ORIGINS AND EVOLUTION OF DIGITAL CREDIT IN KENYA

Webinar:
Digital credit and consumer protection

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Digital Credit and Consumer Protection

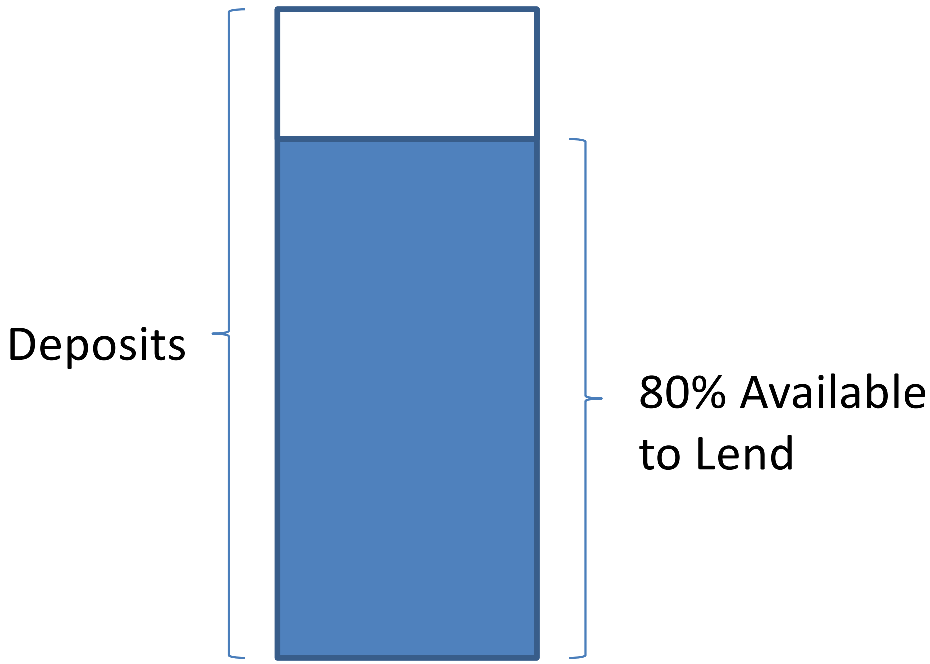
ORIGINS

Disclaimer

- This evaluation is purely my opinion
- Based on 16 years observing the development of the financial sector in Kenya, during which time I worked with multiple banks, Safaricom (M-Pesa), the KBA, the Central Bank of Kenya, FSDK, the National Treasury, multiple other Ministries and Government departments
- So this is a short review of the chain of events that led to the rise of digital credit

Constraints on the Financial Sector

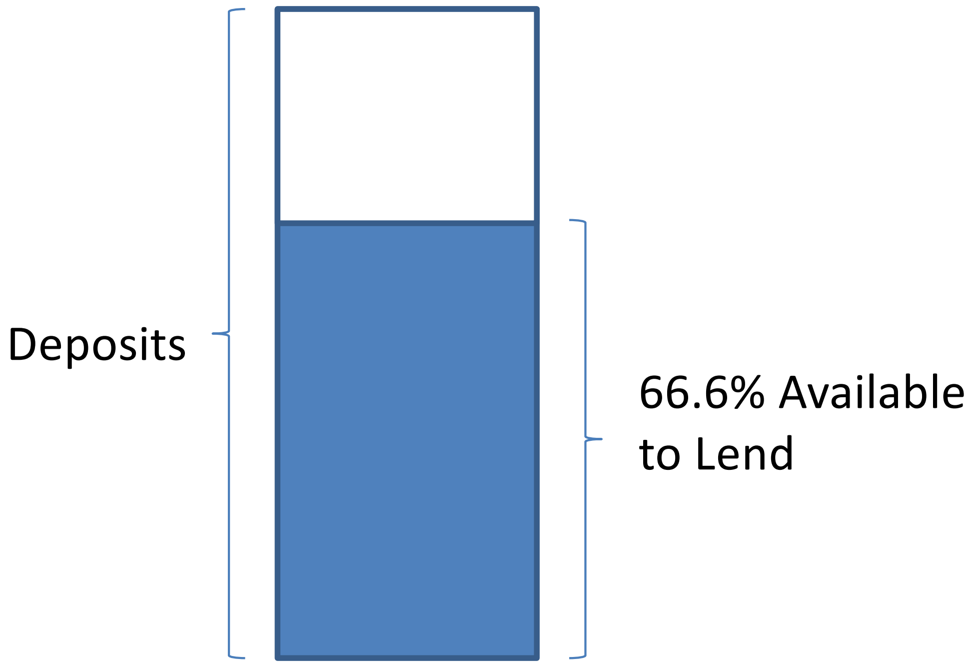
- Multiple bank failures, including two bad failures in 2015, caused CBK to rein in the risks Kenya's banks were taking



- The intent was to both reduce risk, and to force banks to build deposits (and reserves)

Financial Sector Reaction

- Virtue signalling caused some banks to overreact: “aren’t we being prudent?”



- Which caused those banks a significant profitability issue. So they raised interest rates to plug the gap.

Populist Reaction

- Parliament reacted strongly to the wholesale raising of interest rates
- Imposed interest rate caps/floors:
  - Minimum Interest on Deposits: 7%
  - Maximum Interest on Loans: 14%
- Quick back of the envelope calculation suggests that, combining these limits with the 67% limit on lending of deposits, it’s simply not possible to run a bank profitably.

Making Banks Profitable Again

- Like the Internet, Kenya's banks simply 'routed around' disruption, and imposed a broad range of charges on all of their products; so low interest, yes, but combined with a bewildering array of fixed charges.
- Also started to invest the remaining 33% of deposits in Treasury Bills; with interest from 8% to 11%, depending on duration
- Hello, profitability!
  - More or less.

Taking the Wrong Turn?

- Banks began to look at that T-Bill rate as much more attractive than lending to fickle customers, with all of the risks they represent
- More and more of their lending was re-directed to T-Bills, a reliable source of income
  - Also presented as patriotic investment in Kenya’s infrastructure
  - Banks’ buy-in followed by private individuals
- Even the lifting of the Interest rate caps didn’t reduce the banks’ liking for T-Bills
- Result: a stranglehold on lending to individuals and small businesses

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THE RISE OF THE DIGITAL LENDERS

Nature Abhors a Vacuum

- People with liquid assets saw an opportunity – stepping in where the banks had exited
- Exploiting a gap in regulation
  - Who's going to stop me lending some of my money to my friends and neighbours?
- Using a digital-only model
  - App-based; 40+ apps on Google Play in a very short time
  - Lending decisions automated
  - Linking to credit information services
  - Social media campaigns to encourage adoption
  - Potentially hugely beneficial in the COVID-19 era

Where did it all go wrong?

- Rogue operators – the loan sharks of the digital age
  - Bullying/violence: on social media, and in person
  - Adverse credit reports
- Damaging the reputation of a sector with a majority of highly responsible new entrants, and which is fulfilling a real need amongst individuals and small businesses
- In response, the Digital Lenders Association of Kenya (DLAK) was formed in 2019
  - Promoting best practices in lending and – crucially – consumer protection
  - Seeking to promote self-regulation of the sector
  - Issues with persuading customers to seek out the DLAK logo before applying

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REGULATORY RESPONSES

Could Regulation Help?

Maybe some form of lending licence would be desirable

- For those lending more than some threshold, or to more than a handful of people – and are clearly operating it as a business
- Can’t, and shouldn’t, regulate all informal lending
- But this raises issues of:
  - Licence conditions and compliance costs
  - identification of transgressors (and their potential to transform themselves)
  - appropriate enforcement action

Other Regulation

Consumer protection is clearly an issue

- Tightening controls on lending would reduce bad debts
  - Also, making clear the terms of repayment, rather than trying to present it as a gift or a windfall
- Making it clear where people can go for help
- Providing clear directions for complaints

Financial literacy is also an issue

- Understanding loans and repayments
- The links to gambling are also problematic

Summary

- Regulation is difficult, but not impossible
- More needs to be done to encourage already-regulated entities to enter this space more fully
- The reputable digital lenders – the majority – are mostly doing a great job filling in some of the gaps in financial service provision, particularly for the underserved
- Consumer protection and financial literacy need to be addressed with some urgency

THANK YOU

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