate legal recourse to aggrieved consumers.'* Suppliers of services under section 5 of the Bill are deemed to warrant that the services provided under a consumer contract are of a 'reasonable and acceptable' quality. Part II seeks to protect the consumers against inaccurate or misleading estimates and renders illegal the practice of demanding payment for unwanted goods and services. Part III protects consumers from unfair practices including the giving of false, misleading or deceptive representations^{5 6}.

Further, Part VII makes it an offence to provide false, misleading or deceptive representation in documentation explaining the benefits of a product and when providing goods and services. In addition, the Bill provides for a standard of disclosure by stipulating that a borrower is not liable to pay the lender the cost of borrowing under a credit agreement, if the borrower is not provided with statements by the lender or any amount in excess of the amounts specified in any statements received by the borrower has not been notified to them.⁷ It is apparent that all these provisions seek to increase consumer protection and are in line with the word and spirit of the new constitutional dispensation. Notably, there is no statute in place currently that

It is arguable that this exclusion of mortgages within the definition of credit agreement in the Bill is justifiable given the nature of the transaction and that the Banking Act also treats mortgage finance institutions in a different manner to banks and other financial institutions, pursuant to section 10 (1) of the Banking Act, mortgage finance companies may be permitted to do certain acts which other institutions are prohibited from doing such as lending in excess of the institutions core capital.

⁴ Part V (i) at page 58 to 60 of the Consumer Protection Bill, 2011.

⁵ Section 63 prohibits the lender from making oral misrepresentations of the credit agreement and section 64 obligates disclosure of brokerage fees

⁶ Section 56 of the Consumer Protection Bill.

makes similar provisions. The case presented by this research is that such statutory provisions should exist.

Every lender pursuant to the Bill is required to deliver an initial disclosure statement to the borrower containing detailed prescribed information before the borrower enters into the agreement^{2*8}. Notably however, even under the provisions of the Bill, lenders are entitled to charge reasonable charges but what is considered to be reasonable is not defined and is ambiguous. The Bill also prescribes procedures for consumer remedies[^] under Part IX. Section 77 (1) in particular stipulates that *'a consumer agreement is not binding on the consumer unless the agreement is made in accordance with the provisions of this Act and Regulations.'* Section 77 (2) provides that even where a consumer agreement is considered not to be binding, a court may order that it is, therefore giving the courts a wide discretion in determining the issue. This arguably reduces the protection provided to consumers under section 77 (1).

Section 86 of the Bill stipulates that a person that obtains information in the course of exercising a power or carrying out a duty related to the administration of the Bill shall observe secrecy and confidentiality in respect of such information and that no person shall be required to provide a testimony in civil proceedings with regards to information obtained in the exercise of such duty and power. It may be argued that such a provision may assist in sealing the loopholes contained within data protection laws and increase consumer protection by ensuring that confidentiality when dealing with consumer data for example by Credit Reference Bureaus and interested third parties is observed.

28

Section 65 (1) of the Consumer Protection Bill. Section 66 deals with subsequent disclosure of the initial disclosure, in particular, disclosure on interest rates and the provision of notification to the borrower that the payment made is not enough to cover interest because of Principal amount of borrowing has been increased as a result of default charges or failure of the borrower to make payments.

Pursuant to Part IX of the Consumer Protection Bill.

further, part X of the Bill seeks to establish a single body to administer and effect consumer protection that being the Kenya Consumers Protection Advisory Committee,²⁵⁰ The shortcomings of the current institutional framework governing lending by banks in Kenya and the provisions of the Bill relating to the mandate of the Kenya Consumers Protection Advisory Committee will be further expounded on in chapter three of this thesis. That notwithstanding and having regard to the above, the Bill whilst being a move in the right direction, is arguably not without its shortcomings which ought to be constructively debated in parliament with the assistance of experts within the lending and consumer protection fields. It is desirable that a comprehensive, succinct statute dealing with the issues pertaining to lending in general and the protection of borrowers or consumers of bank credit products be enacted to deal with some of the issues experienced by borrowers and highlighted within the body of this chapter.

2.9 An overview of provisions governing consumer protection within the lending industry in the United Kingdom.

There are several acts of Parliament and Regulations dealing with consumer protection in general within the United Kingdom (hereinafter called UK) jurisdiction. These include the Unfair Contract Terms Act 1977, Food Safety Act 1990, the Unfair Terms in Consumer Contract Regulations 1999, SI 1999/2083 and Unfair Trading Regulations, 2008 to name a few²⁵¹. Until 1974 credit in the UK was regulated by a number of 'piecemeal and fragmentary provisions' including the Bill of Sale Acts (1878-1882), Moneylenders Acts (1900-1927), Pawnbrokers Acts (1872-1960) and the Hire Purchase Act 1965.²⁵² Consumer Credit Act 1974 repealed all the Acts in place, except the Bills of Sale Acts which dealt with mortgages or Bills of Sale which were not within the remit of the Consumer Credit Act²⁵³. The main statutory

²⁵¹ pursuant to section 106 of the Consumer Protection Bill
Uuah J and Furmston M (2010), *Commercial and Consumer Law*, Harlow: Pearson
" **o n Limited at page 376 to 382**
ibid

OjJ^taugh the Consumer Credit Act as amended in 2006 was comprehensive in nature, it busi argued that it brought with it complexities and technicalities that both consumers and T ^ s e s find hard to understand.

framework governing consumer credit in the UK since 1974 remains the Consumer Credit Act 1974 (as amended in 2006).

Consumer Credit Act requires most businesses that lend money to consumers or offer goods or services on credit or engage in certain ancillary credit activities to be licensed by the Office of Fair Trading (hereinafter called OFT)²⁵⁴ The Consumer Credit Act also regulates the way in which consumer credit licensees carry on their business. For example there are provisions governing pre-contract disclosure. Section 55A²⁵⁵ of the Consumer Credit Act requires creditors (or intermediaries acting on their behalf) to provide an adequate explanation and also provide the borrower with sufficient pre-contract information to enable the borrower assess whether the agreement is suited to their needs and financial situation. In particular, the explanation must cover any features of the credit which may make it unsuitable for particular types of use, how much the borrower will pay periodically and in total, features which may have a significant adverse effect in a way that the borrower is unlikely to foresee, the principal consequences of failure to make repayments including legal proceedings and repossession where applicable, the right of the consumer to withdraw and how or when this right may be exercised to name a few. The borrower must also be advised that he may ask the lender for further information and explanation when the need arises. In addition, there are Regulations that dictate the information to be provided to the consumer prior to them entering the contractual agreement such as the Consumer Credit (Disclosure of Information) Regulations, 2010, which apply to unsecured credit including loans, hire-purchase, credit cards, overdrafts and some secured credit as well as Consumer Credit (Disclosure of Information) Regulations, 2004 which apply to secured loans²⁵⁶.

²⁵⁴ oft.gov.uk [accessed July 18, 2011].

Section 55A was introduced through a European Directive being the Consumer Credit (EU Directive) Regulations 2010 which were debated and finalized following the recent financial downturn largely thought to have been brought about as a result of irresponsible lending.

²⁵⁵ oft.gov.uk. *Supra note 254*

The Consumer Credit Act 1974 was subject to major revision via the Consumer Credit Act 2006 and subsequent European Directive 2008/48/EC, 23 April 2008²⁵⁷ which was implemented on May 12, 2010. The effect of the latter was that as a member of the European Union, the UK was required to pass laws and regulations giving effect to the Directive. As a result, several Regulations were passed amending the Consumer Credit Act 1974 and supplementing the 2006 amendments to it. The Consumer Credit (Agreements) Regulations 2010²⁵⁸ is one such regulation and applies to unsecured credit²⁵⁹. It requires certain information to be set out in the credit agreement; for example the total amount of credit payable by the borrower, how and when credit will be provided, rate of interest, annual percentage rate, timing of repayments to name a few. In addition, provisions of the Consumer Credit Act govern the supply of copy agreements and statements on request. Where it is impracticable for a supplier of credit to provide the prescribed information within the credit agreement, they may apply to the OFT to waive or vary the requirements.²⁶⁰ The Consumer Credit Act and supplementary regulations also deal with issues such as post contract disclosure²⁶¹, early settlement by the borrower²⁶², brokerage fees²⁶³, credit advertising²⁶⁴

²⁵⁷ Chuah J and Furmston M (2010), *Supra* note 251 at page 486.

²⁵⁸ www.legislation.gov.uk [accessed July 18, 2011].

²⁵⁹ Consumer Credit (Agreements) Regulations 1983 apply to secured credit.

²⁶⁰ Section 60 (3) of the Consumer Credit Act 1974 (as amended in 2006)

²⁶¹ During the lifetime of the regulated credit agreement, the supplier of credit is required to provide the borrowers with annual statements for fixed term credit, periodic statements for running account credit, notice of variation of terms in the agreement, notices of default sums, notices pertaining to post judgment interest pursuant to part VI and VII of the Consumer Credit Act and the Consumer Credit (Information Requirements and Duration of Licenses and Charges) Regulations 2007.

²⁶² Under the Consumer Credit Act 1974, the borrower can settle a regulated credit agreement early by issuing notice to the lender and paying the amount due less the rebate. The borrower is entitled to the amount required in order to effect early settlement. The Consumer Credit (Early Settlements) Regulation 2004 provide new rights of withdrawal from a credit agreement within 14 days of signing,

²⁶³ The Consumer Credit Act limits a credit broker's charges to Sterling Pounds 5 if following an introduction to a lender; the credit agreement is not signed within 6 months. The Act ensures that brokers are only entitled to a nominal fee if the borrower is unable to obtain credit at a price that the consumer is prepared to pay therefore increasing consumer

Protection.

²⁶⁴ Pursuant to section 189 of the Consumer Credit Act, an advertiser means any person indicated by the advertisement as willing to enter into transactions to which the Advertisement relates. This definition is wide in that so long as a supplier wishes to benefit in an advertisement by posting their details then they are considered to be an advertiser and subject to the provisions of the Consumer Credit Act. The Consumer Protection from Unfair Trading Regulations 2008, the Consumer Credits (Advertisements) Regulations 2010 and Consumer Credit (Advertisements) Regulations 2004 (which prohibit unfair commercial

unenforceable credit agreements, unfair relationships to name a few. Pursuant to sections 77, 78 and 79 of the Consumer Credit Act, borrowers are entitled to ask creditors to send them information about their credit agreements and if the information is not provided within 12 working days, the debt becomes unenforceable until they get the information they requested for.²⁶⁵

It is arguable that the provisions of the Consumer Credit Act (as amended in 2006) and supplementary Regulations are both comprehensive and elaborate in terms of consumer protection and the issues pertaining to consumer lending in general. They deal with many of the fundamental aspects of lending to individuals with a view of promoting increased consumer protection. Further, institutions such as the OFT, which seek to protect and promote consumer rights within the financial sector in the UK, govern and monitor *all* providers of credit in order to ensure that the provisions of the Act and associated Regulations are adhered to across the board, failing which the OFT takes action against the relevant institution as evidenced when the OFT took banks to court in the case of the *OFT (Respondent) versus Abbey National plc & Others [2009]*²⁶⁶ claiming that the banks were imposing punitive and unfair bank charges on customers which were over and above the bank's cost of running current accounts and therefore against the law.²⁶⁷ Chapter three of this thesis will look at the mandate of institutions governing the banking sector in Kenya, including their structure in greater detail.

It is debatable that the UK legal framework governing lending in comparison to the Kenyan one is more sophisticated and comprehensive in terms of

practices, including misleading actions or omissions, apply to unsecured and secured credit respectively) all prohibit and deal with false and misleading advertisement.

²⁶⁵ A debtor can pay Sterling Pound 1 to get a copy of their agreement, a statement of account and copies of some of the documents mentioned in the agreement. If not provided within 12 working days, the debt becomes unenforceable meaning that the creditor cannot make the debtor pay the debt before they are supposed to or get a court judgment against the debtor or take anything as security for the agreement.

igyw.bailii.org [accessed July 18, 2011]

The Banks in question beat the OFT on this occasion in a Supreme Court ruling in 2010. However, the course of action is evidence that the OFT is ready and willing to take the banks

regulation of individual or consumer credit agreements²⁶⁸. On the other hand, the UK legal framework is also extremely complex, technical and fragmented, with various regulations dealing with different aspects of lending making it difficult to comprehend and apply for both borrowers and businesses. In my considered view, this to some extent dilutes the protection afforded within the UK jurisdiction because the legal provisions are difficult to comprehend and apply. It is worthwhile noting that there also exist distinct legal regimes dealing with consumer credit in jurisdictions such as Australia and Canada²⁶⁹. This research does not purport to suggest that the provisions contained in these jurisdictions are better or superior to those contained in Kenya merely to compare the provisions noting that arguably, the citizenry in those jurisdictions has a wider and more accessible financial sector requiring more governance and a deeper understanding of finances.

2.10 An assessment of the provisions of the Banking (Amendment) Bill 2011 and Kenya Deposit Insurance Bill 2011

Following the promulgation of the Constitution in August 2010, several bills have been drafted and tabled with a view of enacting new laws in line with the new constitutional dispensation or reviewing/amending existing laws to ensure that they comply with its provisions. This research aims to look at some of the bills drafted in as far as they are applicable to the governance of lending by banks in Kenya. For purposes of completeness, this research aims to highlight the relevant provisions commenting briefly on whether such bills address some of the issues experienced by borrowers or consumers of bank credit products as highlighted in the body of this chapter. At the time of writing, parliamentary debate on the proposed Bills is ongoing.

²⁶⁸ This may be attributed to the fact that the lending sector in the UK is more advanced and complex in nature and the citizenry are more aware, educated and exposed to credit and its workings.

²⁶⁹ As stated previously in chapter 1, in Australia, there is a distinct legal regime, being the National Consumer Credit Protection Act 2001 (currently undergoing debate with regards to Proposed amendments) governing consumer credit and containing similar provisions to those contained within the UK jurisdiction. The position is the same in Canada with the Consumer Protection Act 2002 governing consumer credit.

2 io.i The Banking (Amendment) Bill 2011

The preamble to the Banking (Amendment) Bill 2011 (hereinafter 'the Bill') states that it is a bill for an Act of Parliament to amend the Banking Act, Chapter 488 of the Laws of Kenya currently in force (hereinafter 'the Act'). The Bill proposes to insert section 16B to the Act, which section sets a maximum interest rate that a bank or a financial institution may charge for a loan or monetary advance. This section recommends that such a rate shall not exceed more than four per centum of the Central Bank of Kenya Rate as published by the Monetary Policy Committee. This section, if enacted, is certainly a major step towards increasing protection of borrowers or consumers of bank credit products. It aims to address the inherent dilemma that exists within the banking and financial sector whereby banks arbitrarily increase their commercial lending rates way above the Central Bank of Kenya base rate asserting that the base rate significantly increases their costs of lending, which are in turn passed on to the consumer. It also addresses the fact that there is currently no clear and unequivocal provision restricting or governing commercial interest rates and their increment. Further, Central Bank of Kenya is manifestly empowered by this section to control the conduct of commercial banks, particularly their increase of lending rates through its power to enforce the provisions of the Banking Act, an arrangement that does not exist at present.

Furthermore, the Bill proposes to insert section 16C to the Act, which section imposes a minimum interest rate that a bank or a financial institution ought to pay on deposits held in interest earning accounts. This rate is proposed as at least seventy per centum above the Central Bank of Kenya base rate. This Provision therefore seeks further protection of depositors and secures their interests. This research suggests that enactment of such laws is highly welcomed as it provides the much required certainty within the lending sector arguably promoting market stability.

10 2 The Kenya Deposit Insurance Bill 2011

The preamble to the Kenya Deposit Insurance Bill 2011 (hereinafter 'the Bill') states that it is proposed to be an Act of Parliament that establishes a deposit insurance system^{2?0} for the receivership and liquidation of deposit taking institutions. The Bill institutes the Kenya Deposit Insurance Corporation^{2?1} (hereinafter 'the Corporation'), a state corporation whose object and purpose is) *inter alia*^{2?2}, to provide the customers of member institutions with a deposit insurance scheme.

The Corporation is mandated to amongst other things make investment and enter into any transactions necessary or desirable for the financial management of the deposit insurance fund^{2?3}, which forms the scheme. It is clear from the definition of institutions^{2^} to be governed under the proposed Act that the bill aims to consolidate or pool together the mandatory contributions of institutions into a deposit insurance scheme and streamline the management of such deposit funds thereby affording more protection to the depositors of such institutions, irrespective of its type in the event of liquidation or winding up. A review of the Bill does not however indicate similar blanket provisions or any provisions aimed at protecting borrowers or consumers of bank credit products.

jTM Monies contained within the Deposit Protection Fund pursuant to the Banking Act are to be transferred to the deposit insurance system along with subsequent mandatory contributions from institutions licensed under the Act.

^Section 4 of the Kenya Deposit Insurance Bill 2011

Other objects include receiving, liquidating and winding up any institution in respect of the Corporation has been appointed receiver or liquidator in accordance with the **Provisions** of the Act (should the Bill be enacted).

^ Established under section 21 of the Kenya Deposit Insurance Bill 2011. Section 6 provides su 1 rP^oratⁱoⁿ with additional powers in the management of the Deposit Insurance Fund n as acquiring assets of an institution under liquidation, entering into strategic agreements the Central Bank of Kenya, providing loans, advances and guarantees to an institution |j9@8St other items.

nstitutions under the Bill are described as including banks, financial institutions or i ^ nance companies as defined by the Banking Act or deposit taking microfinance tutions as defined by the Microfinance Act.

Chapter Two Conclusion

It is arguable that an assessment of the current statutory provisions and regulations governing lending by banks in Kenya fall short and are inadequate in as far as they protect the borrower or consumer of bank credit products. This is because the legal framework is fraught with inconsistencies and regulatory gaps that ought to be addressed with a view of increasing the protection afforded to borrowers. The current statutory provisions fail to adequately deal with some of the issues experienced by borrowers such as a lack of disclosure, provision of misleading or false information, misleading advertisement and marketing to name a few. These issues often bring about information asymmetry between the bank and the borrower and further weaken the borrower's bargaining position. Further, the borrower is forced to make a decision without being well informed on the potential consequences of their decision.

The proposed Consumer Protection Bill 2011 is undoubtedly a move in the right direction towards achieving heightened consumer protection in all sectors. Furthermore, the Banking (Amendment) Bill 2011 is a gargantuan move towards increasing protection for borrowers by capping the interest rate payable. That notwithstanding, this research suggests that there should be a single wholesome and/or succinct statute governing the lending sector irrespective of the nature or type of the lending institution. It is recognized that in order to have such a comprehensive statute, the current laws ought to be effectively reviewed and amended, which can prove to be a costly and time consuming exercise. This research however asserts that there is no better time to conduct such review and/or amendment than currently because as a result of the new constitutional dispensation, all laws must be reviewed in order to comply with the provisions of the Constitution with the laws governing the banking sector being no exception.

If a single comprehensive statute is circumspectly drafted it is desirable that it should aim to deal with the issues experienced by borrowers and reduce their

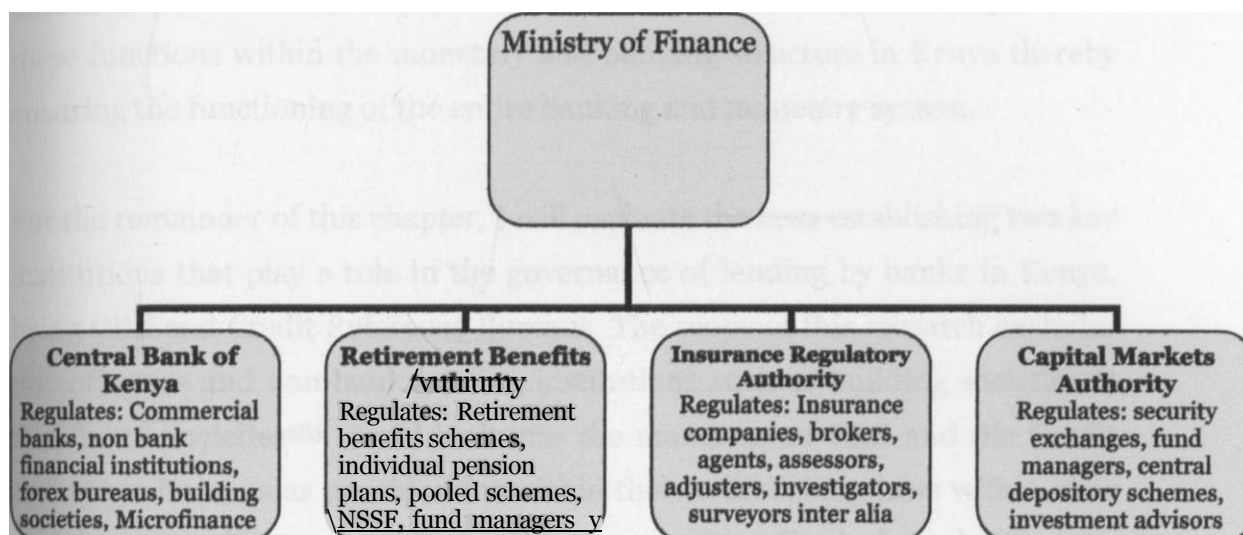
exposure to fraud, misrepresentation, misinformation, non disclosure and other ills that exist within the lending industry. This would indeed be in line with the Molony Committee recommendations, captured and discussed in chapter one, the new constitutional dispensation and international standards. This research suggests that the current legal and regulatory framework governing lending by banks is in dire need of review and updating, however such a review should be conducted wholesomely to avoid legislating in a piecemeal manner which may cause additional conflict, regulatory overlaps and contradictions.

In the next chapter, I will proceed to assess the institutional framework that governs the banking sector, with particular emphasis to the establishments that play a role in the governance of lending by banks in Kenya. I will analyze their mandate and the role that they play with a view to determining if such establishments are sufficiently empowered to effectively and efficiently act in a manner that increases consumer or borrower protection. Where the institution is established as a result of an Act of Parliament, I will evaluate the functions and/or obligations provided for within the statute. Lastly, I will highlight any shortcomings/limitations observed and make proposals for amendments in order to increase the efficiency within the institutional framework with a view of achieving heightened borrower or consumer protection.

CHAPTER THREE: THE INSTITUTIONAL FRAMEWORK GOVERNING LENDING BY BANKS IN KENYA

31 **OUTLINE OF THE INSTITUTIONAL FRAMEWORK GOVERNING THE BANKING AND FINANCIAL SECTOR IN KENYA.**

The existing institutional framework for the banking and financial sector in Kenya consists of *inter alia* the Central Bank of Kenya (hereinafter called 'CBK') and other independent regulators²⁶ that are charged with the supervision of their particular sub-sectors under the overall supervision and docket of the Ministry of Finance.



For purposes of the banking sector, CBK is the main or lead regulator. It was established in 1966 through an Act of Parliament²⁷, which mandates it to exercise any type of central banking functions and enjoy all prerogatives of a central bank²⁸. A central bank, referred to by alternative names in other

pjyww.centralbank.go.ke [accessed February 27, 2011]. During the colonial period, the Monetary and financial policy of the East African territory was regulated by the East Africa Currency Board (EACB), which was established in 1919 and was tasked to maintain the local currency at par with the shilling in the United Kingdom. Upon attaining independence the three East Africa countries (Kenya, Uganda and Tanzania) thought it wise to have independent Central Banks. This saw the collapse of the EACB in the 1960s.

Such as the Retirement Benefits Authority established pursuant to section 3 of the Retirement Benefits Act no 3 of 1997, Insurance Regulatory Authority established pursuant to section 3 of the Insurance Act chapter 487, Capital Markets Authority established pursuant to section 5 of the Capital Markets Act chapter 485a, Sacco and Societies Regulatory Authority established pursuant to section 4 of the Sacco Societies Act number 14 of 2008 to name a few.

Kenya Central Bank of Kenya Act, Chapter 491 of the Laws of Kenya
'ibid at Section 3 (3)

jurisdictions²⁸⁰ is the apex institution of the monetary and banking structure of any country. It is typically an institution which implements the economic policies of its government.²⁸⁰ Some of the functions of a central bank include the issuing of currency which circulates as legal tender, being the fiscal agent, banker and adviser of its respective government, serving as a custodian of cash reserves for commercial banks, keeping and managing foreign exchange reserves, granting advances to commercial banks on a temporary basis as a lender of last resort, acting as a clearing house for the transfer and settlement of mutual claims of commercial banks through the reserves it holds and controlling the credit creation of commercial banks in order to control inflationary and deflationary pressures within an economy²⁸¹. CBK performs these functions within the monetary and banking structure in Kenya thereby ensuring the functioning of the entire banking and monetary system.

For the remainder of this chapter, I will evaluate the laws establishing two key institutions that play a role in the governance of lending by banks in Kenya, being CBK and Credit Reference Bureaus. The scope of this research excludes microfinance and non-bank lending institutions such as building societies²⁸² and Sacco Societies²⁸³. I will look into the mandates of CBK and the Credit Reference Bureaus as provided for within their establishing laws with a view to determining if they are sufficiently empowered to effectively and efficiently discharge their obligations in as far as consumer protection. In addition, for purposes of completeness, I will assess the role and mandate of the Consumer Federation of Kenya (COFEK), which is a private establishment that is not governed by an Act of Parliament. This is because it purports to be a key advocate and enforcer of consumer protection. Finally, I will suggest changes

²⁸⁰ Such as the Reserve Bank of India in India, the Bank of England in the United Kingdom, the Federal Reserve System in the United States of America, the Bank of France in France to name a few

²⁸¹ Jhingan M.L (7th edition, 2004), *Money, Banking, International Trade and Public Finance*, Vrinda Publications (P) Ltd, chapters 17 and 20 and at pages 220 to 234.

²⁸² Section 2 of the Buildings Societies Act, Chapter 489 of the laws of Kenya describes Building societies as a society formed for the purpose of raising by the subscription of members a stock or fund from which to make advances secured on land and registered in accordance with the Act. These are not banks and are not subject to the provisions of the Banking Act, chapter 488 of the laws of Kenya discussed in chapter two.

²⁸³ Pursuant to section 2 of the Sacco Societies Act, a Sacco Society is a Savings and Credit Co-operative Society registered under the Co-operatives Society Act 1997. These are also not banks and are not subject to the provisions of the Banking Act.

that could be made to the institutional framework in order to increase consumer protection within lending by banks in Kenya.

3.2 AN ASSESSMENT OF THE ROLE AND MANDATE OF THE CENTRAL BANK OF KENYA (CBK)

The role of CBK is outlined in sections 4 and 4A of the Central Bank of Kenya Act. The principal object of CBK is to 'formulate and implement monetary policy directed at achieving and maintaining stability in the general level of prices.'²⁸⁴ This objective aims to achieve stable prices- that is low inflation²⁸⁵- and to sustain the value of the Kenya shilling. Following amendments to the law, section 4 (4) provides that the Minister for Finance may by notice in writing to CBK set the price stability targets of the government. It is the responsibility of the Monetary Policy Committee²⁸⁶ of CBK to formulate monetary policy. Maintaining price stability is crucial for the proper functioning of a market based economy as it encourages long term investments and stability in the economy. High rates of inflation lead to inefficiency in a market economy and in the medium to longer term, to a low rate of economic growth²⁸⁷. Other objectives of CBK include fostering the liquidity, solvency and proper functioning of a stable financial system and supporting the economic policy of the government including its objectives for growth and employment.²⁸⁸

²⁸⁴ Section 4(1) of the Central Bank of Kenya Act, Chapter 491 of the Laws of Kenya.

²⁸⁵ As is highlighted in Jhingan M.L (7th edition, 2004), *Money, Banking, International Trade and Public Finance*, Delhi: Vrinda Publications (P) Ltd at page 230, it is typically the case the world over that a central bank exists to safeguard the value of its currency in terms of what it

purchase. When prices of goods and services in an economy keep rising, the value of the goods and services that country's currency can purchase (or exchange for in the case of foreign exchange) diminishes. This leads to loss in value of the currency. Monetary policy is the main tool used in the preservation of the value of the currency in an economy. It involves the control of liquidity or money circulating an economy in order to achieve consistent growth

attain the price objectives set by the government. The volume of liquidity in circulation influences the levels of interest rates and therefore the relative value of the local currency against other currencies.

Pursuant to section 4(D) of the Central Bank of Kenya Act. This committee consists of the Governor of CBK who is the chair, the Deputy Governors who are deputies to the Chairman, the members appointed by the Governor from among the staff, four members appointed by the Minister of Finance for their knowledge, experience and expertise in matters relating to banking, fiscal and monetary policy and the permanent secretary of the Treasury, centralbank.go.ke [accessed February 27, 2011].

²⁸⁶ The committee also expounds on these objectives to include formulating and implementing monetary policy, holding and managing its (read: CBK) foreign exchange reserves, and supervising authorized dealers, issuing currency notes and coins, acting as

In addition, CBK has a Bank Supervision Division, which is specifically mandated with fostering the proper functioning of the financial system. Its aim is to promote and maintain the safety, soundness and integrity of the banking system.²⁸ It achieves this objective through the continuous review of banking and building societies' Acts and guidelines issued, formulation and implementation of the Microfinance Act and regulations issued thereunder and continued review of the guidelines governing foreign exchange bureaus licensed under the CBK Act, the processing of the licenses of commercial banks, non-bank financial institutions, mortgage finance companies, building societies, foreign exchange bureaus, deposit taking microfinance institutions and credit reference bureaus²⁹.

The Bank Supervision Division also evaluates and conducts surveillance on institutions licensed under the Banking Act, Microfinance and Building Societies Act³⁰. It is therefore apparent that CBK through the Bank Supervision Division oversees all institutions, banking and non banking, within the financial services sector to ensure the smooth operation of the banking and financial systems in Kenya. It monitors standards, minimum requirements and procedures ensuring that customers are protected from rogue institutions, which are likely to operate and thrive in an unregulated and unsupervised environment. By constantly reviewing all institutions, CBK largely ensures that its set minimum standards are complied with and maintained facilitating stability of the economy, banking and financial sectors

banker, adviser and fiscal agent to the government and formulating and implementing policies that best promote effective and efficient payment, clearing and settlement systems,

Kenya Central Bank Act, 2008, *Supra* note 287.

»Ibid

CBK is fronted as the lead and/or main regulator in the financial and banking sectors with powers of inspection reserved in its favour in some of the different Acts for example, Part IV of the Microfinance Act governs the power of inspection of deposit taking microfinance institutions while section 63A and 63B in the Buildings Societies Act reserves a power of inspection to buildings societies to name a few. Notably however, there is no power of inspection

** For CBK in some of the Acts for example, the Sacco Societies Act. This lack of CBK agency in the laws is questionable and may cause confusion in trying to understand why and why specifically mandated to supervise some establishments within their establishing Acts

on one hand and protecting the consumer of banking and non banking institutions on the other^{2**}.

By virtue of its role in the formulation of monetary policies pursuant to section 4 of the CBK Act, CBK acts as the controller of credit within the financial and banking sectors in Kenya. CBK performs this role through the implementation and use of key quantitative^{2^} and qualitative^{2^} tools that are formulated within the monetary policy. By adopting both tools CBK tries to influence and control credit creation by commercial banks and its use by customers in order to establish economic stability[^]. This research suggests that CBK's empowerment in controlling credit supply and the conduct of commercial banks in the provision of lending facilities is pivotal to the attainment of increased borrower or consumer protection within lending by banks in Kenya.

Credit control is the means by which CBK controls the lending policy of commercial banks in order to achieve its set objectives^{2*6}, which include the fostering of the liquidity, solvency and proper functioning of a stable market-based financial system.²⁹⁷ It is worth noting that consumer protection is not explicitly stated as being one of the objectives of CBK²⁹⁸. There are three main methods^{2??} that CBK uses to control credit³⁰⁰. These are;

²⁹² By maintaining minimum standards and regularly reviewing the Acts, guidelines and conduct of the different types of institutions, the Bank Supervision Division oversees the conduct of these institutions and ensures that they are fully licensed to conduct the business that they purport to do and are in compliance with the regulatory provisions under their respective Acts.

²⁹³ Cited in www.centralbank.gov.ke [accessed July 17, 2011]. Quantitative methods aim at controlling the cost and quantity of credit by adopting bank rate policy, open market operations and by variations in the reserve ratios of commercial banks. These methods, which cause a variation in actual money stock directly will be explained in greater detail.

^{**} Qualitative methods control the use and direction of credit and involve select credit controls and direction

[^] Jhingan M.L (7th edition, 2004), *Supra* note 280 at pages 230-233

¹⁾ Pursuant to section 4 of the Central Bank of Kenya Act, Chapter 491 of the Laws of Kenya.

^{^7} For example the stabilization of price levels is achieved, in part, through the control of money available in the economy, which is affected by the amount of credit offered by

commercial banks. CBK through its credit control policies controls this money availability (or

thereby indirectly affecting supply and demand and ultimately price levels. During

Periods, CBK tries to contract bank credit. On the contrary, during periods of

depression, CBK influences the expansion of credit. This in turn (in theory) should have a spill

over effect on production, employment and prices -in that increased credit equals increased

consumer spending power which in turn equals increased production, which results in

increased employment and supply of goods resulting in increased economic growth.

^{CBK} As discussed in chapter two, it is arguable that the legislators did not contemplate that the

^{*} Act Would or should govern the relationship between CBK and individual customers. The

- a) Bank or discount rates³⁰¹- CBK, as lender of last resort for commercial banks may provide secured short term loans to commercial banks on an overnight basis at punitive rates thus persuading banks to seek funding in the market and resorting to CBK only as a last solution. CBK controls credit by making variations to the bank rate. If the objective is to expand credit in the market, the CBK lowers the bank rate therefore borrowing from CBK becomes cheaper. By doing this, CBK anticipates that the commercial banks will borrow more from it and consequently increase lending to the customers with such lending being at a lower market rate thereby encouraging business activity.³⁰²
- b) Open Market Operations³⁰³- This method refers to CBK dealing in the sale and purchase of securities, bills and government bonds. This is done to influence the reserves of commercial banks in order to control their power of credit creations

Act was designed to deal with the relationship between banks amongst themselves and CBK with commercial banks. Therefore, in light of this background, it may not be a surprise that such an explicit provision does not exist. That said, CBK's principal objective of maintaining the stability of prices pursuant to section 4 of the CBK Act inadvertently seeks to promote consumer protection.

³⁰⁰ These are mainly quantitative methods, which are designed to impact directly on cash supplies and reserves. There are however qualitative methods such as the ones aimed at preventing excessive use of credit to purchase a specific product, increasing of minimum down payments for specific consumer credit products such as Hire Purchase Agreements to name a few which are also used to control the utilization of credit available in the market.

³⁰⁰ www.centralbank.gov.ke [accessed July 17, 2011] and Jhingan M.L (7th edition, 2004), *Supra* note 280 at pages 225 to 226.

³⁰¹ Jhingan M.L (7th edition, 2004), *Supra* note 280 at page 225

³⁰² All things being equal, expansion of credit on the one hand typically results in expansion in demand because those who wish to procure a product and who would ordinarily not have the purchasing power to buy it are now empowered to do so using credit. This is likely to encourage the increase of prices particularly where demand significantly outweighs supply ^suing in people being willing to pay higher prices for the rare commodity. The opposite happens when CBK raises the bank rate which makes borrowing by commercial banks from it costly- the commercial banks borrow less and in theory, are likely to raise their lending rates to customers (market rates). In this mode of credit control, CBK makes a clear assumption

reduction in the bank rate equals to a reduction in the market rates for loans offered by commercial banks. This is often not the case.

Jhingan M.L (7th edition, 2004), *Supra* note 280 at page 225

For example, where CBK wants to restrict the credit offered by commercial banks for purposes of controlling inflationary pressures within the country, it may sell government securities in the money market for say Kshs 50 billion, the money market will in turn give banks loans amounting to the Kshs 50 billion drawn against accounts held at commercial banks. This will reduce the amounts in the reserve accounts of the respective commercial banks held at CBK, which will require topping up, therefore reducing the amount of money

* available for the respective commercial banks to lend to customers.

c) Variable reserve requirements³⁰⁵- Every commercial bank is required by law to maintain a minimum percentage of its deposits with CBK pursuant to section 38 of the CBK Act.³⁰⁶ The higher the reserve set by CBK, the lower the power of the commercial bank to create credit because their cash or money excess reserves are lower as a result of the increased minimum deposit requirements.

CBK adopts the above tools simultaneously having regard to any externalities that are affecting the economy at the time and the outcomes it wishes to achieve³⁰⁷.

Given the provisions of the CBK Act, it may be argued that CBK's role in credit control is an indirect one³⁰⁸, which is usually accomplished through the control of the CBK bank rate.³⁰⁹ The role of CBK as credit controller is not unequivocally stated within sections 4 to 4(D) of CBK Act. It is incorporated within CBK's mandate of formulating monetary policy and is pinned on its

³⁰⁵ Jhingan M.L (7th edition, 2004), *Supra* note 280 at page 225 and 226

³⁰⁶ Section 38(1) mandates CBK to set the limit of reserves which commercial banks are required to maintain and section 38 (3) mandates CBK to review these reserves either upwards or downwards.

³⁰⁷ As reported in the Daily Nation, September 30, 2011 at pages 1-2, 17 and 26. CBK has recently intervened in the market in an attempt to save the depreciating Kenya shilling which was significantly losing value against the dollar resulting in a drastic increase of inflation, particularly in the import and export trade. Whilst the issue of depreciation of the shilling is outside the scope of this thesis, it serves as a good example to show the importance of role of CBK as the lead regulator within the financial sector. On this occasion, CBK reportedly used the quantitative tool of selling dollars directly to importers to decrease its demand and shore up the depreciating shilling.

³⁰⁸ In that there is no explicit unequivocal objective within the CBK Act mandating CBK to control the credit policy of commercial banks. CBK's role arises from its formulation of monetary policy and its aim to achieve price stability, which in turn is affected by the availability of credit in the economy. By either increasing or decreasing credit availability, CBK controls price fluctuation which translates to inflationary and deflationary pressures within the economy. CBK's role in credit control in this context is therefore indirect.

* Credit control through CBK base rate appears to be used by CBK often. There have been attempts in the past to directly control interest rates charged by commercial banks on **their** loans through the proposal of **statutes** empowering CBK to do so such as the Banking Act referred to as the 'Donde Act' after its proposer Hon Joe Donde. The implementation of **the Donde Act** failed due to amongst other factors, **the** bankers' discontent with its contents leading to the instigation of legal action, which resulted in provisions relating to the control of interest rates being repealed through the Central Bank of Kenya (Amendment) Act 2004. Provisions to control market or commercial interest rates have recently been re-introduced in amendment by Rangwe MP, Martin Ogindo through the Banking (Amendment) Bill 2011. Debate in Parliament on the provisions of the proposed Bill is ongoing.

furtherance of the government's economic policy³¹⁰. Given the indirect nature of CBK's role as controller of credit, it may be argued that CBK is not sufficiently empowered to effectively control the credit policies of commercial banks and is even less empowered to increase borrower protection. The current Minister of Finance has noted this shortcoming within the CBK Act and has proposed that it ought to be reviewed 'to enhance the effectiveness of monetary policy.'³¹¹

Further, certain provisions of the CBK Act such as section 4(3)³¹², raise concern on the independence of CBK when formulating monetary policy, which objective includes its role as credit controller.³¹³ Debate is centered on the objectivity of CBK in formulating monetary policies and implementing available financial instruments to effect such policies in order to control existing inflationary and deflationary pressures.³¹⁴ It may be argued that such criticism surrounding CBK as a regulator within the financial and banking sector does not inspire confidence in CBK's role as controller of credit. In addition, section 4(3) and similar provisions within the CBK Act, which cast doubt on CBK's independence and objectivity create room for conflict between commercial banks that are permitted by the CBK Act to set their own credit

³¹⁰ By virtue of section 4(3) of the Central Bank of Kenya Act, Chapter 491 of the Laws of Kenya which states that CBK is required to support the economic policy of the government, including its objectives for growth and employment.

³¹¹ Daily Nation, October 14, 2011 article titled *Treasury unveils new currency rule as it moves to save the shilling* written by Wachira Kang'aru at pages 1 and 4. For the purposes of completeness, the current Minister of Finance is Uhuru Kenyatta. It remains the case of this thesis that CBK's control of commercial banks' credit policy should be explicitly provided for.

³¹² Section 4(3) provides that CBK shall support the economic policy of the government deluding its objectives for growth and employment.

³¹³ See speech by Lorenzo Bini Smathì, Member of the Executive Board of the European Central Bank, *'Central Bank Independence: from theory to practice'*, delivered at the conference of Governance and Effective partnership at Budapest, Hungarian National Assembly, April 19, 2001 at page 6 [accessed from <http://www.ecb.int/press/key/date/2007/html/sp070410.en.html> on July 17, 2011]

³¹⁴ E. Wamaitha, Daily Nation, September 30, 2011 article titled *'CBK runs out of ideas to fix shilling'* Special Report section at page 17 and on the same page an article written by E. C. G. titled *'Governor has lost touch with reality, bankers allege'*. Both authors argue that the wrong monetary tool and indeed has done so for about a year resulting in a sharp devaluing against the dollar and inflation rates that are out of control. Some as far as to state that CBK has in fact fuelled the problem of the 'run away shilling' refusing or failing to increase interest rates resulting to an increased demand in dollars with commercial banks buying and holding onto dollars knowing that the shilling will depreciate even further causing an even higher demand thereby resulting in increased demand for dollars by the commercial banks when they sell the dollars to the public.

policies including the rate of interests¹⁶ on the one hand, CBK when discharging its role as regulator within the lending sector by virtue of its mandate to effect monetary policy¹⁶ on the other hand and the Treasury, which has influence on CBK and its policies¹⁶.

There are scholars¹⁸ who argue that there are various forms of independence which are fundamental for the effective functioning of any central bank. Such forms of independence include goal independence which occurs when the central bank is given independence to set its own goals and implement them without involving the government at all. Instrumental independence occurs when the central bank has full control over the instruments that affect the inflation process. In order to achieve instrumental independence, the central bank should be free of any obligation to finance government budget deficits directly or indirectly and should have the power to determine interest rates. Further, there is also institutional independence which is achieved when there exists a framework through which the central bank obtains its legal and institutional mandate to perform its functions and achieve its objectives. Functional independence is attained when the central bank has a right to decide on all matters regarding monetary policy and price stability to include setting its policy instrument with the aim of achieving its objective. Personal independence entails that the selection and appointment of board members of CBK should be based on professional competence without an obligation to

This is by virtue of the fact that there is no provision within the CBK Act prohibiting or limiting commercial banks from setting their rate of interest. Prudential Guidelines as fussed in chapter 2, in particular guideline 4 referenced CBK/PG/04 on Risk Classification¹⁹ Assets and Provisions, mainly deal with advance and loan governance issues such as²⁰ classification of loans, risk assessment, what is considered to be a non performing loan and²¹ recovery of the same (as opposed to specifically controlling commercial bank credit policies as rates of interest),
 . ^ o n 4(1) of the CBK Act.

stahr¹⁸ mandated by section 4 to formulate and effect monetary policy with a view of²² the other hand, by virtue of several provisions within the CBK Act such²³ P ^ o n a s a n d CBK is required to consult with the Minister of Finance on its monetary²⁴ *heth²⁵ questions on CBKs independence and objectivity in that it is questionable²⁶ c o ^ would pursue its monetary policy or the Minister would approve such if it was in²⁷ CBK l ^ ^ government's overall economic policy. In addition, pursuant to section 4(3)²⁸ ftoy ^ required to support the economic policy of the government including its objectives,²⁹ Potenti: employment- It would appear from these provisions that there is room for a³⁰ conflict between the various institutions concerned, namely, the government at³¹ K a n d the treasury arm of government represented by the Minister of Finance.
 (*ntro[^ ^orenzo Bini Smathi *Supra* note 292 and Alesina A and Summers L.H (May 1993),³² fticie³³ *Independence and Macroeconomic Performance: Some Comparative*
 'Jo urnal of Money, Credit and Banking, Vol. 25, No.2 at pages 151 to 162.

yield to political and other pressures. These scholars aver that all forms of independence are *vital* for any central bank to effectively and efficiently execute its mandate and achieve its objectives.

It is arguable that CBK's independence may be condemned as being compromised by several provisions within the CBK Act. By way of example, it is debatable that the goal independence of CBK is compromised by the fact that under the provisions of section 4 (3), CBK is required to *support* the economic policy of the government. Questions in this respect abound in the case where CBK's economic policy differs from that of the government, in particular if CBK is likely to pursue or be permitted to pursue its monetary policy in keeping with its mandate to maintain price stability. In addition, by virtue of section 46 of CBK Act, CBK may make direct advances to the government for purposes of offsetting fluctuations between budgetary revenue and payments of the government thereby interfering with CBK's instrumental independence. Further, as the government's banker and adviser pursuant to section 4 it may be argued that CBK's functional independence is also compromised. Given these anomalies within the CBK Act and the apparent compromise of CBK's independence as a regulator, it is questionable whether CBK's efficiency and effectiveness in the implementation of its monetary and fiscal policy (including as credit controller) is maintained at an optimum.

In addition, as a result of these shortcomings with the legal provisions establishing and governing CBK, discrepancies often arise on CBK's relations with both the Treasury and other stakeholders of the monetary and financial Actors such as the Kenya Bankers Association⁴¹. Stakeholders raise concern take issue with matters such as the extent of consultation undertaken by the governor of CBK with them as persons or institutions affected by CBK's and monetary policies⁴² prior to CBK effecting such policy. Further, the

⁴¹ Ibid.

⁴² Kenya Bankers Association aims to safeguard and protect the rights and interests of financial institutions in Kenya. It serves as a lobby for banking sectors' interests and as a platform for addressing issues affecting its members.

⁴³ <http://www.pwc.com/ke/en/industries/banking.jhtml> [accessed January 30, 2012].

⁴⁴ Nation, October 19, 2011 article titled *IMF chief visits today as State seeks help on to billing* at pages 1 and 2, the current Minister for Finance, Uhuru Kenyatta is reported to have said that the relationship between CBK, the Treasury and the banking sector is

⁴⁵ should be and that efforts should be made to make it better. Further, he proposes that

stakeholders argue that they not only play a key role in banking but are also experts in the industry and ought to be extensively consulted.³²¹ All these factors and the resulting push and pull between establishments and/or institutions and/or key players who have a role in the governance of the banking industry does not inspire confidence in CBK. It is desirable that CBK consults and looks like it is taking all measures to consult key players within the industry, arguably resulting in constructive criticism and wide expert input on its proposed policies²² however, CBK should at all times maintain its independence and objectivity to dispel any doubt on the soundness of its monetary and/or fiscal policy.

Moreover, it is desirable that open engagement and consultations between bankers, financiers, economists and other interested and expert stakeholders in monetary policy issues should be undertaken and *seen to be undertaken*. This may assist in countering existing skepticism and increase confidence in CBK's role as regulator. Notably, save for consultations with the Minister of Finance and the government, the CBK Act does not *compel* CBK to engage external experts in its monetary policy formulation³²³. This situation is compounded by the fact that CBK, like any other regulator and player within

the CBK Act should be amended accordingly to give CBK a clearer mandate in credit control. The banks reportedly submitted that the governor of CBK, Prof. Njuguna does not consult with the relevant stakeholders including the Kenya Bankers Association on issues of interest. This provides an example of the tag of war that may ensue between the bankers, Treasury and the CBK all of which reduce the effectiveness of CBK as regulator within the bank lending industry. In the same newspaper, banks including KCB (at page 33) have advertised an upward review of their lending rates following an increase of CBK's base rate to 11% presently.³⁵¹ *ibid*

It may be argued that such policy may be seen to have been finalised and implemented without the input of all stakeholders as opposed to the arbitrary formulation and implementation by CBK. On the other hand, it may be argued that should CBK have to consult extensively on all issues, it may slow down the process of implementing monetary policies in circumstances where it is required to act quickly for example when the value of the shilling is declining rapidly. Under virtue of section 4B of the CBK Act, CBK is required at intervals of no more than 6 months to submit to the Minister of Finance a monetary policy statement for the next twelve months. The statement should specify CBK's policy and the manner in which it intends to achieve the stated reasons for adopting such policies and contain a review and assessment of the implementation of policy preceding the one submitted. The Minister of Finance is then required to table such policy to the appropriate committee of the National Assembly, which shall contain government appointed financial and/or banking experts to deliberate on the Policy. CBK is not compelled to directly consult with persons and/or institutions or the government (external stakeholders) which may be argued to be a tunnel vision given that CBK is required to support government policy resulting in potential perceived lack of objectivity of CBK, the Minister and members of the National Assembly committee.

Oge financial industry, faces external challenges which are outside its control in its operations such as foreign exchange fluctuations³²⁴, all of which have a direct impact on monetary and fiscal policies. Given such externalities, it is questionable and to a large extent largely impractical to expect CBK to maintain the most consumer responsive monetary and fiscal policy at all times. However, this research asserts that there is room to strengthen CBK's efficiency and role as regulator, particularly governing lending by banks, by revising and tightening loopholes that exist in the current provisions of the CBK Act³²⁵.

It is apparent from the above that CBK in its role in the financial, monetary and banking sector doubles as controller of credit in the entire national market -consumer, non-consumer and government credit- in addition with its other roles³²⁶. This gives CBK an exceptionally wide mandate which may arguably be difficult or impractical to discharge. It is desirable that monitored delegations and close working arrangements between financial and banking expert institutions help ease CBK's regulatory pressures and if well structured assist CBK in effectively discharging its obligations, including credit control. Given the increased importance of credit in today's society, it may be desirable that there should be an independent body and/or organ that specializes in lending issues and their governance, including consultations with the relevant parties, citizenry education and reporting, monitoring and/or evaluation of the effects of the implemented credit control tools and the like at regular intervals. In implementing these procedures, it would be beneficial that communication channels between the appropriate stakeholders, consumers and regulating body be kept accessible and open.

Notably foreign exchange is affected by other external factors such as the state of the economies in the different continents, world wars, world politics, international monetary ^ **es to** name a few resulting in a complex and intricate economic paradigm.

86! as Provisions that undermine the independence of CBK as a regulator, insertion of stringent provisions on CBK's control of commercial bank lending policy amongst

A outlined in section 4 of the Central Bank of Kenya Act, Cap 491 of the Laws of Kenya for fostering the liquidity, solvency and proper functioning of a stable market-based I -'in System (section 4 (2)); formulating and implementing foreign exchange policy, I managing foreign exchange reserves, licensing and supervising licensed banks I 'p r's' hanker and adviser to the government, issuing notes and coins (section 4(a)), to

^a few.

In conclusion, it is debatable that the issues surrounding the governance of CBK as a regulator, its relationship with the treasury and government and the inconsistent provisions of the CBK Act all result in undue condemnation of CBK's role as the lead regulator within the banking industry. These issues coupled with the externalities beyond the control of CBK further aggravate the situation. It is therefore desirable that a review of the legal and structural framework of CBK be conducted against its operating environment (political, social and economic). This research suggests that affirming CBK's active role in the control of commercial banks' credit policy through the enactment of statutory provisions unequivocally mandating and empowering CBK to have direct control of such policy would undoubtedly increase the protection afforded to borrowers or consumers of bank credit products.

33 An assessment of the role and mandate of Credit Reference Bureaus and the Consumer Federation of Kenya.

3.3.1 Credit Reference Bureaus

As discussed in Chapter two, the Banking (Credit Reference Bureau) Regulations (hereinafter 'the regulations') establish and license Credit Reference Bureaus to operate bureau business in Kenya. Currently, there are two licensed Credit Reference Bureaus, namely Credit Reference Africa Limited (CRBAfrica Ltd)³²⁸ and Metropol CRB³²⁹. Such bureaus engage in activities which include (*but are not limited to*) compiling and maintaining of a database to generate reports from customer information held, which is later shared with interested third parties and banks. This information assists banks in making an informed decision on whether to avail their products to a particular individual. This is to the benefit of both the bank and the individual because the bank's risk is reduced, in theory, and the individual is deterred from borrowing loans that they cannot afford to service based on their circumstances.

³²⁸ Regulation 3 of the Banking (Credit Reference Bureau) Regulations, 2008.

³²⁹ www.xrbafrica.com/contacts/contacts.asp [accessed November 2, 2011] -

³³⁰ Was licensed in Kenya about a year ago and now has a presence in over 12 countries. Reference Bureau to be licensed in Kenya.

³³¹ Alwi is the second CRB to be licensed in Kenya to date. It was licensed on or around 2011.

professor Ndung'u of CBK in his address during the launch of bank credit information sharing implementation project³³⁰ explained that it is asserted that the level of interest rates is a combination of costs (like information search costs), risk premium and the banks' profit margin. The lack of a credit reference and an information sharing system is therefore a contributing factor to soaring costs of credit due to existing information asymmetry between the banks and potential borrowers with the banks going to great lengths to find out the potential debtor's credit history in order to assess their lending risk. Banks have in the past argued that the costs of searching for credit information relating to a particular client are high resulting in a higher cost of lending³³¹ However, it is interesting to note that despite the presence of a credit information pool in Kenya banks have over the years continued to increase interest rates with the most recent increases being attributed to the increase in the Central Bank of Kenya base rate.³³² it is arguable that this position by the banks makes it difficult to assess the full impact of the presence of credit reference bureaus on lending costs.

A recent study³³³ indicated that remarkable progress in information sharing has been made since the registration of the first credit reference bureau in February 2010. It however highlights that some challenges have been faced particularly with the legal provisions that are in place which it asserts impose stringent registration requirements for the credit reference bureaus and restricts the sharing of bank information with other institutions. That notwithstanding, it is undeniable that credit reference bureaus complement the central role played by banks and other financial institutions in extending

³³⁰ Uju, *Information Sharing to enhance financial sector development*, August 27 2009 at Hotel, Professor Njuguna Ndung'u Governor Central Bank of Kenya, found on <http://www.centralbank.go.ke/downloads/speeches/2009/CreditSharing.pdf> [accessed 20, 2011]

³³¹ TW.ryutPn rnm/article/2011/04/ii/kenya-metropol-idUKLDE7.AiJL2oH04ii J^ a April 11,2011].

³³² as indicated in the Daily Nation dated October 6, 2011 at page 1 and 2. Analysts note on Africa i ?)an^s not adjust their commercial lending rates downwards (at all or ri *titt k? the Central Bank of Kenya base rate when it is reduced.

³³³ Voig? by Davel G, Serakwane T and Kimondo M (February 2012) and titled *Kenya Credit Reference Initiative : A Progress Report 2008-2011 Challenges and* Available at <http://www.fsdkenya.org> [accessed April 21,2012]

lending and financial services within the economy.³³⁴ This is because they, in theory should assist lenders in making faster and more accurate credit decisions based on the information shared. By creating a database and sharing the customer information, good or bad, credit bureaus assist in creating credit histories³³⁵ which aid in credit underwriting thereby assisting lenders and business, in theory, to reduce fraud and manage risk. Customers are also in theory better advised and to some extent limited to borrowing what they can service. This undoubtedly renders credit reference bureaus in principal a positive input in the economy.

In spite of the benefits of credit reference bureaus, this research suggests that the regulations creating credit reference bureaus have shortcomings that somewhat reduce the benefits afforded by the system. Firstly, it is apparent that the customer information collated is both wide and sensitive and should be treated with the discretion and confidentiality that it deserves. Whilst the regulations provide for restrictions on the use of such customer information³³⁶, it may be argued that the current laws on data protection are somewhat lacking in preventing the misuse and/or exploitation of consumer data by unscrupulous third parties and banks. Furthermore, it is arguable that the protection and benefits envisaged by the regulations are achievable only if all parties' concerned work towards enforcing their terms, failing which the customer may be left exposed. The success of the system within the economy will only work if all parties are honest in terms of the initial information provided and diligent in terms of updating the database to keep it accurate.

Lending and financial services within the economy.³³⁴ This is because they, in theory should assist lenders in making faster and more accurate credit decisions based on the information shared. By creating a database and sharing the customer information, good or bad, credit bureaus assist in creating credit histories³³⁵ which aid in credit underwriting thereby assisting lenders and business, in theory, to reduce fraud and manage risk. Customers are also in theory better advised and to some extent limited to borrowing what they can service. This undoubtedly renders credit reference bureaus in principal a positive input in the economy.

In spite of the benefits of credit reference bureaus, this research suggests that the regulations creating credit reference bureaus have shortcomings that somewhat reduce the benefits afforded by the system. Firstly, it is apparent that the customer information collated is both wide and sensitive and should be treated with the discretion and confidentiality that it deserves. Whilst the regulations provide for restrictions on the use of such customer information³³⁶, it may be argued that the current laws on data protection are somewhat lacking in preventing the misuse and/or exploitation of consumer data by unscrupulous third parties and banks. Furthermore, it is arguable that the protection and benefits envisaged by the regulations are achievable only if all parties' concerned work towards enforcing their terms, failing which the customer may be left exposed. The success of the system within the economy will only work if all parties are honest in terms of the initial information provided and diligent in terms of updating the database to keep it accurate.

Lending and financial services within the economy.³³⁴ This is because they, in theory should assist lenders in making faster and more accurate credit decisions based on the information shared. By creating a database and sharing the customer information, good or bad, credit bureaus assist in creating credit histories³³⁵ which aid in credit underwriting thereby assisting lenders and business, in theory, to reduce fraud and manage risk. Customers are also in theory better advised and to some extent limited to borrowing what they can service. This undoubtedly renders credit reference bureaus in principal a positive input in the economy.

In spite of the benefits of credit reference bureaus, this research suggests that the regulations creating credit reference bureaus have shortcomings that somewhat reduce the benefits afforded by the system. Firstly, it is apparent that the customer information collated is both wide and sensitive and should be treated with the discretion and confidentiality that it deserves. Whilst the regulations provide for restrictions on the use of such customer information³³⁶, it may be argued that the current laws on data protection are somewhat lacking in preventing the misuse and/or exploitation of consumer data by unscrupulous third parties and banks. Furthermore, it is arguable that the protection and benefits envisaged by the regulations are achievable only if all parties' concerned work towards enforcing their terms, failing which the customer may be left exposed. The success of the system within the economy will only work if all parties are honest in terms of the initial information provided and diligent in terms of updating the database to keep it accurate.

In practice, there is nothing preventing a consumer of credit facilities, if unchecked, from manipulating the system by being deceitful whilst completing the application for the initial loan, which information is then captured in the credit report pursuant to the provisions of the regulations and subsequently duplicated and exchanged between subscribers thereafter. If left uncorrected, this false data will circulate to lenders who are likely to continue making decisions on the basis of false information to the detriment of both the consumer who may find themselves unable to service the loan and the lending institution whose bad debt or non performing loan provision⁴ is likely to increase. These shortcomings within the laws and regulations and within the application of the credit reference bureau system significantly reduces any protection afforded by the Regulations and licensed bureaus to the consumers of credit.

3.3.2 COFEK³³⁸

The Consumer Federation of Kenya (hereinafter COFEK) prides itself⁴ as being an independent, self funded, multi-sectoral and non profit making society registered on March 26, 2010 as a membership society³⁴⁰ under the Societies Act Cap 108 of the Laws of Kenya. COFEK purports to work with the Government of Kenya, mainstream media, trade unions, regulatory agencies, **the** private sector and other non state actors with a view of achieving solutions ~~that~~ are consumer centered and restoring their pride and confidence in the goods and services within the economy, amongst other things. COFEK also advocates for the empowerment of the consumer through requisite legislation, Policies, and civic awareness on consumer rights amongst other issues³⁴¹. It with consumer related issues in diverse fields such as banking, roads,

outlined in chapter 2, Prudential Guideline 4 defines non performing loans as loans that ~~fail~~ ^{no longer} generating income or when it comes to the institutions knowledge, a credit ~~is~~ ^{no longer} generate income. The loan is deemed as non performing when the ^{*interest} due is unpaid for 90 days or more or interest payments for 90 days has ~~been~~ ^{over} ~~to~~ ^{to a new} loan or refinanced.

^I ~~Act~~ ^{for} Consumer Federation of Kenya, which is located at Ngong Road/Ring Road **In i⁴ Action.**

^{**The nT⁴k⁴*te} www.cofek.org [accessed on December 20,2011].

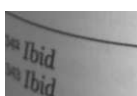
fif⁴ ^{Mto¹¹¹} are ordinary consumers, professionals and institutions from ordinary walks **K i⁴ ^{8u}PP^ort** COFEK's vision, mission and values centered round the protection of the **S L^o** ' goods and services in general as detailed in www.cofek.org [accessed on 2011].

r⁴ ^QEg [accessed December 20,2011].

water, energy, agriculture, education, tourism, food, health, supermarkets, aviation, insurance, local authorities amongst others.³⁴² Although it is a non-state organization based on private member initiatives, this research proposes to highlight COFEK's mandate in brief with a view of determining whether it is best placed to pursue increased consumer protection within lending by banks in Kenya. Since COFEK prides itself in pursuing consumer focused initiatives in diverse sectors including banking, it is highlighted within the context of this research for completeness.

It may be argued that COFEK's mandate is too wide to be effectively achieved in practice. COFEK purports to promote consumer protection on extensive issues contained in diverse sectors rendering its mandate near impossible to efficiently and effectively discharge. Further, the structure of COFEK is such that it relies on research and findings undertaken by third parties who are usually its members, professional or otherwise. This is likely to pose challenges to COFEK when fulfilling its duties because it would be prudent for it to first verify the information obtained by such third parties before acting upon it. A failure to do so, may cause COFEK's credibility to be questioned should it be proved that such information was obtained or interpreted by the third party in a questionable manner or without them conducting sound research.

Further, it is likely that the funding structure of COFEK as an independent self funded organization³⁴³ results in it having to rely on donations from members in addition to its members. As COFEK's resources are not infinite⁶¹ the issues it attests to deal with are extensive and the sectors diverse, it is likely that COFEK is forced to prioritize the issues it wishes to pursue and/or address. To this end, it is probable that the views of its members and other holders, which may not always be consistent, would call for attention posing a challenge to COFEK in the discharge of its duties. In regard to this, it may be desirable that distinct institutions dealing with promoting consumer protection in separate sectors be established.



further, it may be prudent that each organization be funded by its relevant sectors with it being a mandatory requirement for players within that sector such as banks, mortgage companies and other financial institutions within the financial sector to contribute towards funding the same³⁴⁴ along with other well wishers.

An evaluation of the institutional framework in alternative jurisdictions

The regulation of financial services in the United Kingdom (hereinafter UK) in the 1990s was the responsibility of different bodies, in particular, the Financial Services Authority (hereinafter FSA formerly known as the Securities and Investment Board), the Buildings Societies Commission, the insurance arm of the treasury to name a few.³⁴⁵ Steps were taken to transfer responsibility of regulation of the financial sector to a single regulator being the FSA³⁴⁶. The Financial Services Markets Act (hereinafter FSMA)³⁴⁷ was enacted in June 14, 2000 providing the framework within which the FSA would operate and equipping the authority with statutory powers to act. The FSMA also created the Financial Services and Markets Tribunal and established the framework for a single ombudsman and compensation scheme to provide added redress alternatives for the aggrieved consumers within the financial sector.

³⁴⁴ There may be a danger of players within the sector funding the institution because they may have an upper hand and/or unbalanced say in the implementation of that institutions mandate. However, if there is an equal balance between the funding by players and the funding by well wishers, the balance may not be altered and instead the players may go an mile in ensuring that their organizations promote and observe consumer protection knowing that there is a well funded institute overseeing their activities, in Briault C (May 1999), *The Rationale for a Single National Financial Services Regulator*.
³⁴⁵ In May 1997 The Chancellor announced the reform of the financial services system in the UK by merging banking supervision and securities regulations into the Securities and Investment Board (SIB). The SIB changed its name to the FSA in October 1997. The first stage of reform of financial services was completed in 1998 when the responsibility for banking supervision was transferred to the FSA from the Bank of England. In addition, the Financial Services Markets Act (which came into force on 1st December 2001) transferred to the FSA the responsibility of other organizations which included the Buildings Societies Commission, Securities and Investments Authority, Investment Management Regulatory Organisation, Personal Finance Authority to name a few. In January 2005, to implement the Insurance (7th Directive), the FSA took over regulation of general insurance business, (found at www.fsa.gov.uk/about/who/history [accessed February 20, 2012]).

³⁴⁶ Functions that were under the Banking Act 1987 were transferred by the Bank of England to the FSA in 1998 to the FSA.
³⁴⁷ *Financial Services and Markets Act 2000* at www.opsi.gov.uk/acts/acts2000/pdf/ukpga_20000008_en.pdf [accessed February 23, 2012].

Notably, the FSMA is a comprehensive statute consisting of 30 parts many of which are aimed at increasing consumer protection, in furtherance of one of the objectives of the FSA. Part I and Schedule I of FSMA set out these objectives and the mandate of the FSA and guides the exercise of its functions. Section 2(2) lists the FSA's objectives as being the building and maintenance of market confidence, protection of consumers and reduction of financial crimes such as money laundering in co-operation with various law enforcement agencies. When considering the degree of protection to be afforded to the consumers, the FSA is required to have regard to the degree of risk involved, sophistication and experience of the parties to the transaction, the need of consumers for advice and information and the general principle that consumers should take responsibility for their decision³⁴⁸. The FSA is however not required to place particular weight on one of these factors over the others.³⁴⁹

Section 8 of FSMA contains a mandatory provision requiring the FSA to consult with practitioners within the financial market for example banks, lending institutions and the consumers as well. The FSA is required to maintain panels that represent the interests of both the practitioners and consumers. In addition pursuant to section 11, the FSA is required to consider the representations made to it by such panels and where it disagrees with the views expressed, the FSA is required to give its reasons in writing. Relevant to this research, the provisions of the FSMA resolve the issue previously highlighted relating to the lack of provisions within the CBK Act compelling CBK to consult with the players within the financial industry resulting in a tangle between the regulatory bodies, stakeholders and government consequently, leading to the undermining of CBK's efforts to regulate the banking sector and promote consumer protection within the banking and/or financial industry pursuant to its primary objective.

- This is in line with the US Special Committee on Retail Installments Sales, Consumer Protection (Small Loans and Usury discussed in section 1.7 of chapter one and cited in Harvey and Galanter's 6th edition), *The Law on Consumer Protection and Fair Trading*, London: Lexis Nexis, who argue that consumer protection may represent undue 'mollycuddling' of the industry and consequently, one should always ask from what or whom are you protecting the consumer from prior to effecting or enacting consumer protection special measures.
³⁴⁸ Section 5(2) of the Financial Services and Markets Act 2000.

The FSMA also establishes the Financial Services Compensation Scheme (FSCS)³⁵⁰, which is a compensation fund of last resort for customers of firms authorized under FSMA which are unable or unlikely to pay claims instituted against them because they have stopped trading or are in liquidation or have been declared in default of the FSMA, amongst other reasons. Further, the FSMA controls entrants within the financial sector and governs their conduct by ensuring that they meet required set standards. It details the requisite requirements for prior authorization in order to conduct financial business under the act, such authorization being mandatory where regulated activities are being undertaken.³⁵¹ An authorized person may only carry on regulated activities for which they have been given permission by the FSMA to do so.³⁵²

It is arguable that a distinct oversight body such as the FSA with respect to financial products would be desirable in Kenya. A distinct law establishing such an oversight body, setting out the conduct, structure, objectives of the body and listing the types of activities regulated under the provisions of that law amongst other issues would also be advantageous. This is because such a system would seek to set up a main regulator for the financial sector therefore streamlining the current institutional framework in Kenya, which has separate regulators for the different sub sectors. In addition, this would to some extent resolve or at least minimize loopholes that exist within the current institutional framework such as regulatory gaps³⁵³, regulatory overlaps³⁵⁴

SB

www.fscs.org-uk [accessed January 20, 2012]

³⁵⁰ Regulated activities under section 22 are defined as being activities and investments carried on by way of business. Treasury has power under section 419 of the FSMA to specify circumstances in which an activity or investment shall or shall not be regarded as carried on by way of business.

³⁵¹ Section 20 of the Financial Services and Markets Act 2000. There is a general prohibition under section 19 on unauthorized persons carrying on regulated activities in the UK. This general prohibition prohibits persons who are not authorised or exempt under the act from engaging on any regulated activity. Contravention of this general prohibition is a criminal offence under section 23 and agreements made in the course of carrying out an activity in contravention of the general prohibition may be unenforceable under sections 26, 27 and 29. For example the vastly used mobile money transfer services of Zap and Mpesa are not subject to any formal regulatory framework in Kenya in spite of them being utilized to deposit and transfer money. The extent of any attempt to regulate agents is the agency banking guidelines which guide approved appointed agents conducting business on behalf of an institution approved and licensed under the Banking and Microfinance Acts for example appointing an agent to undertake banking business on their behalf.

resulting in duplication of roles. It is worthwhile noting however that in spite of the FSA and a substantive review of legislation and institutions governing banking and financial sectors in the UK, it has failed to achieve a single national financial services regulator with services such as pensions being regulated by a separate regulator being the Pensions Regulators. Further, in spite of the FSA objectives and mandate as the main regulator within the financial services industry in the UK, it failed to avert the well publicized financial credit crunch experienced in 2007/2008.

There are several other countries such as Sweden³⁵⁶, Denmark³⁵⁷, Norway³⁵⁸ and Australia³⁵⁹ that operate a regulatory framework similar such as that of the UK. The reason for highlighting these jurisdictions is that they are commonwealth in nature, as is the Kenyan jurisdiction with the legal practice being heavily weighted on common law, precedents and case law therefore making them comparable. This research does not suggest that these jurisdictions are wholly 'better' or somewhat more superior to the Kenyan jurisdiction but merely seeks to highlight the institutional framework.

³⁵⁴ This occurs as a result of various independent regulators regulating their sub-sectors which may have an overlap of products offered. For example the Insurance Regulatory Authority regulates insurance companies and insurance brokers. Insurance business involves, in part, investment and fund management. Fund managers are also regulated by the Retirement Benefits Authority and Capital Markets Authority and if they are based or work within or in Partnership with a banking institution that has an insurance arm such as CFC Stanbic Bank Ltd, must adhere to the provisions of the Banking Act under the supervision of the CBK.

pensionsregulator.gov.uk [accessed January 20, 2012].

The lead regulator is the Swedish Financial Supervisory Authority known as the Finansinspektionen, <http://www.fi.se/Folder-EN/Startpage/About-FI/> [accessed January 20,

³⁵⁵ The lead regulator is the Danish Financial Services Authority known as the Finanstilsynet. It is tasked with the duty of supervising financial undertakings and the securities market, <http://www.dfsa.dk/> [accessed January 20, 2012].

³⁵⁶ The Financial Supervisory Authority in Norway is known as the Kredittilsynet. It is an independent government agency that builds on laws and decisions emanating from the Parliament, the government and the Ministry of Finance and on international standards for supervision and regulation, <http://www.finanstilsynet.no/en/> [accessed January 20,

³⁵⁷ It has two lead regulatory bodies, one for the prudential supervision of banks, insurance and pension funds (the Australian Prudential Regulation Authority, <http://www.australiaprudential.gov.au/Pages/default.aspx> [accessed January 20, 2012]) and one for the supervision of securities firms (the Australian Securities and Investment Commission, <http://www.asic.gov.au/asic/asic.nsf> [accessed January 20, 2012])

25 An evaluation of the institutional framework in the Consumer Protection Bill 2011.

As explained in chapter two, the Consumer Protection Bill 2011 (hereinafter called 'the 2011 Bill') was proposed following the promulgation of the Constitution of Kenya in 2010 and is subsequent to the unsuccessful attempt to enact the Consumer Protection Bill 2007. The Bill seeks to effect and implement the provisions of the Constitution. Relevant to this research is article 46 which enumerates the rights to which all consumers (including consumers of bank credit products) are entitled. Such rights include the right to goods and services of reasonable quality, right to information necessary for a consumer to gain full benefit from such goods and services, a right to protection of the consumer's economic interests, a right to compensation for loss or injury suffered from defective goods amongst others. The impact of this article on any laws and regulations governing consumer protection is potentially huge and any statute enacted to give effect to article 46 will be a vital step towards increasing consumer protection.

In chapter one, the legal provisions of the 2011 Bill were discussed. Relevant to this chapter is the institutional framework provided for in the 2011 Bill, which seeks to establish a single body to administer and effect consumer protection known as the Kenya Consumers Protection Advisory Committees⁶⁰. This committee would be mandated to advise the Minister of Trade on all aspects relating to consumer protection; formulate policy and legislation proposals along with modification, consolidation, updating of legislation in favour of the consumer; coordinating and networking consumer activities and rising with the consumer to protect consumer interests; carrying out, noting and participating in consumer education programs and providing to consumers on their rights and responsibilities under the appropriate³⁸ well as making available to consumers the general information effecting, their interests; creating and establishing a conflict resolution mechanism on consumer issues to name a few.³⁶¹ It is apparent that such a

³⁸ Under section 89 of the Consumer Protection Bill 2011.

³⁶¹ Under section 90 of the Consumer Protection Bill. Notably, there currently exists the Corporation of Kenya (COFEK), which also deals with consumer protection issues.

wiy would be instrumental in increasing consumer protection however, it is noteworthy that the body's mandate is merely an advisory one as opposed to a more active role involving consumer protection as is the case of the FSA in the fjK.³⁶² It would be desirous for such a body to have an active role so as to ensure that its impact is not diluted or it does not develop to be an ineffectual organization.

3 6 An assessment of the provisions of the Kenya Deposit Insurance Bill 2011 and the Banking (Amendment) Bill 2011.

Chapter two highlights provisions Bills enacted following promulgation of the new constitutional dispensation in 2010. For purposes of completeness, this Thesis examines the provisions of these Bills in order to establish if they seek to address the shortcomings of the current institutional framework as highlighted within the body of this chapter.

The Kenya Deposit Insurance Bill 2011 institutes the Kenya Deposit Insurance Corporation mandated with providing the customers of its member institutions with a deposit insurance scheme. This proposed Bill does not therefore seek to establish a new institution to govern issues pertaining to consumer protection nor does it seek to establish an institution overseeing and regulating the lending industry. As such, it may be argued that the proposed Bill does not seek to address the shortcomings that exist within the current institutional framework. Likewise, the Banking (Amendment) Bill 2011 was also discussed in chapter two. This Bill seeks to set a minimum cap for interest payable by banks on deposits held and a maximum cap on interest

J^uably, the mandate of the Kenya Consumer Protection Advisory Committee as outlined in Bill would be narrower and more structured towards consumer protection of Kenyan ' Bsumers. COFEK obligations as outlined in www.cofek.co.ke [accessed January 20, 2012] ^de to include achieving a fair, just and safe marketplace for both Kenyan and regional Ptomers.

Con* Ct* on Consumer Protection Bill 2007 proposed the establishment of the Kenya bill Umer Protection Authority. In contrast to the Consumer Protection Bill 2011, the 2007 ^ndated the Kenya Consumer Protection Authority, amongst other functions, to actively » uct its duties (which are similar to those contained within the 2011 Bill establishing the "The Consumer Protection Advisory Committee) as opposed to 'advising' the Minister of the ' on sai ne. It is therefore arguable that the 2011 Bill somewhat reduces the extent of burner protection measures that ware proposed in the 2007 Bill.

chargeable on advances made⁶³. It does not seek to address the issues pertaining to and the anomalies existing in the current institutional framework.

3.7 Chapter Three Conclusion

There are evident shortcomings in the current institutional framework governing lending by banks in Kenya which are in part attributed to the laws forming and mandating the regulating institutions. There is therefore a need to review these laws with particular regard being had to the institutions' mandate, structure and objectives. The Constitution of Kenya is a statement of intent and its entrenchment of principles relating to consumer protection emphasizes the heightened importance of the concept and the need to have efficient and effective institutions to enforce any laws enacted.

The establishment of a single body overseeing consumer related issues such as the Kenya Consumer Protection Advisory Committee within the context of the Consumer Protection Bill 2011 is arguably a positive step in the right direction aimed at increasing consumer protection. However, to be effective, such a body ought to be fully mandated to deal with consumer protection issues in an active capacity as opposed to merely an advisory role as is currently the case. The 2011 Bill proposes to set up an advisory committee with the active role being reserved for the Minister of Trade, a set up which does not adequately address the existing irregularities. Much to the contrary, it may be argued that such a set up creates another layer to an already crowded system, which should not, in my considered view be the aim of a statute seeking to streamline and make comprehensive the laws, regulations and institutions governing consumer related matters.

u .

§ forward, it is desirable that any Bill relating to consumer protection be fruitively discussed with a view of resolving some of the issues hted in this chapter such as duplication of roles, wide institutional

irouin interest payable on deposits is proposed at 70% of the Central Bank of
l e r a t e a n c e m a x i m u m interest chargeable on advances is proposed at 4% above

mandates and shortcomings within the structure of institutions. These pitfalls make it difficult for institutions to efficiently and effectively discharge their mandate, which if well done would assist in increasing consumer protection.

CHAPTER FOUR: PRESENTATION AND ANALYSIS OF THE PRIMARY RESEARCH FINDINGS.

4.1 INTRODUCTION

This research has so far assessed the legal framework governing the bank lending industry highlighting loopholes observed within the laws and regulations in as far as they fail to adequately provide for the protection of borrowers or consumers of bank credit products. Where such shortcomings exist, suggestions have been made to rectify them. Further, this research has evaluated the key institutions governing the banking sector, in particular the establishing laws of such institutions and their mandate, considering whether in my considered view they are sufficiently empowered to effectively and efficiently discharge their obligations. Lastly, this research has so far briefly analysed the bills proposed in line with the new constitutional dispensation in order to determine to what extent they rectify the current position and address existing issues.

In this chapter, this research looks into the practical aspect of lending by banks, in particular, the processing of the credit applications from prospective borrowers. The main objective of conducting primary or field research was to assess the level and nature of information that was disseminated on a practical level from the outset and during the course of the bank employees processing the applications. This research suggests that disclosure at the outset of the application is a vital aspect of consumer protection. Further, the primary research sought, albeit to a lesser extent to establish the extent of standardization of the bank's procedures, the level of discretion left to the employees and the bank employees' awareness of the legal provisions governing lending by banks in Kenya.

4.2 RESEARCH METHOD

Research on the customer respondents was conducted by way of three focus group discussions guided by questionnaires and consisting of ten (10) respondents per group. The selection criterion was that respondents should be unacquainted or had experience of trying to obtain bank credit within the past

two (2) years. The focus groups were divided into age groups thirty (30) to thirty five (35) years; thirty six (36) to forty five (45) years and forty six (46) to fifty five (55) years. As explained in chapter one, it was assumed that members of each age group shared similar reasons for seeking credit, had similar economic circumstances and/or economic needs, work history, exposure to credit, family and personal needs, similar preferences and/or risk appetites to name a few traits at the time of conducting the research. One of the limitations of this research thesis/project is that these assumptions may be proved wrong.

Research on the bank respondents was conducted by way of personal interviews guided by questionnaires. Attached to this thesis are the sample questionnaires utilised in the focus group discussion (see **Appendix 1**) and for the bank representative interviews (see **Appendix 3**).

43 DISCUSSION AND ANALYSIS OF RESEARCH FINDINGS

4.3.1 Bank Customer Respondents

All the respondents forming the respective focus groups irrespective of age bracket had successfully obtained a loan or some other form of credit facility from a bank for personal use over the past two years. There were varied reasons given for the respondent's need to obtain credit. Majority of the 30-35 years age bracket (9) indicated that they had obtained credit for purposes of paying outstanding school fees and purchasing household effects. Such loans were not substantial and were either bank personal loans (7) or overdraft facilities (2) with the maximum credit obtained by the respondents being Kenya Shillings fifteen thousand for bank personal loans and Kenya Shillings ten thousand for overdraft facilities. With respect to the age group 36-45 years the reason for obtaining the credit was varied with three (3) respondents indicating they had obtained personal loans to pursue business ventures, four (4) indicating that they had mortgages the remaining three (3) indicating that they had obtained overdrafts for purposes of paying fees and undertaking home improvements. Majority of the age group 46-55 years indicated that they had mortgages (8) with one respondent having a personal loan for the purchase of a car and another indicating that they had obtained

overdraft for purposes of paying medical expenses. For this group the personal loans and overdrafts limits were significantly higher than those of other respondents, disproving the assumption that this age bracket would be attractive to lenders given that they were fast approaching retirement with the likelihood of an unsteady income. Although the findings on the reasons provided for obtaining credit to some extent support the assumption that persons within the designated age groups may seek credit for similar reasons, they are inconclusive as to whether the situation would be the same had a larger respondent base been sought. It is therefore arguable that given the size of the groups, it is not sufficient to determine whether the assumption of a common reason for seeking credit or shared preferences is right or wrong.

Notably, within all the groups, a majority of the respondents (8 within the age group 30-35 years; 7 within the age group 36-45 years; 5 within the age group 46-55 years) had obtained credit from Equity Bank. Further, in all the age groups, majority of the respondents (all respondents within the age group 30-35 years; 9 respondents within the age group 36-45 years; all respondents within the age group 46-55 years) had obtained credit from a bank they are currently banking with. A majority of respondents within the age groups 30-35 years and 36-45 years, being 7 and 8 respectively had been informed of the credit facility through a bank sales representative (field agent) with the remainder of the respondents making enquiries from the branch direct (1 in the age group 30-35 years and 2 in the age group 36-45 years) or responding to an advertisement (1 from the age group 30-35 years and none from the age group 36-45 years). However, within the age group 46-55 years, majority (6) of the respondents attended the bank to make enquiries on the credit product while three (3) respondents obtaining information on the credit product from Sales representatives and one (1) person responding to an advertisement. The findings relating to how the respondents had been informed of the credit facility were unexpected in that it was anticipated that more respondents would have been exposed to banks' advertisements on their products.

A majority of all respondents (19 out of 30) equating to 63% stated that the bank Natives dealt with their pre-contract enquiries poorly with one

respondent from the age groups 30-35 years and 36-45 years and two (2) respondents from the age group 46-55 years indicating that the bank representatives had dealt with their pre-contract enquiries very poorly. Some of the explanations provided for this include that respondents felt that in many cases, the bank representatives were not fully conversant with the details of the product being sought, others stated that the bank representatives appeared to be working under pressure or in a hurry to conclude matters and get the respondents to commit and did not answer questions raised by the respondents in detail or to their satisfaction, some expressed that the bank credit officers were rude to them and that they were poor in following up on any references or missing documents resulting in the credit application being unduly delayed. One respondent within the age group 46-55 years expressed that there was favouritism expressed to customers who were obtaining larger sums of credit or regular borrowers with their applications taking precedence and being expedited at the expense of other borrowers. Upon making enquiries with bank representatives, it was established that it was usual practice in some banks that respondents borrowing in excess of Kenya Shillings One Million and regular borrowers were given priority and were dealt with by the Head of Credit, which arguably is not surprising given the level of risk involved.

Further, majority of the respondents (7 within the age groups 30-35 years and 46-55 years and 6 within the age group 36-45 years) were of the view that bank representatives were partially upfront and honest and forthcoming with information requested during pre-contract enquiries. All respondents irrespective of age group expressed that bank representatives were very forthcoming with information highlighting the benefits of the credit product and were more reluctant in answering questions or highlighting the negative aspects of the product. In some cases, respondents expressed that the bank representatives were unaware of some of the components of the credit product such as cumulative interest or there being no window to pay lump payments in order to reduce the capital sum borrowed, redemption of some components. In addition, majority of all respondents (8 within the age group 30-35 years; 6 within the age group 36-45 years and 6

within the age group 46-55 years) equating 67% stated that in their view, bank representatives were not fully knowledgeable on the credit facility the respondents were interested in. They expressed concern that the bank representatives were comfortable to read through the paperwork with them however when the respondent asked a question requiring explanation of a term within the agreement and its impact upon the respondent or asked a question pertaining to an attribute of the credit facility that was not addressed within the paperwork, the bank representative left their desk to make enquiries with another colleague before returning to the respondent, an act which did not inspire confidence in the application process. All the respondents who expressed concern on the partial knowledge of bank representatives of the credit product sought stated that the representatives were non committal on interest rates, their variability, forecast on impact of interest increments on the respondents' repayment and how cumulative interest worked. All respondents rated the way their applications was handled as fair however, majority (8 within the age group 30-35 years; 7 within the age group 36-45 years and 9 within the age group 46-55 years) expressed that the bank representative did not give structured, clear and simplified information on the credit facility.

Moreover, majority of the respondents (7 within the age group 30-35 years; 9 within the age group 36-45 years and 8 within the age group 46-55 years) indicated that bank representatives attempted to sell them another credit Product unrelated to the one they were making enquiries about. Those respondents who indicated this stated that the additional products were either ^{to}Pup loans or insurance, with no other products being highlighted. Many of ^{res}Pondents within the age group 30-35 years and 36-45 years (6 and 7 Actively) took on these additional products however, a minority (2) within ^{3^e} group 46-55 years did so. This may be attributed to increased ^{^DFi}

ence of credit by the oldest age group with majority of them (8)

^{Hai}ning that they

were sure of what they wanted at the time of applying for and would request for insurance and/or any additional product of [^] accord without influence from the bank representative. Of those within the age groups 30-35 years and 36-45 years who

undertook the additional products, many (5 in each case) indicated that they did not prove useful or necessary to them and in hindsight, given all the information about the additional products, they would not have taken them on. The two respondents who took on the additional products within the age group 46-55 years confirmed that they considered them necessary, which supports the groups' assertion that they are not vulnerable to sales representatives and are aware of what they require.

Notably, majority of the respondents (7 within the age group 30-35 years; 6 within the age group 36-45 years and 6 within the age group 46-55 years) expressed that the bank representatives explained the terms and conditions of the credit contract clearly but stated that the representatives struggled to offer an explanation where the contract was silent on a particular matter or where a term or condition was not simplistically stated. All respondents (30) answered that the terms of the contract were standardized with majority of the respondents stating that some of the standard terms did not meet their requirements (9 within the age group 30-35 years; 7 within the age group 36-45 years and 9 within the age group 46-55 years). From this, it may be deduced that banks use standardized terms and conditions extensively and typically do not allow customers to negotiate the terms. All the research respondents who stated that the standardized terms did not meet their requirements expressed that they desired to negotiate terms relating to interest rates, repayment methods and repayment periods.

In all cases, a majority (8 within the age group 30-35 years; 9 within the age group 36-45 years; 7 within the age group 46-55 years) of the respondents stated that the bank representatives did not clearly explain what measures they would take if they failed to honour their repayment obligations in accordance with the terms of the contract. When probed further, the respondents largely explained (7 within the age group 30-35 years; 9 within the age group 36-45 years and 6 within the age group 46-55 years) totaling 19 that the banks assumed knowledge on the part of the consumers and did not explain any reprieve options available to the respondents should they face financial difficulties and be unable to keep up their agreed

payments. In addition, a total of twenty five respondents (8 within the age group 30-35 years; 9 within the age group 36-45 years and 8 within the age group 46-55 years) totaling 83% indicated that in their view the bank took an ^reasonably long time to process their credit application with majority of the respondents (6 within the age group 30-35 years; 9 within the age group 36-45 years and 7 within the age group 46-55 years) indicating that they attempted to apply elsewhere due to the delay occasioned by the bank in processing their application. All respondents who sought an additional application explained that the bank failed to communicate during the intervening period seemingly leaving the matter in abeyance with the respondents not being updated on the progress of their application without prompting the bank to do so.

At the time of conducting the research, majority of the respondents (7 within the age group 30-35 years; 6 within the age group 36-45 years and 8 within the age group 46-55 years) had managed to repay the credit back in accordance with the terms of the credit contract. Notably, the research was conducted prior to increases in the Central Bank of Kenya base rate⁶⁴ and consequently the increase in commercial lending rates therefore, given the well documented change in economic circumstances⁶⁵; additional research would need to be conducted on this point to establish whether the repayment status by respondents is still the same. The respondents who had defaulted in Payments (3 within the age group 30-35 years; 4 within the age group 36-45 years and 2 within the age group 46-55 years) indicated that they were not >y with the action taken by the bank on default. They expressed that blowing the first or at most second month of default, the bank moved to ^cement action, instructing lawyers and deducting payments from their lories without notice, where salary was credited to an account held at the l^ngbank as a loan requirement, attachment of the respondent's goods (in cases cars) without notice. All the respondents who had defaulted

^crease was from 6.25% to 8% and as at December 2011 stood at 20.04% - ^^^plbarrkgo.ke [accessed January 20, 2011].

ihjJ^1 data from the Kenya National Bureau of Statistics (KNBS) shows that the rate of ^ V 11 December was 18.9% with it reaching an all time high of 19.72 % in November w e Primary research for the purposes of this thesis was conducted in September 2011

ihs.or.ke/news/ [accessed February 16,2011]

explained that the bank representatives were unwilling to listen to their reasons of default and that in their views; they took an unreasonably heavy handed approach on defaulters. It was noted that there was no standard timeline within which default action was taken, some banks took enforcement action after two months of default and others after a respondent missed one payment. Whilst it is appreciated that the bank is entitled to take action against defaulters, this research argues that this should be done in a regulated manner and within parameters that take into account the borrower's rights. Almost all the respondents who had defaulted in payments (save for 1 within the age group 30-35 years) indicated that they considered that the bank representatives dealt with their circumstances poorly when they started experiencing difficulties in making repayments.

Majority of the respondents (8 within the age group 30-35 years and 9 within the age group 36-45 years and 46-55 years) totaling an overwhelming 87% indicated that the bank representatives did not explain the borrower's rights under the contract to include any right of cancellation, cooling off period, disclosure to name a few. Given the complex nature of credit agreements and the increased importance of credit in society, this thesis argues that the bank representatives should be compelled to highlight the consumers' rights as well as any aspects within the credit agreement that may adversely affect the consumer to ensure that they make an informed decision. The research findings indicate that the bank representatives concentrate on the benefits of the credit facility which may be unsurprising as they aim to 'sell' their employer's product. As such, the laws and regulations governing lending must to step in so as to adequately protect the borrower and reduce the retention of bank representatives on the extent of disclosure they offer.

majority of the respondents (8 within the age group 30-35 years; 7 the age group 36-45 years and 8 within the age group 46-55 years) 77% were not aware of any laws, rules and regulations governing loans by banks in Kenya with those that were aware expressing that they

were not clear on the specific contents of such laws, merely that they exist.³⁶⁶ All respondents (30) indicated that they were not aware of any specific laws currently in place and aimed at protecting the rights of consumers of bank credit products. They all expressed a desire for such laws with the main point of concern being escalating interest rates.

Responses to some of the questions posed to bank customer respondents are tabulated in **Appendix 2**.

4.3.2 Bank Representative Respondents.

The research conducted on bank representatives was limited to personal interviews with credit officers from five different banks namely, Equity Bank, Kenya Commercial Bank, Commercial Bank of Africa, Consolidated Bank and Standard Chartered Bank. A personal interview was also conducted with the Head of Credit from one of the branches of each bank, totaling ten bank respondents. In all cases, both the Head of Credit and Credit Officers sought anonymity for fear of breaching the confidentiality obligation in their contract of employment and/or losing their jobs given the sensitive nature of the research topic. As a result of this, whilst the views of the bank representatives are noted herein, the bank and/or branch name have been withheld resulting in an additional limitation to the research.

It was noted that all the credit officers processed or dealt with the credit applications at the first instance and that they had worked for their employer for less than 5 years. Majority of the officers (4) had worked for their employer for less than two years. Further, it was found that a person can commence work with the credit department and be involved in the processing of credit applications at commencement of employment without induction and/or and/or adequate supervision. The competence of such credit officers in understanding of complex credit matters to include trade finance

³⁶⁶ Only 6 respondents who were aware of the existence of such laws (two within the age group 18-35 years, 3 within the age group 36-45 years and 2 within the age group 46-55 years) in the Central Bank of Kenya and Banking Acts but were unable to quote any provisions or articulate the extent to which CBK or any other institution protects the rights of bank lending products. They were also unable to cite any sanctions under the law that can be taken against banks in default.

patters is questionable. Notably, all Heads of Credit had worked for their employer within the credit department for 5-10 years. Further, majority (3) of credit officers indicated that to the best of their knowledge their employer did not have a written credit policy procedure. One of the credit officer respondent was not aware if such a policy procedure existed and one confirmed that a procedural document outlining, in bullet form, what the bank representative ought to request from the customer in terms of documents to process the application along with mandatory issues that ought to be brought to the customer's attention existed.

Upon further investigation, the Head of Credit of three (3) of the banks (Equity, Commercial Bank of Africa and Standard Chartered Bank) confirmed that a written credit procedure existed and was available only for customers borrowing large sums (over one million) with such customers on occasion (not always) being requested to attest by signing the same (over and above the credit agreement) that the bank representatives had adhered to such policy and that they were satisfied and understood their obligations under the contract. These customers were dealt with by the Head of Credit directly. Both the Credit Officer whose employer had a credit policy and the Heads of Credit (6 respondents) confirmed that regular borrowers were not required to sign the credit policy irrespective of the sums as they were 'aware of the procedure'. The responses of the credit officers and the Heads of Credit on the existence and availability of credit policies indicates that there is inconsistency in the knowledge of credit officers and that of Heads of Credit and/or even if such Policies were in existence, the Credit Officers were largely unaware of it. In some instances, the credit agreement was posted to the regular borrower to without explanation of the terms and conditions therein.

Majority of the respondents (9) indicated that their employer did not offer regular structured training on developments within the lending sector and they hold internal training seminars on the changes in laws and regulations affecting the banking sector or provide them with updates on within the market place. Given the nature of the financial and banking industry including the lending sector, and the rapid change in trends

experienced, it is desirable that banks should organise either in-house or external training for all staff members, including those dealing with credit. Further, all the respondents were aware of the Credit Reference Bureaus and were also aware of how they worked. The credit officer respondents however explained that they were not requesting credit reports for every credit application but did so for what they termed as significant borrowing (over fifty thousand (50,000/=) for a majority of the banks (4). Notably, all the Credit Officer and Head of Credit respondents were aware of the contents of prudential regulation 4 relating to Risk Classification and its contents insofar as non performing loans and the bank's limitation on charging of interest on such a loan. They were of the view that the current laws and regulations governing the banking industry adequately protected the consumers of bank credit products and should not be reviewed to include a provision capping commercial interest rates.

Responses to some of the questions posed to bank representative respondents are tabulated in Appendix 4.

44 Summary of Research Findings

1 The research reported in this thesis was conceived to either prove or disprove the hypothesis set out in chapter one, being that the reason for the existence of low levels of consumer protection within the bank lending industry is as a result of an inadequate legal, institutional and practical framework. Chapter one and two set out to evaluate the legal and institutional framework governing lending by banks in Kenya highlighting perceived shortcomings where these were observed. In this chapter, this research set out to investigate practical aspect of lending in particular, the conduct of bank representatives in the processing of applications from prospective borrowers

^ particular emphasis on the nature and extent of the information generated at the outset.

^ many of the findings of the research conducted on bank customers and ^ in chapter four indicates that twenty three out of thirty respondents 77% of consumers of bank credit interviewed were of the view that

bank representatives dealt with their pre-contract enquiries either poorly or very poorly. Further, 67% of the bank customer respondents considered that the bank representatives processing their credit applications were not fully knowledgeable on the credit facility they were interested in. Moreover, 73% of the bank customers interviewed were of the opinion that the bank representatives processing their credit applications assumed knowledge of the procedure to be followed should the consumer default in their payment and did not highlight any reprieve options available to the consumer should they experience financial difficulties. An overwhelming 87% of the bank customer respondents indicated that the bank representatives did not explain to them their rights under the credit agreement, to include any rights of cancellation or right of early redemption or disclosure, if any. Further 77% of the bank customers interviewed were not aware of any laws, rules and regulations governing lending by banks in Kenya. All bank customer respondents indicated that they were not aware of any laws in place aimed at protecting their rights as borrowers or consumers of bank credit products.

Further, a summary of research findings of research conducted on the bank representatives although clouded by the request for the anonymity of the respondents indicates that staff members who had not worked with their employers for more than 5 years with a majority of the credit officers interviewed (4) having worked for a period of less than two years were involved in the credit application procedure. Further, it was found that one ^ simultaneously commence working for the credit department and Processing credit applications without adequate training or supervision. Three of the five credit officers interviewed indicated that they were not aware of existence of a written credit policy procedure however, all the Heads of ^ it confirmed that there were credit policies however, these were only liable to borrowers of significant amounts (over one million) indicating an stency in the knowledge of Heads of Credit and the Credit Officers, ^ ty (6) of the respondents (1 credit officer who was aware of the Uce of a credit policies and all Heads of Credit) indicated that regular £ ers were not always required to sign credit policies where they existed Li*g that on occasion such policies were ignored. An overwhelming

majority of respondents (9) both credit officers and Heads of Credit indicated that their employer did not provide them with regular structured training on developments within the lending sector or the laws rules and regulations governing it and/or skills in solving credit problems.

5• **CHAPTER FIVE: RESEARCH CONCLUSION AND RECOMMENDATIONS**

5 i **Research Conclusion**

This research set out to address three research questions outlined in chapter one, as follows:

- 5.1.1 What is the current legal and institutional framework governing lending by banks in Kenya?
- 5.1.2 Are there regulatory gaps, overlaps and shortcomings that exist within the existing legal and institutional framework in so far as they deal with and provide for protection of borrowers or consumers of bank credit products?
- 5.1.3 What are the recommended changes, if any, to the laws, regulations, institutions and practice governing lending by banks in Kenya that may be effected so as to achieve an adequate or higher level of protection of the borrower or consumer of bank credit products?
- 5.1.4 How do banks and their representatives deal with and process credit applications submitted by prospective borrowers and in particular, what is the nature and extent of information provided to such borrowers at the outset?
- 5.1.5 What changes to the laws, regulations, institutions and practice may be recommended in order to increase the protection afforded to borrowers or consumers of bank credit products?

This research in chapter two sought to evaluate the laws and regulations governing lending by banks in Kenya. In addition bills proposed in order to amend or review the existing laws in line with the new constitutional dispensation were considered as part of the legal framework noting that they were undergoing parliamentary debate at the time of writing.

¹¹ chapter three, this research assessed the mandates, objectives and iveness of institutions governing lending by banks in Kenya. It was noted such institutions derived their authority and mandate from the statutes

forming them. Further, the statutes legitimizing and mandating the institutions were outlined and evaluated insofar as the extent to which they provide or fail to provide an effective and efficient framework for the institution to operate in. The research noted that besides the institutions governing the banking sector as a whole, there were other institutions that purported to have an active role in consumer protection such as the Consumer Federation of Kenya (COFEK), whose mandate was also reviewed in as far as the extent to which it promotes heightened consumer protection within the banking sector.

Furthermore, this research in both chapters highlighted shortcomings and/or loopholes and/or anomalies that were perceived to exist in both the legal and institutional frameworks governing lending by banks in Kenya. The shortcomings highlighted within the legal framework were centered round the lack of comprehensive provisions addressing real issues experienced by borrowers or consumers of bank credit products. In addition, this research suggested that these provisions did not adequately protect such borrowers or consumers of bank credit products from the issues they faced which were identified as including mis-advertisement, lack of disclosure, provision of false, inaccurate or misleading information and unfair practices by bank representatives amongst others.

The main objective of undertaking primary research was to explore the extent « disclosure made to potential borrowers by bank employees from the outset and during the processing of their credit application. Further, albeit to a lesser extent, the primary research sought to explore the extent to which standard terms were used and whether potential borrowers were permitted to negotiate any of the terms. Enquiries into the manner in which the bank employees dealt with potential borrowers when processing their credit applications and the level of discretion left to such employees were also made. The research proposes that conducting the primary research in addition to an analysis of the legal and institutional framework provides a more complete picture of the operation of lending by banks in Kenya. The primary

research provides a more comprehensive outlook of the difficulties experienced by borrowers or consumers of bank credit products.

The primary research findings indicated that majority of borrowers or consumers of bank credit products interviewed were of the view that bank representatives processing their applications were not fully knowledgeable on the product they were interested in and did not explain to them their rights under the agreement. Further, a majority of borrowers or consumers of bank credit products were not aware of any legal provisions governing lending by banks in Kenya or protecting their rights as borrowers. The primary research also established that the use of a standardized credit policy by bank representatives was irregular, the experience of such representatives processing the credit applications in some cases was minimal and the bank employees were not provided with regular on-the-job training.

This research asserts that the current legal framework to include the statute, regulations and guidelines do not contain provisions which adequately control the conduct of commercial banks in as far as their lending policies nor do they contain provisions that sufficiently empower the Central Bank of Kenya to control the lending policies of commercial banks. As a result of this, this research suggests that the legal framework has significant shortcomings in as far as protecting the borrower or consumer of bank credit products against issues that exist within the lending industry and which may affect them adversely. Some of the shortcomings with the laws and regulations identified in this research include the control and setting of a cap on interest rates to curb the commercial banks' arbitrary increase of such rates whenever market rates or the Central Bank of Kenya rate is altered; lack of provisions setting a standard and obligating banks to disclose a minimum amount of information to the potential borrower at the outset, lack of provisions prohibiting the dissemination of false or misleading information on bank credit products or prohibiting misleading advertising to potential borrowers to name a few.

In addition, this research suggests that the penalties set do not serve as deterrents to defaulting banks because they are set too low and are

not commensurate to the potential benefit enjoyed by the bank as a result of such default. This research proposes that the benefit may be equated to damages suffered by the borrower or consumer of bank credit products as a result of the bank's default and the penalties should be guided by such benefit. Moreover, this research argues that the laws establishing institutions that govern lending by banks in Kenya contain ambiguities and loopholes that cause such institutions not to effectively and efficiently discharge their role of governing banks and their credit policies. These ambiguities include the provision of too wide a mandate making it difficult or near impossible for the institution to effectively discharge its mandate. Further the establishing law include provisions that seemingly compromise the independence of the institution (read: Central Bank of Kenya) as the lead regulator in the banking sector (to include the bank's credit policies) thereby making it difficult for the institution to effectively discharge its mandate without interference from external factors. This research argues that these problems that exist within the legal and institutional framework instill little confidence in the system further aggravating the situation.

Subject to the assumptions and limitations outlined in chapter one being correct and having regard to the shortcomings highlighted within the legal and institutional framework and the primary research findings, this research suggests that the protection of borrowers or consumers of bank credit products is not adequate within the current framework. This research further proposes that the laws, regulations, institutions and practical aspects of lending by banks in Kenya ought to be reviewed and amended in order to increase the protection of borrowers or consumers of bank credit products in line with the new constitutional dispensation which entrenches consumer rights by virtue of article 46.

This research however notes that it may prove difficult to control the conduct of bank representatives to include their poor communication or enforce legal provisions at the individual employee level. That notwithstanding, this research asserts that with a comprehensive legal and institutional framework in place, regulating institutions would be sufficiently empowered to seek out

banks that are defaulting in their obligations and deal with them accordingly, further, courts would be obligated to adjudicate and enforce fines or penalties as set out within such a legal framework, which if set high enough should serve as sufficient deterrents to defaulting banks. This research asserts that doing so would undoubtedly increase the level of protection afforded to borrowers or consumers of bank credit products and/or deal with and/or prevent some of the ills that are experienced by potential borrowers.

5.2 RECOMMENDATIONS

In light of the above findings, it is recommended that steps be taken to improve the existing legal and institutional framework with a view of increasing consumer protection. It is arguable that should there be comprehensive water-tight legislation, the practical conduct of lending by banks in Kenya, the setting of bank lending policies would also inadvertently be better regulated and controlled so long as such legislation was properly enforced. This research acknowledges that enforcement is a vital element of effective regulation and that a jurisdiction may have comprehensive laws which are never enforced rendering them superfluous. That notwithstanding this research suggests that the main problem in the current legal and institutional framework is the provisions of the statute, laws and regulations which either do not effectively empower regulators to enforce them against defaulting lending institutions or sufficiently provide for the protection of borrowers or consumers of bank credit products.

This research suggests that the following proposals should be adopted with a view of improving on the existing system and achieving heightened protection of the borrower or consumer of bank credit products;-

Legal provisions governing lending by banks in Kenya

A single comprehensive statute dealing with lending to individuals utilizing credit for their private consumption (or consumers as defined in chapter 491 of the constitution) should be enacted. This is because this research recognizes that such borrowers or individuals have an unequal bargaining power as compared to lending institutions and as a result there exists significant information

asymmetry that ought to be addressed. Whilst this research notes that there are different types of credit or lending products which are diverse in nature such as Hire Purchase Agreements, Credit Cards, Overdrafts , upfront bank loans, mortgages to name a few, it is proposed that a statute should be enacted containing clear definitions of the credit or lending products falling within its ambit. Further, the statute should set an upper limit for loans that would be governed under it for example, loans up to say Kenya Shillings Five Hundred Thousand.

This research proposes that with clear definitions and limits set, the statute should be made applicable to all forms or types of lending (save for mortgages) irrespective of the nature of the lending institution. It is suggested that the statute should contain a general section addressing issues that are applicable to all lending agreements irrespective of the type of institution lending for example, rates of interest, minimum disclosure requirements, template of a lending agreement, period provided to potential borrower to read and consider agreement (cooling off period), consumer rights, enforcement procedure, prohibit providing false or misleading information, prohibit mis-advertisement, define and prohibit certain unfair practices such as charging brokerage fees and charges that have not been brought to the potential borrower's knowledge to name a few. This research proposes that the statute should then be divided into sections or parts addressing issues unique to a particular form of credit for example Hire Purchase Agreements, Credit Cards and Overdrafts as defined within the statute.

This research recognizes that the Consumer Protection Bill is designed in a similar manner but notes that there is no upper limit set within the Bill and farther, the Bill makes no reference to the Acts of Parliament currently governing different types of institutions and how the provisions of those Acts will be reconciled to those of the Bill. It is arguable that setting an upper limit may assist in managing the risk undertaken by the lending institution by during that agreements falling within the ambit of the statute being inducted in a set manner. This ensures that minimum standards in the induct and execution of agreements are maintained. The limit also reassures

lending institutions that may be skeptical of the concept of handing all lending agreements in the same manner irrespective of the sums or risk involved. Further, this research suggests that lending agreements over the set limit may be referred to another Act, which should impose more stringent obligations on both the borrower and the lending institution. This research proposes that given the unique nature of mortgages, they should be dealt with under a distinct Act seeking to govern the conduct and execution of all mortgage agreements.

Whilst it is recognized that it would be difficult to draft, enact and enforce a single statute for all types of lending by all types of organizations, this research proposes that the categorizing of statutes by way of limits (as opposed to the type of lending institution) with mortgages being governed separately constitutes a better framework than the piece-meal one that exists at the moment where different acts govern different types of institutions such as SACCOs, Building Societies, Microfinance Institutions, Banks, Housing Finance Institution, Kenya Post Bank to name a few.

At the time of writing, various proposed bills namely Banking (Amendment) Bill 2011 and Consumer Protection Bill 2011 were undergoing parliamentary debate. Whilst it is acknowledged that the contents of these Bills, discussed in chapter one are a move in the right direction, this research proposes that the bills have inherent shortcomings that ought to be discussed and consulted upon prior to enactment. It is proposed that emphasis should not be placed on amending existing Acts governing the different types of institutions to insert provisions governing lending in Kenya or increasing consumer protection as is the case with the Banking (Amendment) Bill 2011 but an overhaul of the legal framework should be conducted with the concept of increasing the protection of borrowers within the lending sector being the core motive irrespective of the type of lending institution.

^stly, this research recognizes that it may be difficult from a practical standpoint to regulate the conduct of individual employees or enforcement of listing legislation by the respective lending institutions however, it is

suggested that enforcement of clearly outlined, succinct and comprehensive legislation is more effective and efficient than the enforcement of contradictory, inadequate and conflicting piecemeal legislation as is currently the case. This research asserts that having such conflicting, inadequate and piecemeal legislation confuses both the borrower and the enforces diluting the provisions of the legislation and making it superfluous.

5.2.2 *The institutional framework governing lending by banks in Kenya*

This research suggests that a single oversight body specifically in charge of financial sector should be established with power to prosecute lending institutions irrespective of type if in default of statutory provisions. Further, it is proposed that such an institution should have an active role in educating borrowers and whistle blowing on defaulting institutions and carrying out field studies in its own capacity and reporting on the same. In order to reduce a conflict of interests within the sector, it is proposed that there should be statutory provisions obligating such an institution to consult with the relevant stakeholders formally reporting on both the agreed and dissenting views.

Further, this research proposes that the institution in question should be required to consult with the supervision divisions of each type of institution for example, the Bank Supervision Division of the Central Bank of Kenya insofar as bank regulations, Sacco Regulatory Authority insofar as Sacco Societies and the like and ought to support the role of such supervision divisions in a more vigilant and watchful manner reporting any breaches or defaults. The main objective of the oversight body would however be to oversee consumer protection issues thereby acting as the 'eyes' of the various supervision division at the grass root level. This, it is argued, would bring the institution closer to the reach of potential borrowers by being more accessible as an intermediary. In alternative as an interim measure, given the increased role of credit in today's society, CBK ought to be given a clear and unequivocal Mandate to directly control commercial bank's credit policy to include setting of interest rates pending the conclusion of a review of consumer protection laws. This research suggests that the latter proposal is merely an alternative

one because it would seek to expand CBK's already wide mandate making it more difficult for CBK to discharge it.

5.2.3 *The practical conduct of lending by banks in Kenya*

This research recognizes that the practical conduct and process of lending by banks in Kenya is a difficult aspect to control and legislate for. However, it is proposed that if there are comprehensive laws mandating an institution to have an active role in supervising lending as suggested above, it may act as a mystery shopper, regularly posing through its agents as potential borrowers and conducting its own surveillance on the conduct of bank representatives when processing applications. It may also whistle blow where it is found that a lending institution is lax in enforcing existing laws even taking judicial action against defaulting institutions. It is suggested that by having such a system in place, lending institutions would be more diligent in setting policies to guide their staff and vigilant in ensuring that these policies are adhered to thereby inadvertently controlling the practical conduct of lending albeit indirectly. This research asserts that this would be a better framework than the one that currently exists and would assist in setting standards to be adhered to by employees of lending institutions thereby achieving increased protection of borrowers.

6. BIBLIOGRAPHY

Books

1. Bix B (2006, 4th edition), *Jurisprudence: Theory and Context*, London: Sweet and Maxwell.
2. Breyer S.G. (1982), *Regulation and its Reform: Typical Justifications for Regulation*, Cambridge: Harvard University Press
3. Chuah J and Furmston M (2010), *Commercial and Consumer Law*, Harlow: Pearson Education Limited
4. Goldring J, Maher L, Mckeough J and Pearson G (1997, 5th edition), *Consumer Protection Law*, Perth: Federation Press.
5. Goodhart C.A.E, (1989, 2nd edition) *Money, Information and Uncertainty: The Economic Arguments for Regulation*, Pelgrave Macmillan
6. Harris J.W. (2004, 2nd edition), *Legal Philosophies*, Oxford: Oxford University Press.
7. Harvey B and Parry D (2000, 6th edition), *The Law on Consumer Protection and Fair Trading*, London: Lexus Nexus UK.
8. Jackson T (2005, 3rd edition), *The Law of Kenya*, Nairobi: Kenya Literature Bureau.
9. Lakshminath A and Sridhar M (2007, 10th edition) *Ramaswamy Iyer's: The Law of Torts* New Delhi: Lexis Nexus.
10. Lowe R and Woodroffe G (2004, 6th edition), *Consumer Law and Practice*, London: Sweet and Maxwell.
11. Mckeough J and Pearson G (1997, 5th edition), *Consumer Protection Law*, Perth: Federation Press
12. Megrah M and Ryder F.R. (8th edition, 1972), *Paget's Law of Banking*, London: Butterworth & Co Publishers Ltd.
13. Offer A (2007), *The Challenge of Affluence: Self Control and Well-Being in the United States and Britain since 1950*, Oxford University Press: Oxford

tals and Articles

- H. Agarwal, S., S. Chomsisengphet, C. Liu, and N.S. Souleles (2006). "Do Consumers Choose the Right Credit Contract?" Working Paper No. 2006-U, Federal Reserve Bank of Chicago, Chicago, IL.

- 15- Alesina A and Summers L.H (May 1993), Central Bank Independence and Macroeconomic Performance: Some Comparative Evidence, *Journal of Money, Credit and Banking*, Vol. 25, No.2
16. Ardic O.P, Ibrahim J.A, Mylenko N (January 2009), Consumer Protection Laws and Regulations in Deposit and Loan Services. Available at <http://econ.worldbank.org>.
17. Barr, M.S., S. Mullainathan, and E. Shafir (2008). "Behaviorally Informed Financial Services Regulation," Report, New America Foundation. Available at <http://www.Newamerica.net>.
18. Beck T (2009), Chapter 2: FinAccess 2009: Trends, Analysis and Policy Conclusions. Available at http://www.fsdkenya.org/finaccess/documents/chapter2_finaccess_results_analysis.pdf.
19. Benartzi, S. and R.H. Thaler (2002). "How Much Is Investor Autonomy Worth?" *Journal of Finance*, 57(4): 1593-1616.
20. Bertrand, M., S. Mullainathan, and E. Shafir (2004). "A Behavioral-Economics View of Poverty," *American Economic Review*, 94(2): 419-423.
21. Briault C (May 1999), The Rationale for a Single National Financial Services Regulator
22. Brix, L. and K. McKee (2010). "Consumer Protection Regulation in Low-access Environments: Opportunities to Promote Responsible Finance," CGAP Focus Note 60. Washington, DC: CGAP.
23. Campbell, J.Y. (2006). "Household Finance," *Journal of Finance*, 61(4): 1553-1604.
24. CGAP (2009). *Financial Access 2009: Measuring Access to Financial Services around the World*, Washington, DC: CGAP and the World Bank.
- 25-Central Bank of Kenya (December 2007), Survey on Bank Charges and Lending Rates. Available at http://www.fsdkenya.org/pdf_documents/o8-Kf13-2Q_Survey_on_bank_charges.pdf.
- Collins, D., J. Morduch, S. Rutherford, and O. Ruthven (2009). *Portfolios of the Poor: How the World's Poor Live on \$2 a Day*, Princeton, NJ: Princeton University Press

27. Daily Nation, December 10 2005; Daily Nation, Friday June 17 2011; Daily Nation, June 30, 2011; Daily Nation, July 6 2011; Daily Nation, September 30, 2011; Daily Nation, October 14, 2011;
28. Davel G, Serakwane T and Kimondo M (February 2012), Kenya Credit Information Sharing Initiative : A Progress Report 2008-2011 Challenges and Opportunities available at <http://www.fsdkenya.org>.
29. Diamond A (1963), The Molony Committee Final Report of the Committee on Consumer Protection, The Modern Law Review, Vol 26.
30. Ebers, M. (2004). "Information and Advising Requirements in the Financial Services Sector: Principles and Peculiarities in EC Law," *Electronic Journal of Comparative Law*, Vol. 8.2 available at <http://www.eicl.org>.
31. Elliehausen, G. (2010) "Implications of Behavioral Research for the Use and Regulation of Consumer credit Products," Finance and Economics Discussion Series, No: 2010-25, Federal Reserve Board.
32. Financial Sector Assessment: A Handbook, The World Bank and the International Monetary Fund, Chapter 5, Evaluating Financial Sector Supervision: Banking, Insurance and Securities Markets
33. Financial Sector Deepening (FSD)-Kenya (2009). *Definition of a Standard Measure for Consumer Interest Rates in Kenya: A Scoping Study*, Nairobi: Kenya available at <http://www.fsdkenya.org>.
34. Lorenzo Bini Smathi (2001), Central Bank Independence: from theory to practice [accessed from <http://www.ecb.int/press/key/date/2007/html/sp0704iQ.en.html> on July 12, 2011]
35. Maynes S. E (1979), Consumer protection: The issues, Journal of Consumer Policy, Volume 3, Number 2, June 1979.
- Miller, M., N. Godfrey, B. Levesque, and E. Stark (2009). "The Case for Financial Literacy in Developing Countries: Promoting Access to Finance by Empowering Consumers," World Bank, DFID, OECD, and CGAP joint note, Washington, DC: World Bank available at <http://www.oecd.org>.
- World Bank (2009), Chapter 1: Financial Inclusion: Recent Developments and Lessons from Kenya. Available at

http://www.fsdkenya.org/finaccess/documents/chapteri_finaccess_results_analysis.pdf

38. Ndiritu E, Consumer Protection in Kenya: Theory, Law and Practice (unpublished manuscript edited by Okech-Owiti and J Okello).
39. Porteous, D. (2009) "Consumer Protection in Credit Markets," Policy Focus Note: 1, Financial Access Initiative available at <http://www.financialaccess.org>.
40. Saving J.L, Consumer Sovereignty in the Modern Global Era. Journal of Private Enterprise, Fall 2006.
41. Sylvia Lane, (2005), The Rationale For Government Intervention In Seller-Consumer Relationships, Review Of Policy Research. Volume 2 Issue 3, Pages 419 - 428
42. U.S. G.A.O. (2006). "Credit Cards: Increased Complexity in Rates and Fees Heightens Need for More Effective Disclosures to Consumers," United States Government Accountability Office, Report to the Ranking Minority Member, Permanent Subcommittee.
43. Waldfogel, Joel, Does consumer irrationality Trump Consumer Sovereignty? Evidence from Gifts and Own Purchases (October 2002). Available at SSRN: <http://ssrn.com/abstract=337261> or doi:io.2139/ssrn.337261.
44. West Encyclopedia of American Law on Consumers found on www.answers.com [accessed on November 11, 2010].
- 1 45. Wilson, T., N. Howell, and G. Sheehan (2009). "Protecting the Most Vulnerable in Consumer Credit Transactions," *Journal of Consumer Policy*, 32(2): 117-140

I Uh1^of Statutes

J⁴⁶ Banking Act, Chapter 488 of the Laws of Kenya

^ banking (Credit Reference Bureau) Regulations, 2008

p Banking (Penalties) Regulations 1999

^ Banking (increase of Rate of Banking and other Charges) Regulations *006

J Siting (Amendment) Bill 2011

hidings Societies Act, Chapter 489 of the laws of Kenya

52. Capital Markets Act, Cap 485a of the Laws of Kenya
53. Central Bank of Kenya Act, Chapter 491 of the Laws of Kenya
54. Civil Procedure Act Chapter 21 of the Laws of Kenya.
55. Companies Act, Chapter 486 of the Laws of Kenya
56. Consumer Credit Act 1974 (as amended in 2006) (UK)
57. Consumer Credit (Disclosure of Information) Regulations, 2004 (UK)
58. Consumer Credit (Agreements) Regulations 2010 (UK)
59. Consumer Protection Bill
60. Financial Services Markets Act (2000) (UK)
61. Insurance Act chapter 487 of the Laws of Kenya
62. European Directive 2008/48/EC, 23 April 2008
63. Kenya Deposit Insurance Bill 2011
64. Microfinance Act, Cap 19 of 2006 of the Laws of Kenya
65. Prudential Guidelines 2006
66. Sacco Societies Act number 14 of 2008 of the Laws of Kenya
67. Sale of Goods Act, Chapter 31 of the Laws of Kenya.
68. Standards Act, Chapter 496 of the Laws of Kenya.
69. The former Constitution of the Republic of Kenya, 2007.
70. The Constitution of the Republic of Kenya, 2010.
71. Trade Descriptions Act, Chapter 505 of the Laws of Kenya.
72. Unfair Terms in Consumer Contracts Regulations 1999 SI 2083 (UK)
73. Unfair Trading Regulations 2008 SI 1277

Oases

74. ABN Ambro Bank NV -v- Le Monde Foods Ltd Civil Application No Nairobi 15 of 2002.
75. Bao Investment and Office Management Services Ltd -v- Housing Finance Ltd Nbi Court of Appeal Case No 171 of 2006.
76. Berkshire County Council -v- Olympic Holdings Ltd [1994] Crim LR 277
- pBrinksmat Ltd -v- Elcombe (1988) 3 ALL ER 188
- ^•Catherine Njuguni Kanya -v- Commercial Bank of Africa [2001] HCC No 1&6i of 2001
- '^ege, Simon W -v- Paramount Bank of Kenya Ltd Milimani Civil Suit No | 360 of 2001.

80. Commissioner of Taxation v English, Scottish and Australian Bank Ltd (1920) AC 683.
81. Donoghue v Stevenson [1932] AC 562
82. First National Finance Ltd -v- Kutus Auto Hardware Ltd and 2 others [2006] eKLR
83. Great Railway Company v London and County Banking Co Ltd (1901) AC 414
84. Hedley Byrne & Co Ltd v Heller & Partners Ltd [1964] AC 465
85. Joachimson v Swiss Bank Corporation [1921] 3 KB 110; Vol 3 A.B 110
86. Kenya Akiba Microfinance -v- Central Bank of Kenya, the Attorney General and Commissioner of Police, HCCC No 644 of 2005
87. Kyangavo -v- KCB Ltd and Another HCC No 428 of 2001
88. Ladbroke and Co v Todd (1914) 19 Comm.
89. Lumsden and Co v London Trustee Savings Bank [1971] 1 Lloyd's Rep 114
90. Muiruri, Margaret Njeri -v- Bank of Baroda Civil Appeal No 9 of 2001.
91. Mutsongar -v- Nyati (1984) KLR 425
92. OFT (Respondent) versus Abbey National plc & Others [2009]
93. Peter Kinyanjui Nyaga -v- Kenya Commercial Bank [2011] HCC No 517 of 2010
94. Robinson v Midland Bank Ltd (1925) 41 TLR 402
95. Samuel Bosire v Gladys Monyangi Omosa & another [2010] eKLR
96. Shah -v- Guilders International Bank Ltd Court of Appeal Civil Case No I 135 of 2001.
97. Simiyu -v- HFCK [2001] 2 EA 540
98. Tiwi Beach Hotel Ltd -v- Stamm, Court of Appeal Mbsa, Civil Case No 63 of 1990
99. Trust Bank Ltd -v- Paramount Universal Bank Ltd, Ajay Shah and Praful Shah [2001] HCC No 1243 of 2001
- ¹⁰⁰- Trust Bank Ltd -v- Eros Chemists Ltd & Another Civil Appeal No 133 of *999-
- ¹⁰¹- United Dominions Trust v Kirkwood (1966) 2 QB 431
Woods v Martins Bank Ltd (1959) 1 QB 55

file sources

Pfj <http://econ.worldbank.org> [accessed April 21, 2012].

- 104- <http://www.euractiv.com/en/food/parliament-starts-debate-consumer-rights-directive-news-4Q48QQ> [accessed November 7, 2010].
- 105- <http://www.cofek.co.ke/> [accessed November 10, 2010]).
106. www.kebs.org [accessed January 25, 2011]
107. www.oft.gov.uk [accessed Marc 4, 2011]
108. <http://www.fsa.gov.uk/pages/Library/Communication/PR/2010/042.shtml> [accessed February 28, 2011]
109. <http://www.accion.org/Page.aspx?pid=i4iQ-> [accessed February 28, 2011]
110. <http://www.knbs.or.ke/news/> [accessed February 16, 2011]
111. <http://www.kcbbankgroup.com> [accessed June 15, 2011].
112. <http://www.finanstilsvnet.no/en/> [accessed January 20, 2012].
113. <http://www.apra.gov.au/Pages/default.aspx> [accessed January 20, 2012]
114. www.centralbank.go.ke [accessed February 27, 2011]
115. www.legislation.gov.uk [accessed July 18, 2011].
116. www.bailii.org [accessed July 18, 2011]
117. www.pwc.com [accessed January 30, 2012].
118. www.crbafrica.com [accessed November 2, 2011]
119. www.opsi.gov.uk [accessed January 3, 2012].
120. www.fscs.org.uk [accessed January 20, 2012]
- 121- www.pensionsregulator.gov.uk [accessed January 20, 2012].
- 122- www.oecd.org [accessed April 21, 2012].
- 123- www.dfsa.dk [accessed January 20, 2012].
- 124- www.fsdkenya.org [accessed April 21, 2012].

APPENDIX 1
(PROJECT QUESTIONNAIRE-FOCUS GROUP)

PROJECT QUESTIONNAIRE- FOCUS GROUP

PERSONAL INFORMATION

Name of Contact person for the group:

Phone No:

Address:

Age bracket:

| | | | | | |
|-------------|--|-------------|--|-------------|--|
| 30-35 Years | | 36-45 Years | | 46-55 Years | |
|-------------|--|-------------|--|-------------|--|

Marital Status

of group

Members: Married Members,

Unmarried Members

REDIT INFORMATION

1. Have you obtained a loan or some other form of credit facility from a bank for personal use within the last two (2) years?

Yes- Answer - No. of Respondents:

No - Answer- No. of Respondents:

If your answer to question 1 is yes, what form of credit did you obtain from the bank?

Key: Male: M Female : F

| Credit products | Reason | M / F | Total |
|--------------------|--------|-------|-------|
| Bank Personal Loan | | | |
| Overdraft | | | |
| Credit Cards | | | |
| Mortgages | | | |
| Other | | | |

3 Which bank did you obtain the credit from?

| Credit Issuer | No. of persons in Focus Group |
|--|--------------------------------------|
| Equity | |
| Barclays Bank | |
| Co-operative Bank | |
| Kenya Commercial Bank | |
| Other(s) Family Bank/ Consolidated Bank Specify | |

NB: Other Banks are not limited to but Include Family Bank and Consolidated Bank

[Did you obtain the credit facility from the bank you have previously banked with or one you currently bank with?

| Credit taken from: | Previous Bank/ Institution | Current Bank/ Institution |
|---------------------------|-----------------------------------|----------------------------------|
| No. of Respondents | | |

rYou obtained the credit facility from the bank you have previously banked with or that p currently bank with, please confirm how long you have been its customer?

| No. of years with Bank | No. of Respondents |
|-------------------------------|---------------------------|
| 1-5 | |
| 5-10 | |
| 10-15 | |

Over 15

How did you come to know about the credit facility you obtained?

| How did you come to know about the credit facility on offer? | No. of Respondents |
|---|--------------------|
| Advertising by the bank (e.g. billboard, magazine, TV etc) | |
| Through a sales representative (Through Field Agents) | |
| 1 entered a branch and sought information direct (Branch Visit) | |
| Through the internet & Institution(s) Websites | |
| 1 was informed of the product by a friend (Third Party Advise) | |
| Other. (Specify.....) | |

V In your view, how did the bank staff members deal with any questions that you raised
1 prior to applying for the credit?

| Information rating | Reason | No. of Respondents |
|--------------------|---|--------------------|
| 1 Excellent | Well Explained, well understood, supportive literature documentation regarding the credit facility was issued and follow ups were done. No pressure to commit. Went out of their way to explain critical aspects you did not ask about (example: Interest rates may vary, Ways they may recover loans, how and when, broke down the financial jargon and terms) Answered all your questions | |
| [Good | Explained adequately, Understood most information but not everything. Limited supporting documentation and Literature, Little or no follow up. Little or no pressure to commit. | |

| | | |
|-----------|---|--|
| | They answered all your questions. Felt they should have done more explaining on matters you may have not known before hand. | |
| Poor | Not adequately Explained, Limited supporting documentation or literature. No follow up. Pressured to commit. Should have done more | |
| Very Poor | Not well Explained no readily available supporting documentation and Literature. No follow up, Pressure to commit. A lot more was desired. Feel short in most areas of expectation. | |
| Other | | |

NB Context of Follow up:

applies when Agents/ Employees of a lending institution allow a consumer of such lending Utilities some period to consider and evaluate the information provided on a product or service. Agents would be expected after such period(s) to follow up the proposition ensuring pecustomer is happy to proceed.

Ummary/ Voluntary Explanation(s) from Focus Group

What was the role of the bank representative dealing with any questions you were Presenting prior to and at the initial stages of your credit application?

Staff Member who addressed your query/application

No. of Respondents

Cr edit officer

Trade finance officer

Manager

| | |
|--|--|
| Back Office staff | |
| Sales Representative | |
| Customer service Desk | |
| Other. (Specify.....) | |
| Not Sure Explain....; | |

9 Do you consider that the bank's staff member was upfront, honest and forthcoming with the information you were making enquiries on? (please explain)

Yes: No of Respondents

No.: No of Respondents

Partially:

Respondent (s) No:

Reason(s)

In your view, was the bank's staff member well /fully knowledgeable on the credit facility you were interested in? (please explain)

H (Number of Respondents):

Reason (s)

0i (Number of Respondents):

fcon(s)

jl. if your answer to question 10 is 'No', what information provided by the bank's staff member did you (the focus group) consider to be inadequate? (please explain)

12. On a scale of one to five (on an Average score from the focus group) where one represents excellent and five represents poor, how would you rate the way the bank's representative handled your application for the loan or credit?

Excellent Great Good Fair Poorly

13. In your opinion, did the bank give you structured, clear and simplified information on the credit facility you obtained? (please explain)

Yes- (No. of Respondents):

No - (No. of Respondents):

14. What information did the bank's representative require from you at the initial stages of your application for the credit facility? (please specify)

15. Were you able to provide the bank's representative with this information?

No:

If you were not able to immediately provide the information the bank required for purposes of processing your application, what timescales did the bank's representative give you to provide it?

Not Clear

22. Were the terms and conditions of the credit contract standardized or did the bank allow you to negotiate some or all of the terms? (please explain)

Yes: No:: Other:

(Please Explain)

23 Where the bank gave you an opportunity to negotiate some or all of the terms of contract, which ones did you negotiate to meet your requirements? (please explain)

Terms and conditions of the credit contract that you had the Bank
opportunity to negotiate so as to meet your requirements

In your view, did the standard terms in the consumer credit contract largely meet your requirements?

Yes No:

Your answer to question 25 is 'No', what standardized terms do you feel did not meet your requirements? (please specify)

1

| Standardized Terms of the credit contract that you felt did not meet your requirements | Credit Product |
|--|----------------|
| | |
| | |
| | |
| | |
| | |
| | |

26. Did the bank clearly explain to you the measures it would take if you did failed to repay the credit facility in accordance with the terms and conditions of the contract?

Yes _____ No _____

27. How long did the Bank take to process your loan?

| Time frame in weeks | No. of Respondents | Was the time period reasonable |
|---------------------|--------------------|--------------------------------|
| 2-4 weeks | | |
| 4-8 weeks | | |
| 8-12 weeks | | |
| Over 12 weeks | | |

ⁱⁿ the intervening period between your application and loan processing approval or feline, did you apply elsewhere?

29. If your answer to question 29 is yes, Why?

| Respondent(s) made another credit application | Reason(s) |
|---|-----------|
| | |

30. Have you managed to repay the credit back in accordance with the terms of the credit — contract?

Yes: _____ No: _____

31. If your answer to question 30 is 'No', why were you unable to repay the credit facility in accordance with the terms and conditions of the credit contract? (please explain)

| Respondent(s) | Reason for default/ violation of terms and conditions |
|---------------|---|
| | |
| | |
| | |
| | |

Where applicable, what steps did the bank take to enforce the credit agreement where you did not meet your repayment obligations? (please explain)

33. Where applicable, what notice period did the bank give you before taking enforcement action against you for defaulting on the repayments? (please explain)

34 How do you feel the bank dealt with your circumstances when you started experiencing difficulties in repaying the credit facility? (please explain)

| How the Bank dealt with your circumstances | No. of Respondents | Explain |
|--|--------------------|---------|
| Excellent | | |
| Great | | |
| Good | | |
| Fair | | |
| Poorly | | |

^Throughout the credit application process, do you consider that the bank and its representatives ensured that you understood how the credit facility functioned and your rights under the contract?

Yes: _____ No: _____

Here your answer to question 34 is 'No', in what area or way do you feel that the bank failed in its role* (please explain)

37. Are you aware of any laws, rules and regulations governing the bank lending industry in Kenya?

Yes:

No:

38. If your answer to question 37 is 'Yes' please list the provisions you are aware of below.

39. Are you aware of any laws, rules and regulations within the bank lending industry aimed at protecting your rights as a consumer of bank credit products?

Yes:

No:

40. If your answer to question 39 is 'Yes' please list the provisions you are aware of below.

'1 Where applicable, what are your views on the effects of the provisions listed in question 37 and 39 to you as a consumer and user of bank credit? (please explain)

^a bank user and customer, what changes of the laws, rules and regulations do you consider to be necessary for the purposes of protecting your rights? (please explain)

Thank you for participating in this interview / focus group.

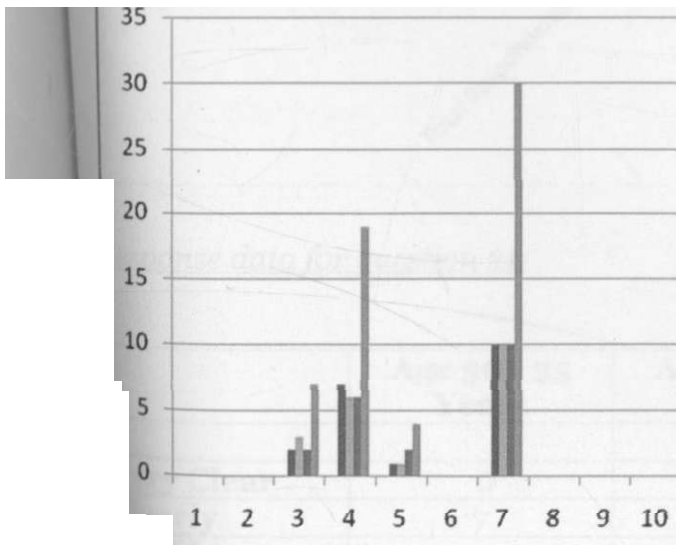
APPENDIX 2
(TABULATED RESPONSES-FOCUS GROUP)

APPENDIX 2

TABULATED RESPONSES TO SELECTED QUESTIONS POSED TO THE BANK CUSTOMER RESPONDENTS

Response data for question 7:

| Level of Service | Age Group 30-35 Years | Age Group 36-45 Years | Age Group 46-55 Years | Sum of Total Respondents Sampled |
|--|------------------------------|------------------------------|------------------------------|---|
| Excellent | 0 | 0 | 0 | 0 |
| Good | 2 | 3 | 2 | 7 |
| Poor | 7 | 6 | 6 | 19 |
| Very Poor | 1 | 1 | 2 | 4 |
| Total Respondents Sampled per Group | 10 | 10 | 10 | 30 |

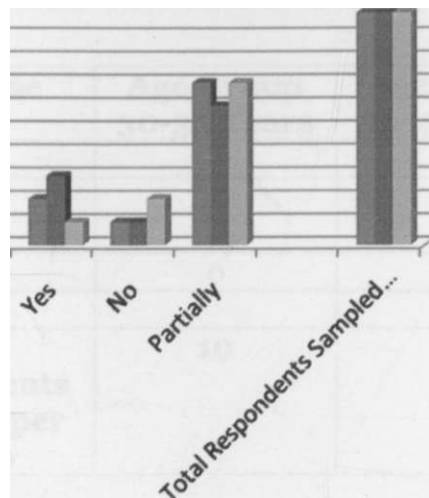


- Level of Service
- Age Group 30-35 Years
- Age Group 36-45 Years
- Age Group 46-55 Years
- Sum of Total Respondents Sampled

Response data for question q:

| Level of Service | Age Group 30-35 Years | Age Group 36-45 Years | Age Group 46-55 Years |
|--|----------------------------------|----------------------------------|----------------------------------|
| Yes | 2 | 3 | 1 |
| No | 1 | 1 | 2 |
| Partially | 7 | 6 | 7 |
| Total Respondents Sampled per Group | 10 | 10 | 10 |

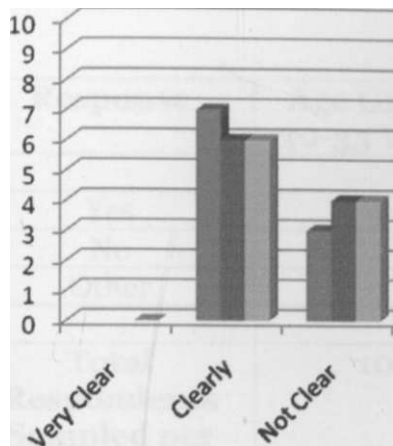
10
9
8
7
6
5
4
3
2
1
0



Age Group 30-35 Years
Age Group 36-45 Years
Age Group 46-55 Years

Response data for question 21:

| | Age 30 - 35 Years | Age 36-45 Years | Age 46 - 55 Years |
|------------------------------|------------------------------|----------------------------|------------------------------|
| Very Clear | 0 | 0 | 0 |
| Clearly Not Clear | | | |
| Total Respondents | 10 | 10 | 10 |



i Age 30- 35 Years
 i Age 36- 45 Years
 Age 46-55 Years

Response data for question 22:

| Response | Age Group 30-35 Years | Age Group 36-45 Years | Age Group 46-55 Years | Total Respondents |
|--|-----------------------|-----------------------|-----------------------|-------------------|
| Yes | 10 | 10 | 10 | 30 |
| No | 0 | 0 | 0 | 0 |
| Other | 0 | 0 | 0 | 0 |
| Total Respondents Sampled per Group | 10 | 10 | 10 | 30 |

30
 25
 20
 15 ¥
 10
 5
 0



Age Group 30-35 Years
 Age Group 36-45 Years
 Age Group 46-55 Years
 Total Respondents

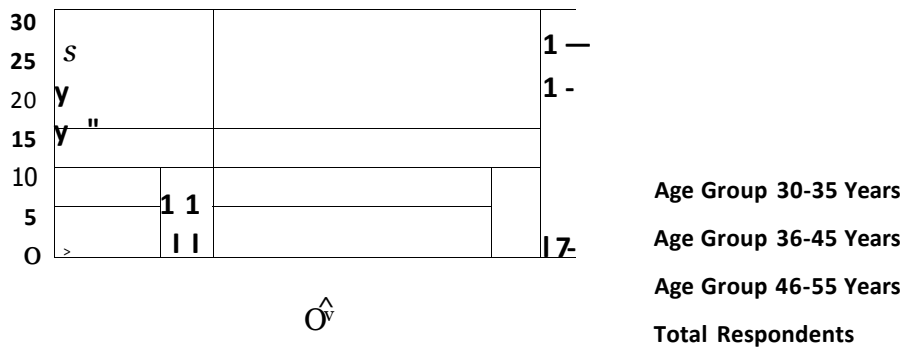
0

J>"

£^{if}

Response data for question 24:

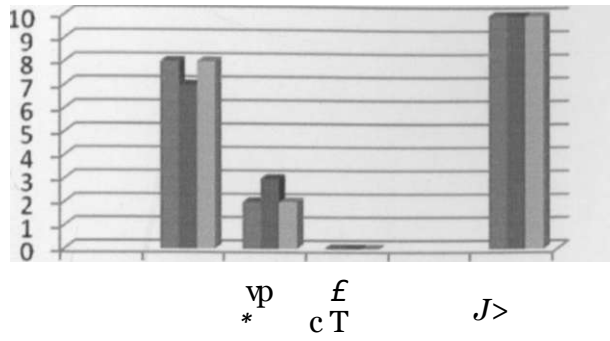
| Response | Age Group 30-35 Years | Age Group 36-45 Years | Age Group 46-55 Years | Total Respondents |
|--|-----------------------|-----------------------|-----------------------|-------------------|
| Yes | 9 | 7 | 9 | 25 |
| No | 1 | 3 | 1 | 5 |
| Other | 0 | 0 | 0 | 0 |
| Total Respondents Sampled per Group | 10 | 10 | 10 | 30 |



f

Response data for question 37:

| Level of Service | Age Group 30-35 Years | Age Group 36-45 Years | Age Group 46-55 Years |
|--|-----------------------|-----------------------|-----------------------|
| Yes | 8 | 7 | 8 |
| No | 2 | 3 | 2 |
| Other | 0 | 0 | 0 |
| Total Respondents Sampled per Group | 10 | 10 | 10 |



Age Group 30-35 Years
 i Age Group 36-45 Years
 Age Group 46-55 Years

jf

APPENDIX 3
(PROJECT QUESTIONNAIRE-BANK
REPRESENTATIVES)

PROJECT QUESTIONNAIRE- BANK REPRESENTATIVES

PERSONAL INFORMATION

Name:

Gender: Male Female

Phone No: !

Email:

Employer: .

Employment Role:

CREDIT PROVISION INFORMATION

1. How long have you worked for your current employer?

1-2 years 3-5 years 5-10 years over 10 years

2. During the course of your employment with your current employer, what roles have you undertaken? (please specify)

3. What role do you undertake within your employer's credit or lending department? (please specify)

• How long have you been engaged in the credit or lending department of your employer bank?

I 1-2 years 3-5 years 5-10years over 10 years

5. During the term of your employment, have you attended training courses on the education, procedures and provision of credit facilities organized by your employer?

Yes

No

6. If your answer to question 5 is 'yes', please state what course you attended giving a brief description of the course content.

7. Do you deal with credit applications made by individuals to your employer bank?

Yes

No

8. If the answer to question 7 is yes, what role do you play in the processing of the individual credit applications? (please specify)

9. What credit facilities or products does your employer provide? (please list)

10. Do you process applications for credit from individuals who ordinarily DO NOT bank with your employer?

Yes

No

11. Does your employer have a written procedure/policy for the processing and approval of credit applications made by individuals?

Yes

No

12. If your answer to question 11 is 'yes', briefly describe your employer's procedure for processing and approving credit applications by individuals.

r- If your answer to question 11 is 'No', what steps has your employer put in place to govern the
I Processing and approval of individual credit applications? (please describe)

14. What are the key factors your employer and/or its representatives consider when approving a credit application? (please list)

15. Does the procedure for processing and approving individual credit applications vary depending on whether or not the person banks with your employer?

Yes

No

16. Has your employer put procedures in place to ensure that the individual or customer understands their obligations under the credit agreement?

Yes

No

17. If your answer to question 16 is 'yes', what procedures has your employer put in place? (briefly describe)

If your answer to question 16 is 'No', what steps does your employer or its representatives undertake to ensure that the customer understands their obligations under the credit agreement? (please describe)



19. Does your employer have a written policy governing the steps that should be undertaken by the bank representatives when the customer defaults in making payments? (please explain)

20. How does your employer ensure that their lending policies and regulations are followed by those involved in the processing of credit applications? (please describe)

21. What steps do your employer's representatives undertake to educate the individual or customer on the benefits and disadvantages of the credit facility? (briefly explain)

22. Are you aware of the recently licensed Credit Reference Bureau?

Yes

No

23. In your view, what role will the Credit Reference Bureau play within the consumer credit lending industry? (please outline)

24. Do you consider that the licensing of the Consumer Reference Bureau is a key development in the consumer lending industry?

Yes

No

25. If your answer to question 24 is 'yes', please outline what effect you consider the Consumer Reference Bureau will have in the consumer lending industry? (briefly describe)

**26. What changes would you like to see effected within the consumer lending industry in general?
(please outline)**

**27. Do you consider that the current laws, regulations and provisions adequately protect the rights
of the consumers within the consumer lending industry?**

Yes

No

**28. If your answer to question 27 is 'No', what changes would you propose in order to achieve a
higher level of consumer protection within the lending industry? (please explain)**

APPENDIX 4
(TABULATED RESPONSES-FCANR
REPRESENTATIVES)

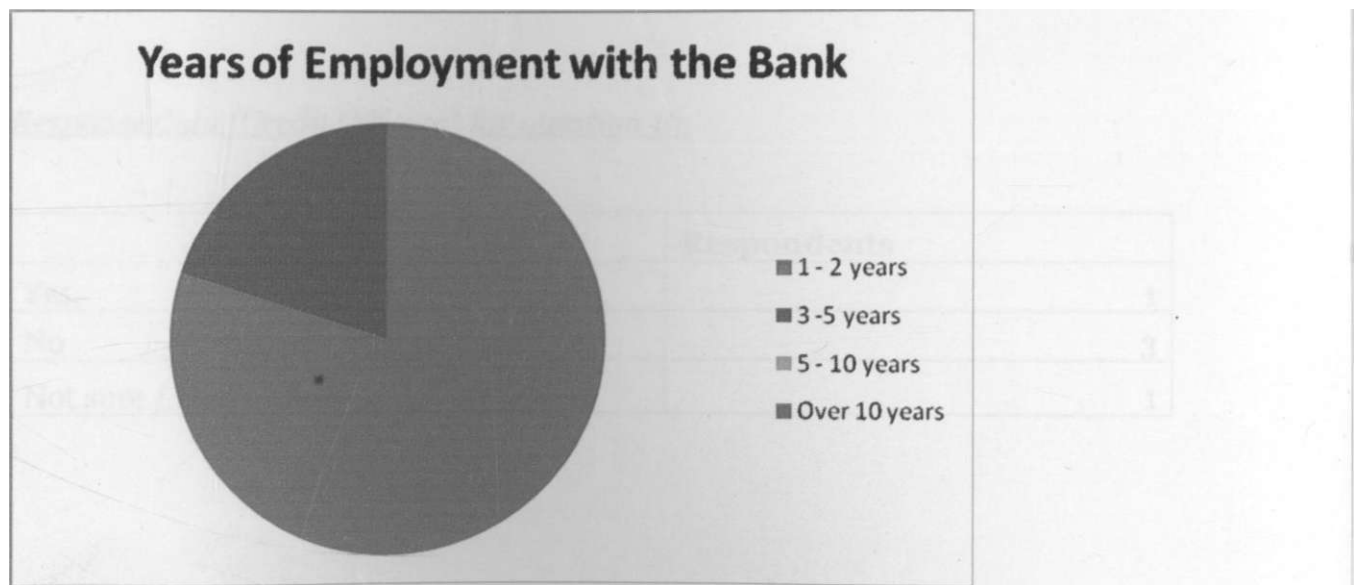
APPENDIX A.

TABULATED RESPONSES TO SELECTED QUESTIONS POSED TO THE BANK REPRESENTATIVES.

Response data (Credit Officers) for question 1:

| | 1 - 2 years | 3 - 5 years | 5 - 10 years | Over 10 years |
|-----------------------------------|-------------|-------------|--------------|---------------|
| Years of Employment with the Bank | 4 | 1 | 0 | 0 |

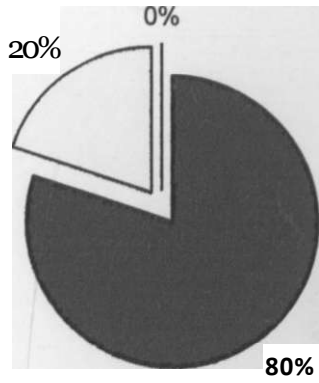
All Heads of Credit had worked with their employer for 5-10 years within the credit department.



Response data (Credit Officers) for question d:

| | 1- 2 Years | 3-5 Years | 5 - i 0 Years | Over 10 Years |
|--|------------|-----------|---------------|---------------|
| Number of Years Interviewed Employees worked in Credit | 4 | 1 | 0 | 0 |

Question 4.

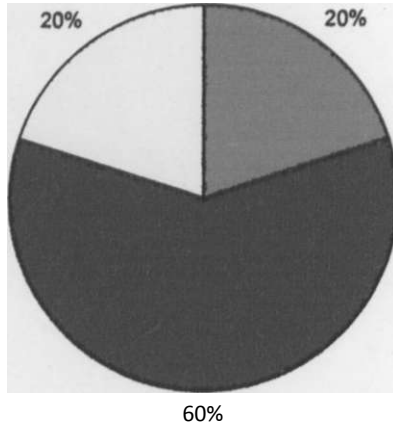


- 1-2 Years
- 3-5 Years
- 5-10 Years
- Over 10 Years

Response data (Credit Officers) for question iq:

| | Respondents |
|-----------------------|--------------------|
| Yes | 1 |
| No | 3 |
| Not sure / Don't Know | 1 |

Question 19.



- Yes
- No
- Not sure / Don't Know

see data (all respondents) for question 24:

| | |
|------------------------------------|----|
| Yearly | 0 |
| Every two years | 1 |
| More than two Years | 2 |
| Usually Unscheduled or Haphazard | 6 |
| Don't Know | 1 |
| | |
| Total Bank Respondents Interviewed | 10 |

