Financial Services Sector Report

Q3 2022

MMAN ADVOCATES

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BANKING

On 19th August 2022, The High Court of Kenya delivered its judgement in Petition E002 of 2021: Mugure & 2 others v Higher Education Loans Board where it held that all lenders including digital lenders and microfinance institutions, whether regulated under the Banking Act or not, are subject to the application of the in duplum rule.

I. Judicial Decisions

Mugure & 2 others v Higher Education Loans Board (Petition E002 of 2021) [2022] KEHC 11951 (KLR) (Civ) (19 August 2022) (Judgment)[1]

Brief Facts

To finance their undergraduate studies, the Petitioners applied for and were granted loan facilities by the Higher Education Loans Board (hereafter, "**HELB**"). The Petitioners contended that HELB was unreasonably levying exorbitant interest and penalties on the outstanding balances thereby making it difficult or impossible for them to repay the outstanding amounts. To illustrate, the 1st Petitioner's loan account had, in a span of 12 years, ballooned from KShs.82,980.00 to KShs.540,464.10.

The Petitioners contended that the interest and penalties levied on their loan accounts had more than doubled in breach of the in duplum rule which limits the amount recoverable by a bank on a defaulted facility to the principal owing when the loan became nonperforming plus contractual interest not exceeding the principal owing when the loan becomes non-performing plus recovery expenses.

The Petitioners urged the Honourable Court to, inter alia,:

(a) declare that by imposing interest amounts and penalties in excess of the principal amount, the respondent was in contravention of articles 43 (1)(e) and (f) of the Constitution of Kenya, 2010 (Constitution) and section 44(A)(1) and (2) of the Banking Act;
(b) declare section 15 (2) of the Higher Education Loans Board Act as unconstitutional to the extent that it contravened the in duplum rule.

The Respondent opposed the Petition on the twin grounds that:

(a) section 44A of the Banking Act did not apply to it since the provisions regarding repayment of HELB loans were not only contractual but also statutory;
(b) it, i.e., the Respondent had already undertaken measures to cap the accruing interest on the Petitioners' accounts and other loanees of HELB;

Issues for Determination

The court identified the issues for determination as:

(a) Whether the *in duplum* rule was applicable to bodies lending monies other than banks.
(b) Whether the continued imposition of interest and penalties on non-performing loan accounts by the Higher Education Loans Board even when the

[1] Available at http://kenyalaw.org/caselaw/cases/view/238886/ accesses on 30th September 2022

interest and penalties exceeded the principal amount amounted to discrimination .

(c) What was the nature and rationale of the *in duplum* rule in Kenya?

Findings

After considering the parties' rivaling positions, the Honourable Court made the following findings:

(a) The prevailing consensus, as set out in the case of Desires Derive Limited versus Britam Life Assurance Co. (K) Ltd [2016] eKLR, was that the in duplum rule only applied to banks and financial institutions regulated under the Banking Act.

(b) The rationale for the in duplum rule was to advance public interest in the financial sector by protecting borrowers from exploitation by lenders who permit interest to rise to astronomical figures, a position expressed by the Court of Appeal in the case of Mwambeja Ranching Company Limited & another versus Kenya National Capital Corporation [2019] eKLR.

(c) Since the in duplum rule was implemented to further public interest and protect borrowers from exorbitant interest, the statutory intention of parliament should extend to all lenders, not just banking institutions.

In view of the above findings, the Honourable Court allowed the Petition and declared that:

(a) By imposing interest amounts and penalties or fines that exceed the principal amount, the Respondent contravened the provisions of article 43(1)(e) and (f) and article 27 of the Constitution;

(b) Section 15(2) of the HELB Act, to the extent that it leads to interest rates and fines becoming more than the principal amount advanced, is unconstitutional;

(c) The Respondent was not entitled to recover from the Petitioners or its loanees an amount exceeding double the amount advanced in contravention of the in duplum rule.

Implication

The legal consequence of this decision is that **all lenders** including digital lenders and microfinance institutions, whether regulated under the Banking Act or not, are subject to the application of the in duplum rule. Accordingly, they cannot, on a defaulted facility, recover any amount more than the principal owing when the loan became nonperforming plus contractual interest not exceeding the principal owing when the loan becomes non-performing plus recovery expenses.

MMAN Advocates will be happy to assist on any issues arising from this decision.

FINTECH

The quarter under review saw CBK announce the full interoperability of mobile money services in Kenya through the launch of paybill interoperability by Safaricom PLC, Airtel Networks Kenya Limited and Telkom Kenya Limited. It further saw the expiry of the transition period for unregulated Digital Credit Providers on 17th September 2022.

I. Guidelines, Notices and Circulars

On 15th July 2022, the Central Bank of Kenya ('CBK') issued a press release announcing the full interoperability of mobile money services in Kenya. This was achieved by the launch of *paybill* interoperability by the three mobile money providers Safaricom PLC, Airtel Networks Kenya Limited and Telkom Kenya Limited. The CBK noted that full interoperability will deepen digitalization of payments increasing choice, affordability and customer-centricity of payment services.

CBK further issued a press release on 19th September 2022 noting the expiry of the transition period for unregulated Digital Credit Providers on 17th September 2022. CBK advised that it engaged other regulators and agencies necessary to the licensing process including the Office of the Data Protection Commissioner. While ten (10) applicants have been licensed as Digital Credit Providers, other applications were still under review largely due to pending documentation. The CBK reminded all unregulated Digital Credit Providers that did not apply for licensing to cease and desist from conducting digital credit business.

II. Judicial Decisions

Association of Micro-finance v The Central Bank of Kenya & 3 others (Constitutional Petition E008 of 2022) [2022] KEHC 13053 (KLR) (22 September 2022)[2]

Brief Facts

On 7th December 2021, the President assented to the Central Bank of Kenya (Amendment) Act, 2021 (hereafter, "the Amendment Act") which Amendment Act:

(a) Amended section 57 of the Central Bank of Kenya Act by giving the Central Bank of Kenya (hereafter, "the CBK") the power to make regulations for purposes of giving effect to the provisions of the Amendment Act.
(b) Inserted Section 59 into the Central Bank of Kenya Act requiring the envisioned regulations to be made within 3 months of commencement of the Amendment Act.
(c) Required players in the digital credit businesses, not regulated under any other law, to acquire licenses under the Central Bank of Kenya (Digital Credit Providers) Regulations, 2022 (hereafter, "the DCP Regulations") within six months of publication of such regulations.

On 23rd December 2021, the CBK invited comments on the draft DCP Regulations. The Petitioner's members on whose behalf it filed the Petition did not offer their representations on the draft DCP Regulations.

On 21st March 2022, the CBK announced the publication and operationalisation of the DCP Regulations and issued a notice to the effect that all previously unregulated Digital Credit Providers were required to apply for a license within 6 months of the publication of the regulations, failure to which they would cease operations.

Petitioner's Case

The Petitioner contended that its members, comprising non-deposit taking microfinance institutions, should not have been brought under the ambit of the Amendment Act by the DCP Regulations. From the Petitioner's viewpoint, the mischief sought to be cured by the Amendment Act were the challenges posed by unregulated digital credit providers where there was no human contact between the Lender and the customer. The Petitioner's members, it was argued, to the extent that they

[2] Available at http://kenyalaw.org/caselaw/cases/view/241163/ accessed on 30th September 2022

engaged in more than just credit lending through digital platforms, were not contemplated under the Amendment Act.

The Petitioner maintained that its members ought to have been regulated under the Microfinance Act and not the Central Bank of Kenya Act. By extension, the Petitioner argued, the DCP Regulations ought to apply to Digital Credit Providers which are distinct from non-deposit taking microfinance institutions since said regulations prohibited the Petitioner's members from taking cash collateral, the main security of non-deposit taking micro finance institutions.

In the Petitioner's view, the Amendment Act and the DCP Regulations unreasonably sought to place all businesses engaging in the business of digital credit, not regulated under any other law, within the ambit of the DCP Regulations without appreciating that:

(a) that all businesses, including lending businesses, currently run-on digital platforms; and
(b) there were businesses offering digital credit services alongside other services.

The Petitioner invited the Court to declare as unconstitutional, the provisions of section 59 of the Central Bank of Kenya Act and/or the entire Amendment Act on grounds (inter alia) that:

(a) the amendments and enactment were not preceded by public participation;
(b) they were discriminatory against non-deposit taking microfinance institutions, to the extent that they exempted the institutions licensed under the Banking Act, Microfinance Act, Sacco Societies Act;
(c) they violated the Petitioner's right to a fair administrative action protected under Article 47 of the Constitution of Kenya, 2010.

Respondent's Case

In response to the Petition, the Respondents submitted that:

(a) the process leading up to the enactment of the Amendment Act and operationalisation of the DCP Regulations was characterised by sufficient public participation.
(b) even though Regulation 8 (2) of the DCP Regulations prohibit non-deposit taking microfinance institutions from accepting cash collaterals, the taking of cash collateral constituted deposit taking activity regulated under the Banking Act and the Microfinance Act. Accordingly, it was illegal for an institution describing itself as a non-deposit taking microfinance institution to accept cash collateral. As such, any of the Petitioner's members whose business involved the taking of cash as collateral was required to obtain a license from the Central Bank of Kenya.
(c) the Amendment Act and the DCP Regulations were designed to bring all unregulated digital credit providers, including the Petitioner's members, under the ambit of the supervisory and regulatory powers of the Central Bank of Kenya. As such, the issue of discrimination could not arise.
(d) the Petitioner had not provided any evidence that its members on whose behalf the Petition had been filed were regulated under any other law in the provision of digital credit services.
(e) the reason for the exemption of the other institutions is that all the other institutions that have been exempted under Regulation 2 of the DCP Regulations were already regulated under the Banking Act, the Microfinance Act, and the Sacco Societies Act.

Issues for Determination

1 Whether there was public participation in the enactment of Section 59 of the Amendment Act.
2 Whether Regulation 2 of the DCP Regulations discriminates and/or

violates the Petitioner's members rights under Article 27 of the Constitution.

3 Whether Section 59 of the Amendment Act and the DCP Regulations violated the Petitioner's right to a fair administrative action protected under Article 47 of the Constitution of Kenya, 2010.

Findings:

The Honourable Court made the following findings:

1 The Respondents had elaborated the steps taken in the enactment of the Amendment Act and formulation of the DCP Regulations. In fact, the Petitioner's own case was that it was aware of the processes leading to the enactment of the Amendment Act and the Regulations but did not participate because it was under the impression that its members were not Digital Credit Providers as defined under the Amendment Act. As such, the Respondents could not be blamed for the Petitioner's failure to present its views.

2 No regulations governing the business carried on by members of the Petitioner existed as at the time of the enactment of the Amendment Act. Accordingly, since the Petitioner's members could not know the content of regulations that would be formulated, their right to fair administrative action could not have been violated as contended.

3 The lack of regulations regarding the affairs of the Petitioner's members was a plausible reason to not treat them in the same manner as those entities that are already being regulated under their respective Acts of Parliament.

4 The Petitioner had not demonstrated that any entity operating exactly as the members on whose behalf it had filed the Petition is exempt from the said provision. As such, the issue of discrimination did not arise.

5 The enactment of Amendment Act and the DCP Regulations was necessitated by the need to superintend, the manner in which the Petitioner's members conduct their business in relation to the public whom they serve. Consequently, their enactment could not amount to infringement of the constitutional rights of the Petitioner's members.

Following the above findings, the Honourable Court dismissed the Petition.

Implication:

This decision has given clarity on the regulatory reach of the Central Bank of Kenya regarding digital credit providers. It is now clear that non deposit taking microfinance institutions, including those in the business of offering digital credit services, are subject to the provisions of the DCP Regulations and must be licensed by the Central Bank of Kenya.

The inclusion of all digital credit providers within the regulatory umbrella of the Central Bank of Kenya will go a long way in addressing instances of unethical conduct that have hitherto plagued non-deposit taking microfinance institutions operating the business of digital credit. Such include predatory practices, high cost of facility and other charges, unethical debt collection practices, abuse of personal information, money laundering and financing of terrorism.

INVESTMENTS

The quarter saw the Capital Markets Authority continue to roll out a comprehensive review of its regulatory framework, inviting public comment on various new pieces of draft subsidiary legislation that seek to ensure the regulatory environment is responsive to market needs and emerging issues.

I. Subsidiary Legislation

Capital Markets Act (Licensing Requirements) (General)(Amendment) (No. 2) Regulations, 2022, Legal Notice 135 of 2022

The Amendment Regulations were published by virtue of section 12 of the Capital Markets Act, No. 17 of 1989 (the "Act") to make changes to the Capital Markets (Licensing Requirements) (General) Regulations, 2002 (the "Principal Regulations"). The Principal Regulations set the licensing procedures for the operation of a securities exchange and securities exchange trading system.

The Amendment Regulations seek to amend the Principal Regulations specifically the fifth schedule of the Principal Regulations on the brokerage commission and fees. Paragraph 3 under the schedule is deleted and substituted with the following:

a) For corporate debt instruments (Secondary market)

Brokerage Commission %	Transaction fee				Total transaction fees payable by investor
	NSE %	CMA %	CDSC %	ICF %	Total
0.024	0.0035	0.0015	0.02	0.004	0.0035

b) For government debt instruments (Secondary market)

Brokerage Commission %	Transaction fee			Total transaction fees payable by investor
	NSE %	CMA %	ICF %	Total
0.024	0.0055	0.015	0.004	0.035

You may find a copy of the Amendment Regulations here.

II. Guidelines, Notices and Circulars

A public notice issued by the Capital Markets Authority ('CMA') on 8th August 2022 invited public proposals for amendments on the capital markets regulations listed below:

i. the Capital Markets (Licensing Requirements) (General) Regulations, 2002;
ii. the Capital Markets (Take-Overs and Mergers) Regulations, 2002;
iii. the Capital Markets (Conducts of Business) (Market Intermediaries) Regulations, 2011;
iv. the Capital Markets (Corporate Governance) (Market Intermediaries) Regulations, 2011; and
v. the Guidelines on Financial Resource Requirements for Market Intermediaries, 2012.

CMA noted that the review of the various regulations was intended to make them responsive to market needs and address emerging issues. While initial submission of proposals would close on 16th September 2022, the CMA issued a further notice extending submission of comments to 4th October 2022 and including the capital markets regulations

listed below for public proposals for amendments:

vi. the Capital Markets (Foreign Investors) Regulations, 2002;
vii. the Capital Markets (Real Estate Investment Trusts Collective Investment Schemes) Regulations, 2013;
viii. the Central Depositories (Regulation of Central Depositories) Rules, 2004; and
ix. the Capital Markets Tribunal Rules, 2002.

CMA issued a public notice on 12th August 2022 inviting public and stakeholder comments on the draft Capital Markets (Credit Rating Agencies) Regulations, 2022. The draft regulations were developed following a review of the Capital Markets (Credit Rating Agencies) Guidelines, 2001 and are aimed at enhancing best practices on conduct of credit ratings in Kenya, providing investor protection and increasing the level of oversight of credit rating agencies by the CMA. CMA issued a further notice extending the submission of comments on the draft regulations to 4th October 2022.

The Nairobi Stock Exchange ('NSE') issued a press release on 6th July 2022 announcing the waiver of the NSE transaction levy on all equity day trades for a period of thirty days. NSE noted that the waiver intended to encourage Kenyans participate and take advantage of daily price movements of securities listed on the NSE. On 9th September 2022, the NSE issued a further notice extending the waiver of its fees on equity day trades for the rest of the year 2022 with the aim of boosting market activity and creating an opportunity for investors to enjoy higher liquidity.

SACCO SOCIETIES

With the passing of the Sacco Societies (Amendment) Act, 2022, SASRA will establish an electronic system which will provide an avenue through which SASRA shall incorporate an obligation on Saccos to report Credit Reference data to SASRA. This is meant to deal with the existing gap in supervision and will further streamline the reporting system.

I. Acts of Parliament

The Sacco Societies (Amendment) Act, 2022

From the recent amendment, we can see that the main objective of the Act is to provide for Information Communication Technology as a way through which Saccos should submit as well as receive statutory reports. This also covers any other relevant information that aids the day-to-day operations of a Sacco.

The Act has introduced an electronic system that mandates all Saccos to make the required disclosure. The principal Act (Sacco Societies Act, 2008) at section 41 provides that ***"A Sacco shall, not later than 3 months after the end of each financial year, submit to the Sacco Societies Regulatory Authority (SASRA), in the prescribed form (a) an audited balance sheet, showing its assets and liabilities; (b) an audited profit and loss account; and (c) a copy of the auditor's report."***

Main Highlights of The Act

Electronic System

- Clause 9(1) of the Act has amended section 53 of the Principal Act. It gives SASRA the mandate of establishing as well as operating an electronic filing system for the main purpose of filing of statutory returns including documents and any other information that is to be furnished to Saccos.

- Clause 9(2) of the Act stipulates that SASRA shall issue guidelines on the use as well as

the procedure of the system. This includes registration of Saccos to participate in the system, statutory returns, documents or other information to be transmitted through the system and any other matter for the better use and provision of the system.

- Clause 9(3) of the Act places an emphasis on submission of information through the system to SASRA.
- Clause 9(4) of the Act stipulates that SASRA (where necessary) shall issue a notice to provide documents to the registered account of the specific Sacco.

Alignment with other relevant laws

In addition to the few amendments that the Act has brought about on the terms and definitions to the current constitutional dispensation, it will also result into a harmonization of a few pieces of legislation as below:

- Cooperative Societies Act

  Clause 6 of the Act has amended section 27 of the Principal Act by introducing sub-section 8 which stipulates that "*the registration of a Sacco Society the license of which is revoked under the Act shall be cancelled in accordance with Section 62 of the Co-operative Societies Act.*"

- Alignment with Credit Reference Bureau (CRB) Regulations 2020

  The provisions of Section 54 of the Principal Act stipulate that Saccos are mandated to exchange information with the Authority, amongst themselves as well as CRBs in the ordinary course of business. In the event that such information discloses the individual account holder, it should only be shared upon receipt of the account holder's consent.

  With such regulations, Saccos were included as authorized subscribers of credit data; they can now share and receive creditor information with CRBs without requiring an account holder's consent.

With the passing of the Sacco Societies (Amendment) Act, 2022, the electronic system to be established by SASRA provides an avenue through which SASRA shall incorporate an obligation on Saccos to report Credit Reference data to SASRA. This means that the system shall effectively deal with the existing gap in supervision as well as streamline the reporting system.

NOTARIES PUBLIC • COMMISSIONERS FOR OATHS • PATENT AGENTS

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