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**Working Paper**

## Legal & regulatory framework for digital financial services in Kenya: A case for urgent reforms

KBA Centre for Research on Financial Markets and Policy Working Paper Series, No. 68

**Provided in Cooperation with:**

Kenya Bankers Association (KBA), Nairobi

*Suggested Citation:* Githu, Jackson Macharia (2023) : Legal & regulatory framework for digital financial services in Kenya: A case for urgent reforms, KBA Centre for Research on Financial Markets and Policy Working Paper Series, No. 68, Kenya Bankers Association (KBA), Nairobi

This Version is available at:

<https://hdl.handle.net/10419/271529>

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# Legal & Regulatory Framework for Digital Financial Services in Kenya – A Case for Urgent Reforms

Jackson Macharia Githu

May 2023

KBA Centre for Research on Financial Markets and Policy®  
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# Legal & Regulatory Framework for Digital Financial Services in Kenya – A Case for Urgent Reforms

Jackson Macharia Githu<sup>1</sup>

## Abstract

*This paper reviews the legal and regulatory framework governing digital financial services in Kenya including some of the unanswered questions by the current regulatory framework. The paper focusses on the question of the statutory definition of the rapidly evolving payment services, the architecture of the regulatory framework of the digital financial services and the regulation of digital credit providers. The paper identifies that there are risks and opportunities in the current regulatory framework and the regulatory regime should strike the required balance. The paper concludes by recommending that Parliament amends the definition of payment services in the National Payment Services Act. Further, even though the digital lenders regulatory framework has just come into force, the paper calls for its continued enhancement. The paper also calls for some minimum regulatory guidelines to be issued for the currently unregulated non digital lenders on areas such as interest rates and consumer protection. The paper also urges reconsideration of the regulatory framework to consolidate the regulators, laws and regulations on the area.*

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## 1.0 Introduction

**D**igital financial services have emerged and continue to gain a lot of interest not only in Kenya but also globally. Right from evolution of mobile money to the CBK Discussion Paper on Central Bank Digital Currencies<sup>1</sup>, Kenya is at the heart of digital financial services evolution. Currently, Kenya has been ranked the fifth country in the world in terms of adopting crypto currencies ahead of countries like Nigeria, South Africa, and leading economies of the world such as United States of America and China.<sup>2</sup> In the same rankings, Kenya was ranked first in the world in terms of Person to Person (P2P) exchange trade volume.<sup>3</sup> According to UNCTAD, as at June 2022, 8.5% of the Kenyans are holding crypto currency.<sup>4</sup> From a historical perspective, mobile money evolution started in Kenya and today the country is a global leader. Indeed, Kenya was referred to as the Silicon Savannah due to its leading technological innovations in Africa.<sup>5</sup> The Central Bank of Kenya has taken a leadership position in the continent and issued a discussion paper to seek stakeholders' view on the possibility of rolling out a central bank digital currency (CBDC) again confirming the place of Kenya as a leader in the digital financial services.

Despite the rapid technological innovations, the Kenyan legal and regulatory framework has not responded to the changes on time. For example, it is only in 2021 that Parliament enacted the Central Bank Amendment Act 2021 giving

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1. CBK released a CBDC discussion paper in March 2022 and required public to submit comments by 20th May 2022.
  2. <https://go.chainalysis.com/rs/503-FAP-074/images/Geography-of-Cryptocurrency-2021.pdf>. Accessed on 7th April 2022.
  3. Ibid.
  4. All that Glitters is Not Gold: The High Cost of Leaving Cryptocurrencies Unregulated, Policy Brief No. 100m June 2022. Available in <https://unctad.org/webflyer/all-glitters-not-gold-high-cost-leaving-cryptocurrencies-unregulated>.
  5. <https://www.s-ge.com/en/article/global-opportunities/20213-c6-kenya-tech-hub-fint1/>. Accessed on 7th April 2022.

CBK powers to regulate digital lenders despite these actors having been in the market for several years. The Central Bank of Kenya (Digital Credit Providers) Regulations, 2022 were issued which inter alia requires the digital lenders to implement consumer protection measures and obtain CBK licensing as from September 2022. The launch of the CBK discussion paper on CDBC's elicited a debate on the alternatives to cryptocurrency among scholars and practitioners in the financial sector.

The regulations for the payment sector in Kenya are contained in different statutes and subsidiary regulations. These include the Banking Act<sup>6</sup>, the Prudential Guidelines For the Institutions Licensed Under the Banking Act<sup>7</sup>, Money Remittance Regulations 2013<sup>8</sup>, the National Payment Systems Act<sup>9</sup>, National Payment Systems Regulations<sup>10</sup>, Kenya Information Communications Act<sup>11</sup> and the regulations thereunder amongst several other statutes. Varied aspects of the digital financial services are regulated separately by different regulators such as the CBK and the Communications Authority of Kenya (CAK). This fragmented nature of the regulatory framework means that entities seeking to play in this space have to scour through different statutes, regulations and circulars to know their obligations.

Furthermore, the number of regulations applicable means that an industry change/shift would require several amendments. The nature of the regulatory regime poses a number of challenges which can be addressed by a review.

This paper therefore examines the current regulatory framework and proposes a harmonization to balance between the risks and opportunities. With the advent of innovative digital services solution, the paper seeks to research on the leading innovative regulatory approaches in some of the leading jurisdictions.

This study is motivated by rapid rise of innovative digital financial services which has not been followed by a corresponding change in the regulatory framework. From a legal, compliance and business operations perspectives, there is an interest in the intersection of digital financial services and the governing law and regulations.

The key hypothesis made by this paper is that the legal and regulatory framework for the digital financial services is not optimally designed to respond to the market realities. The second hypothesis is that digital financial services have leaped ahead of regulations. The paper has made conclusions on these hypotheses.

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6. Cap 488 of the Laws of Kenya

7. Issued in 2013.

8. Legal Notice 66, issued under the Central Bank Act.

9. Act No. 39 of 2011.

10. LEGAL NOTICE NO. 109 of 2014.

11. Act No. 2 of 1998.



## 1.2 Research Methodology

The research was done through a desk top review of the legal and regulatory framework to identify the digital financial services and the applicable legal and regulatory framework. The research included internet searches and review of books and publications on the research topic. The review generally includes an assessment of the existing legislations and regulations and a comparison with what is applicable in other relevant jurisdictions. Implications of status quo are laid out with reference to financial sector performance and/or potential liability risks.

## 2.0 Overview of the Regulatory Framework of the Banking Sector in Kenya

**B**anks are licensed under the Banking Act<sup>12</sup> while microfinance banks are licensed under Microfinance Act.<sup>13</sup> They must be incorporated as companies under the Companies Act<sup>14</sup> before they are licensed. The Central Bank of Kenya has supervisory authority over the banks. The main business of the banks is to collect deposits from the public, deposits which are payable on demand and the utilization of those deposits mainly through issuing loans. Banks have also ventured heavily into the payments space as integral players in the payment sector, making them subject to the NPS Act. Banks are undoubtedly the key players in the Kenya's financial sectors.<sup>15</sup>

A bank refers to an institution licensed under Section 5 of the Banking Act<sup>16</sup> and which is engaged in banking business<sup>17</sup>. The Act defines banking business to mean 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

12. Cap 488 of the Laws of Kenya.

13. Act No. 12 of 2006.

14. Act No. 17 of 2015.

15. According to Central Bank of Kenya's Annual Supervision Report in 2021, the banks' total net assets grew by 11.4 percent from Ksh.5.4 trillion in December 2020 to Ksh.6.0 trillion in December 2021. Customer deposits increased by 11.0 percent from Ksh.4.0 trillion in December 2020 to Ksh.4.5 trillion in December 2021.

16. Cap 488 of the Laws of Kenya.

17. Banking Act defines a bank to mean a company which carries on, or proposes to carry on, banking business in Kenya but does not include the Central Bank. It further defines banking business to mean:

- (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;





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. This definition of the banking business is heavily borrowed from the common law position as espoused in the celebrated case of *United Dominions Trust vs. Kirkwood*<sup>18</sup> where the English Court of Appeal listed the characteristics of a bank as to include involvement in the conduct of current accounts, the payment of cheques, and the collection of cheques for customers. The Constitution<sup>19</sup> and The Central Bank of Kenya Act<sup>20</sup> establishes the Central Bank of Kenya and gives it powers to supervise banks licensed under the Banking Act, forex bureaus and other specified financial institutions.

The law of banking comes in between to facilitate and regulate the banking process. From the point of incorporating the company to be licensed as a bank, licensing, capital and reserve requirements, restrictions on business undertakings, consumer protection to the supervision of the banks – the law plays a facilitative role in ensuring that the banks, the

economy and the customer engages in a relationship that is beneficial to the stakeholders.

After a bank is licensed,<sup>21</sup> various restrictions are put in place to ensure that banks operate within the law and the regulations. The Central Bank of Kenya Prudential Guidelines for Institutions Licensed under the Banking Act is a subsidiary legislation providing the detailed regulations on the banks. These rules cover diverse aspects such as licensing, corporate governance, capital adequacy, risk classifications and assets classifications, accounts and audit, liquidity management, Mergers, Amalgamations, Transfers of Assets and Liabilities, Proceeds of Crime and Money Laundering (Prevention) amongst a host of many other areas.

Other restrictions include restrictions on loans and advances<sup>22</sup>, trade and investments<sup>23</sup>, ownership of share capital<sup>24</sup> and making advances for purchase of land.<sup>25</sup> These restrictions are intended to ensure that the bank is run in accordance with certain minimum standards and that depositors' funds are safe and available to depositors as and when called upon.

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18. [1966] 2 QB 431T.

19. Article 231 of the Constitution.

20. Cap 491 of the Laws of Kenya.

21. A bank is licensed pursuant to Section 4 and 5 of the Banking Act.

22. Section 11 of the Banking Act.

23. Section 12 of the Banking Act.

24. Section 13 of the Banking Act.

25. Section 14 of the Banking Act.

There are several other statutes which regulate the banking sector. These include the National Payment Services Act<sup>26</sup> which regulates the payment services where banks are key players. The Consumer Protection Act<sup>27</sup> provides for the specific requirements relating to credit and other consumer protection measures which the banks are required to comply with. The Kenya Deposit Insurance Corporation Act<sup>28</sup> oblige the banks to implement the deposit insurance scheme and recently, the Kenya National Deposit Insurance Corporation introduced the risk-based premiums where banks are now paying deposit insurance depending on their CAMEL ratings.<sup>29</sup>

## 2.2 Regulation of Digital Financial Services

Digital financial services can be defined as delivery of financial services through digital channels such as the internet, software applications and USSD which are accessed through gadgets such as mobile phones and computers. Financial services can be defined to mean the economic services provided by financial institutions/entities, which encompasses a broad range of businesses that manage money, including

credit unions, banks, credit-card companies, insurance companies, accountancy companies, consumer-finance companies, stock brokerages, investment funds, individual asset managers, and some government-sponsored enterprises.<sup>30</sup>

From the Kenyan context, financial services can be defined from a regulatory perspective to mean the services regulated by Central Bank of Kenya, Capital Markets Authority, Retirement Benefits Authority, Insurance Regulatory Authority, Sacco Societies Regulatory Authority, Commissioner for Cooperative Development amongst others. Another working definition that can be adopted is to define financial services to mean the services related to banking, insurance, cooperative societies, retirement schemes, financial investments such as shares and bonds amongst others.

The regulation of digital financial services is a broad area covered by several statutes and regulations. These statutes include the Banking Act<sup>31</sup>, Central Bank of Kenya Act<sup>32</sup>, The Prudential Guidelines For Institutions Licensed under the Banking Act,

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26. Act No. 39 of 2011.

27. Act No. 46 of 2012.

28. Act No. 10 of 2012.

29. <https://kdic.go.ke/sites/default/files/2021-06/Differential%20Premium%20System%20%28DPS%29%20%20E2%80%93%20Risk-Based%20Premium%20Model%20%28%29.pdf>. Accessed on 1 September 2022.

30. Asmundson, Irena (28 March 2012). «Financial Services: Getting the Goods». Finance and Development. IMF

31. Cap 488 of the Laws of Kenya

32. Cap 491 of the Laws of Kenya..



The Capital Markets Act<sup>33</sup> and the regulations thereunder, the National Payment Systems Act<sup>34</sup> and the Regulations thereunder, the Kenya Information and Communications Act<sup>35</sup> and the regulations there under, the Insurance Act<sup>36</sup> and the regulations thereunder, the Retirement Benefits Act<sup>37</sup> and the regulations thereunder, the Cooperative Societies Act<sup>38</sup> and the regulations thereunder and even the SACCO Societies Act.<sup>39</sup>

It follows that the regulation of digital financial services falls under several statutes and regulations which cannot be comprehensively covered under the paper. This paper therefore is restricted to some of the current issues such as the payment services, regulatory framework and digital lenders.

### 2.3 Payment Services

The National Payment Services Act<sup>40</sup> provides for the regulation and supervision of payment systems and payment service providers, and for connected

purposes. Under the Act<sup>41</sup>, Central Bank of Kenya may designate a payment system for the purposes of the Act. The Act provides for the operationalization of the payment regimes in Kenya.

The Act covers areas and players such as the Payment Service Providers, switches, and settlement systems, among others. The National Payment Systems Regulations<sup>42</sup> were promulgated pursuant to the NPS Act. They cover in detail aspects such as Payment Service Providers, small money issuers and other relevant areas in the payment space.

A key issue in the payments space is the definition of payment services. Neither the Act, nor the Regulations<sup>43</sup> defines payment services conclusively. The regulations define a payment service to mean the retail transfers service offered by a payment service provider. It is not clear the meaning or implication of the word retail in the definition. On the other hand, the Act<sup>44</sup> defines a payment service provider to mean:

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33. Cap 485A of the Laws of Kenya.

34. Act No. 39 of 2011.

35. Act No. 2 of 1998.

36. Cap 487 of the Laws of Kenya.

37. Act No. 3 of 1997.

38. Cap 490 of the Laws of Kenya.

39. Act No. 14 of 2008.

40. Act No. 39 of 2011.

41. Section 3.

42. Issued in 2014.

43. Section 2.

44. Section 2.

- a person, company or organization acting as provider in relation to sending, receiving, storing or processing of payments or the provision of other services in relation to payment services through any electronic system;
- a person, company or organization which owns, possesses, operates, manages or controls a public switched network for the provision of payment services; or
- any other person, company or organization that processes or stores data on behalf of such payment service providers or users of such payment services. The definitions in the Act and in the regulations pose a number of challenges. First, the definition of a Payment Service Provider (PSP) is too broad to be capable of allocating a precise meaning or implementation. This is despite the fact that it is an offence punishable under the law to conduct payment services without a license issued by the Central Bank of Kenya.<sup>45</sup>

The first definition of a PSP above should be made more precise by providing a number or minimal threshold e.g. providing such services to not more than a specific number of users – say twenty or thirty persons. The use of the words, such as sending, receiving, processing, etc., makes the definition imprecise and subject to misinterpretation.

Further, the third definition is too broad and incapable

of proper implementation. Under the definition, any person processing or storing data on behalf of a PSP or users of such payment services amounts to a PSP. This would mean that an ICT provider providing services of processing or storing data on behalf of a PSP also becomes a PSP. This is not likely to have been the intention of legislature when it was drafting the NPS Act.

Further, the NPS Act and the regulations thereunder provides for detailed requirements of a PSP. These requirements should be tailored to create a different category of a PSP provider who deals with a limited mandate, for example, the same way we have a bank and a microfinance institution. Small Payment service providers may not have the capacity or ability to meet all the licensing requirements stipulated in the Act. Lack of these legal options may lead to unintended non-compliance with the laws and regulations and stifle innovations denying the economy their inherent potential gains.

For comparison purposes, a review of the Payments Regulations in the United Kingdom, show that it is important to consider how other countries have handled the payments space. United Kingdom's Payment Services Regulations 2017 define a payment service to mean any of the activities specified in Part 1 of Schedule 1 (payment services) when carried out as a regular occupation or business activity, other than any of the activities specified in Part 2 of that Schedule

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45. Section 12 (2) of the Act prescribes that it is an offence for someone to conduct the business of a payment service provider except as authorized under the Act.



(activities which do not constitute payment services). Part 1 of Schedule 1 of the Regulations lists the extent of services which amount to payment services.<sup>46</sup> On the other hand, part 2 of Schedule 1<sup>47</sup> lists in detail what

is not covered or what does not amount to payment services. It is recommended that Kenyan regulations take a similar approach to ensure that there is clarity on what is and what is not payment services.

46. SCHEDULE 1, Payment Services, PART 1

**Payment services**

1. Subject to Part 2, the following, when carried out as a regular occupation or business activity, are payment services—
  - (a) services enabling cash to be placed on a payment account and all of the operations required for operating a payment account;
  - (b) services enabling cash withdrawals from a payment account and all of the operations required for operating a payment account;
  - (c) the execution of payment transactions, including transfers of funds on a payment account with the user's payment service provider or with another payment service provider—
    - (i) execution of direct debits, including one-off direct debits;
    - (ii) execution of payment transactions through a payment card or a similar device;
    - (iii) execution of credit transfers, including standing orders;
  - (d) the execution of payment transactions where the funds are covered by a credit line for a payment service user—
    - (i) execution of direct debits, including one-off direct debits;
    - (ii) execution of payment transactions through a payment card or a similar device;
    - (iii) execution of credit transfers, including standing orders;
  - (e) issuing payment instruments or acquiring payment transactions;
  - (f) money remittance;
  - (g) payment initiation services;
  - (h) account information services.

47. PART 2

Activities which do not constitute payment services

2. The following do not constitute payment services—

- (a) payment transactions executed wholly in cash and directly between the payer and the payee, without any intermediary intervention;

- (b) payment transactions between the payer and the payee through a commercial agent authorised in an agreement to negotiate or conclude the sale or purchase of goods or services on behalf of either the payer or the payee but not both the payer and the payee;
- (c) the professional physical transport of banknotes and coins, including their collection, processing and delivery;
- (d) payment transactions consisting of non-professional cash collection and delivery as part of a not-for-profit or charitable activity;
- (e) services where cash is provided by the payee to the payer as part of a payment transaction for the purchase of goods or services following an explicit request by the payer immediately before the execution of the payment transaction;
- (f) cash-to-cash currency exchange operations where the funds are not held on a payment account;
- (g) payment transactions based on any of the following documents drawn on the payment service provider with a view to placing funds at the disposal of the payee—
  - (i) paper cheques of any kind, including traveller's cheques;
  - (ii) bankers' drafts;
  - (iii) paper-based vouchers;
  - (iv) paper postal orders;
- (h) payment transactions carried out within a payment or securities settlement system between payment service providers and settlement agents, central counterparties, clearing houses, central banks or other participants in the system;
- (i) payment transactions related to securities asset servicing, including dividends, income or other distributions, or redemption or sale, carried out by persons referred to in subparagraph (h) or by investment firms, credit institutions, collective investment undertakings or asset management companies providing investment services or by any other entities allowed to have the custody of financial instruments;

- (j) services provided by technical service providers, which support the provision of payment services, without the provider entering at any time into possession of the funds to be transferred, excluding payment initiation services or account information services but including—
  - (i) the processing and storage of data;
  - (ii) trust and privacy protection services;
  - (iii) data and entity authentication;
  - (iv) information technology;
  - (v) communication network provision; and
  - (vi) the provision and maintenance of terminals and devices used for payment services;
- (k) services based on specific payment instruments that can be used only in a limited way and meet one of the following conditions—
  - (i) allow the holder to acquire goods or services only in the issuer's premises;
  - (ii) are issued by a professional issuer and allow the holder to acquire goods or services only within a limited network of service providers which have direct commercial agreements with the issuer;
  - (iii) may be used only to acquire a very limited range of goods or services; or
  - (iv) are valid only in a single EEA State, are provided at the request of an undertaking or a public sector entity, and are regulated by a national or regional public authority for specific social or tax purposes to acquire specific goods or services from suppliers which have a commercial agreement with the issuer.
- (l) payment transactions resulting from services provided by a provider of electronic communications networks or services, including transactions between persons other than that provider and a subscriber, where those services are provided in addition to electronic communications services for a subscriber to the network or service, and where the additional service is—
  - (i) for purchase of digital content and voice-based services, regardless of the device used for the purchase or consumption of the digital content, and charged to the related bill; or
  - (ii) performed from or via an electronic device and charged to the related bill for the purchase of tickets or for donations to organisations which are registered or recognized as charities by public authorities, whether in the United Kingdom or elsewhere, provided that the value of any single payment transaction does not exceed £40, and the cumulative value of payment transactions for an individual subscriber in a month does not exceed £240;
- (m) payment transactions carried out between payment service providers, or their agents or branches, for their own account;
- (n) payment transactions and related services between a parent undertaking and its subsidiary or between subsidiaries of the same parent undertaking, without any intermediary intervention by a payment service provider other than an undertaking belonging to the same group;
- (o) cash withdrawal services provided through automatic teller machines, where the provider—
  - (i) is acting on behalf of one or more card issuers;
  - (ii) is not party to the framework contract with the customer withdrawing money from a payment account; and
  - (iii) does not conduct any other payment service.



## 2.4 Legal & Regulatory Overlap

With the interconnectedness of the digital financial services, it is important to reconsider whether the regulatory framework is optimally designed to meet the current demands. For example, it is important to consider whether the United Kingdom regulatory model where Financial Conduct Authority (FCA), Prudential Conduct Authority and Bank of England have been established as the regulatory authorities in the financial sector. The three institutions are closely interrelated. For example, Prudential Regulatory Authority (PRA) is part of the Bank of England and acts as the prudential regulator. PRA creates policies for firms to follow as well as regulate aspects of the business to ensure that the financial services and products are provided in a safe and sound manner.<sup>48</sup> On the other hand, FCA works with firms to ensure fair outcomes for consumers. One of its responsibilities is regulating and ensuring fair practice in consumer credit.<sup>49</sup> On the other hand, the Bank of England acts as UK's central bank and deals with aspects such as currency issuance, inflation and supporting resiliency of the financial system.<sup>50</sup>

The legal and regulatory framework of digital financial service sector in Kenya is contained in different statutes and subsidiary regulations. These include the Banking Act<sup>51</sup>, the Prudential Guidelines for the Institutions Licensed Under the Banking Act<sup>52</sup>, Money Remittance Regulations 2013<sup>53</sup>, the National Payment Systems Act<sup>54</sup>, National Payment Systems Regulations<sup>55</sup>, Kenya Information Communications Act<sup>56</sup> and the regulations thereunder amongst several other statutes. The sector is also governed by different regulators such as the Central Bank of Kenya, Insurance Regulatory Authority, Retirements Benefits Authority, Saccos Societies Regulatory Authority amongst others. All these regulators act as both prudential and conduct regulators while additionally for Central Bank of Kenya, it also acts as the central bank and monetary authority in Kenya.

This fragmented nature of the regulatory framework means that entities seeking to play in this space have to scour through different statutes, regulations and circulars to know their obligations. Furthermore, the number of regulations applicable means that an

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48. <https://www.bankofengland.co.uk/knowledgebank/what-is-the-prudential-regulation-authority-pra>. Accessed on 20 August 2022.

49. Ibid.

50. <https://www.bankofengland.co.uk/about#:~:text=We%20provide%20wholesale%20banking%20services,banks%20and%20other%20financial%20institutions..> Accessed on 20 August 2022.

51. Cap 488 of the Laws of Kenya.

52. Issued in 2013.

53. Legal Notice 66, issued under the Central Bank Act.

54. Act No. 39 of 2011.

55. LEGAL NOTICE NO. 109 of 2014.

56. Act No. 2 of 1998.

industry change/shift would require amendment of several laws under different stakeholders. The nature of the regulatory regime poses these challenges which can be addressed by a review and possibly some level of consolidation.

Further, different regulators covering similar thematic areas (e.g. consumer protection, capital requirements of different entities etc.) may create inefficiencies and related challenges. Whereas this paper does not go into the detail of the different regulatory models, it is clear that the fragmented regulatory model in Kenya requires to be re-evaluated in light of the emerging best practices in other markets. It is important to note that the Financial Services Authority bill was considered by Parliament in 2016 and has not been passed to law to date. The bill sought to establish uniform norms and standards in relation to the conduct of providers of financial products and financial services, establish the Financial Services Authority, the Financial Sector Ombudsman and the Financial Sector Tribunal and also promote a fair and efficient financial sector in Kenya.

## 2.5 Regulation of Digital Lenders

Parliament of Kenya amended the Central Bank Amendment Act in 2021 to give CBK powers to regulate all digital lenders. These lenders had been in the market for several years. An apparent need

for their regulation<sup>57</sup> stemmed from increased public outcry over concerns on measures applied by some of the digital lenders ranging from predatory lending, abuse of consumer data, aggressive recovery process, among others.<sup>58</sup>

After the aforesaid amendment to the CBK Act, the Central Bank of Kenya (Digital Credit Providers) Regulations, 2022 were issued which inter alia requires the digital lenders as from September 2022 to implement consumer protection measures and obtain CBK licensing. These regulations<sup>59</sup> provide that a person shall not establish or carry out digital credit business in Kenya or otherwise hold himself out as carrying out digital credit business in Kenya unless that person is licensed by CBK in accordance with the regulations or is a person whose digital credit business is regulated under any other written law. The regulations, however do not apply to the following institutions:

- (a) an institution licensed under the Banking Act;
- (b) an institution licensed under the Microfinance Act, 2006;
- (c) a Sacco society licensed under the Sacco Societies Act, 2008;
- (d) the Kenya Post Office Savings Bank supervised under the Kenya Post Office Savings Bank Act;
- (e) credit arrangements involving the provision of

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57. <https://news.trust.org/item/20220119085754-1v7ss/>. Accessed on 8th August 2022.

58. Ibid.

59. Section 2





credit by a person that is merely incidental to the sale of goods or provision of services by the person whose primary business is the provision of the goods or services;

- (f) an entity whose digital credit business is regulated under any other written law;
- (g) any other entity approved by the Bank.<sup>60</sup>

The Central Bank of Kenya Amendment Act defines digital credit to mean a credit facility or arrangement where money is lent or borrowed through a digital channel. A digital channel is defined to mean the internet, mobile devices, computer devices, applications and any other digital systems as may be prescribed by the Central Bank. The net effect of these provisions is to ensure that all digital credit providers are covered by the regulations if they are not regulated under any other law.

These regulations are a welcome measure to address the aforementioned challenges in the industry. However, the way the digital lenders regulations are worded raises the question of whether a lender whose customers apply via sending an application via email and the loan is disbursed via mobile wallet needs to be regulated. Further, it is not clear whether the regulations intended to cover cases where a credit

provider has a physical office where customers apply for loans through completing a physical form and after credit assessment, disbursement is made through mobile wallet or a cheque or a bank transfer which all are digital channels utilizing a mobile phone or a computer. If the intention was to cover this scenario, the regulations have a far-reaching application. The ambiguity in the regulations exposes players to legal liability down the road should a conflicting interpretation be adopted by the implementing authorities.

According to FinAccess Survey 2021, 28% of the adult population is utilizing financial services including loans from informal and unregulated groups while the digital loan apps are being utilized by only 6% of the adult population in Kenya.<sup>61</sup> Additionally, some non-digital lenders – commonly referred to as ‘shylocks’ remain unregulated yet are very prevalent operating for pursuing a ‘pound of flesh’. Regulating non-digital credit only lenders can include a guidance on the maximum rate of interest and other light weight requirements to allow consumers seek redress in case of violations. This would greatly address some of the complaints on usury and unprofessional debt recovery which continue to lead to various public outcries.<sup>62</sup>

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60. Section 1.

61. <https://www.knbs.or.ke/wp-content/uploads/2021/12/2021-Finaccess-Household-Survey-Report.pdf>.

62. <https://www.pd.co.ke/news/shylocks-leave-a-trail-of-tears-misery->

It is worthy to note that Kenya is a pioneer in mobile digital credit provision and therefore many countries will be looking up to the regulatory step taken by Kenya. Consequently, there are few countries to draw lessons from. The European Union is in the process of implementing a regulatory framework for non-

bank lenders touching or relating to bigtech<sup>63</sup> and fintech<sup>64</sup> providers and European Banking Authority has released a paper on the matter.<sup>65</sup> The paper calls for registration and regulation on this space and it is therefore important to consider the developing digital lending regulation across the world.

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63. Big technology such as Google, Facebook (Meta), Apple amongst others.

64. Financial technology players

65. [https://www.eba.europa.eu/sites/default/documents/files/document\\_library/Publications/Reports/2022/1032199/Report%20on%20response%20to%20the%20non-bank%20lending%20request%20from%20the%20CfA%20on%20Digital%20Finance.pdf](https://www.eba.europa.eu/sites/default/documents/files/document_library/Publications/Reports/2022/1032199/Report%20on%20response%20to%20the%20non-bank%20lending%20request%20from%20the%20CfA%20on%20Digital%20Finance.pdf). Accessed on 15 September 2022.

## 3.0 Conclusions and Recommendations

**T**o conclude, the research has confirmed the hypothesis of the study. First, it has been concluded that there are several statutes and regulators governing digital financial services. The laws and regulations are spread across several statutes and regulations therefore making it difficult to implement and update. It is important for Kenya to re-consider combining or reconfiguring the financial sector regulatory framework in line with developments in the markets such as the United Kingdom and South Africa. Financial sector regulators are several and since they are cases where they are implementing similar standards such as fair market conduct or consumer protection in the financial services sector, it is necessary to consider consolidation or having such services regulated by an overarching regulator. The National Treasury is urged to make the necessary proposals to Parliament to amend the underlying laws.

Further, as far as payment services are concerned, the law is inadequate and does not define payment services comprehensively. This creates difficulties in implementation and compliance. It is recommended that payment services be defined more precisely. Lessons can be drawn from countries such as the United Kingdom where the regulations provide detailed examples of what is and what is not a payment service. Parliament is urged to amend the NPS Act to provide a more precise definition while the Central Bank of Kenya is urged to consider the ambiguities in the law and guide the industry accordingly.

The digital credit providers regulations seek to regulate providers who are lending or borrowing through digital channels. There is an aspect of ambiguity in the regulations on whether providers who use manual or physical documents until the disbursement stage which is done through mobile money or bank transfer or cheques are covered by the regulations. That notwithstanding, the main concern on digital credit regulation is the clear exclusion of providers who do not use any digital channel. According to FinAccess Survey 2021, 28% of the adult

population is utilizing financial services including loans from informal and unregulated groups while the digital loan apps are being utilized by only 6% of the adult population.<sup>63</sup> Therefore, the paper calls for certain minimum regulation for this informal credit sector to cover areas such as consumer protection, interest rates and fair debt recovery processes. This will foster the balance between innovation and consumer protection. In this vein, Parliament and Treasury are urged to reconsider this space and pass the necessary

light weight legislation to protect consumers and foster innovation.

In conclusion, the research has proposed various changes to the legal and regulatory regime with a view to improve the same. At the end of the day, the law and regulation are playing catch up to the innovations and they need to take into consideration all the relevant and sometimes conflicting needs of the stakeholders.

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63. <https://www.knbs.or.ke/wp-content/uploads/2021/12/2021-Finaccess-Household-Survey-Report.pdf>.

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