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THE CENTRE FOR RESEARCH ON FINANCIAL MARKETS AND POLICY®

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

Executive Summary

The financial services sector is as highly regulated area in many countries including Kenya. It is therefore critical to consider whether the regulatory framework is designed appropriately for today's realities. The definition of the payment services, the architecture of the financial services' regulatory framework and regulation of digital lenders are some of the area's worth closer consideration in the current times.

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1. Introduction

A legal and regulatory framework has to strike the balance between encouraging innovation on one hand and (over) regulation and consumer protection on the other hand. The definition of payment services in the National Payment Services Act requires an overhaul to remove ambiguities and borrow from leading jurisdictions such as the United Kingdom. The architecture of the financial services regulatory framework needs to be reconfigured to meet the changing demands. Kenya is a global leader in mobile money and the regulation of the digital credit provision is a leading move globally. However, there are certain weaknesses in the regulatory framework which needs to be addressed.

2. Context and importance

According to Chainalysis, Kenya has been ranked as the fifth country in the world in adopting crypto currencies ahead of countries like Nigeria, South Africa, and leading economies of the world such as United States of America and China. In the same rankings, Kenya was ranked first in the world in terms of Person to Person (P2P) exchange trade volume. As at June 2022, UNCTAD communicated that 8.5% of the Kenyans are holding crypto currency. Kenya is also a world leader in the mobile money and digital credit provision. Whether cryptocurrency is considered as a currency, payment mechanism or as an asset, it is clear that Kenya is ahead of many countries in adoption of various digital financial assets.

Despite all these developments, Kenya's payment landscape continues to be governed by a National Payment Services Act which was enacted in 2011. This Act has not factored in the rapid changes which have taken place in the last ten years. The Central Bank of Kenya has been taking action against players who are deemed to be in the payment services without proper licensing. On the digital credit provision, the new regulations were issued in September 2022 and run the risk of not meeting their full objectives if the existing gaps are not addressed.

3. Methods and findings

The research was done through a desk top study of the legal and regulatory framework to identify the digital financial services and the applicable legal and regulatory framework. The review includes an assessment of the existing statutes and regulations and a comparison with what is applicable in other relevant jurisdictions. The research established that the definition of the payment services in the Payment Services Act is ambiguous and incapable of precise implementation. Further, the regulatory framework for digital financials services involves several regulators and regulations which introduces inefficiencies and overlaps. On digital credit providers, the research established that whereas Kenya is a world leader on this area, a significant portion of the population consume unregulated credit services exposing them to negative consequences of unregulated credit. Further, the definition of digital channels and digital credit in the CBK Amendment Act 2021 are broad and prone to different interpretations.

4. Policy implications

On the basis of the above findings, the following recommendations are made:

1. Policy makers, Parliament and National Treasury to consider amending the definition of payment services in the National Payment Services Act to clearly stipulate what constitutes or does not constitute payment services.

2. Policy makers, the National Treasury and Parliament consider consolidating the laws and regulations governing the financial sector and further consider consolidating the regulators to clearly demarcate prudential and market conduct regulation.

3. Policy makers, the National Treasury and Parliament to consider establishing a lightweight regulatory framework for the unregulated non digital credit.

4. Central Bank of Kenya to consider interpreting digital channels and digital credit in the Central Bank Amendment 2021 in a manner to protect consumers and advance innovation.

5. Reference

Githu, J. M Legal & Regulatory Framework for Digital Financial Services in Kenya – A Case for Urgent Reforms, KBA Working Paper Series (WPS/04/2022)

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