

CONSUMER PROTECTION DIAGNOSTIC STUDY

KENYA

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Ministry of Finance



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The Kenya Financial Sector Deepening (FSD) programme was established in early 2005 to support the development of financial markets in Kenya as a means to stimulate wealth creation and reduce poverty. Working in partnership with the financial services industry, the programme's goal is to expand access to financial services among lower income households and smaller enterprises. It operates as an independent trust under the supervision of professional trustees, KPMG Kenya, with policy guidance from a Programme Investment Committee (PIC). In addition to the Government of Kenya, funders include the UK's Department for International Development (DFID), the World Bank, the Swedish International Development Agency (SIDA), Agence Française de Développement (AFD) and the Bill and Melinda Gates Foundation.

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Abbreviations

AMA	ASCA management agency	KBA	Kenya Bankers Association
AMFI	Association of Microfinance Institutions	KSHS	Kenyan Shilling
ASCA	Accumulating Savings and Credit Association	KUSCCO	Kenya Union of Savings and Credit Co-operatives
CBK	Central Bank of Kenya	MFI	Micro-Finance Institution
CCK	Communications Commission of Kenya	MFSP	Mobile financial service providers
CIN	Consumer Information Network of Kenya	MOCDM	Ministry of Co-operative Development and Marketing
CMA	Capital Markets Authority	MOF	Ministry of Finance
CPT	Consumer Protection Task Force	MTO	Mobile telephone operators
DTM	Deposit-taking Microfinance Institution	NHIF	National Hospital Insurance Fund
FDIC	Federal Deposit Insurance Corporation	NPSD	National Payment Systems Division (of the Bank Supervision Department of the Central Bank of Kenya)
FEPP	Financial Education and Consumer Protection Partnership	NSSF	National Social Security Fund
FGD	Focus Group Discussion	RBA	Retirement Benefits Authority
FOSA	Front office service activates (of SACCOs)	ROSCA	Rotating Savings and Credit Association
FSD	Financial Sector Deepening/Kenya	SACCO	Saving and Credit Cooperative
GOK	Government of Kenya	SASRA	SACCO Societies Regulatory Authority
IRA	Insurance Regulatory Authority	US\$	United States dollar
IRAC	Interest Rate Advisory Centre		

Executive Summary

KEY FINDINGS AND RECOMMENDATIONS

The Kenyan population uses financial services from a broad array of providers. The financial sector regulators provide some, but incomplete and sometimes inconsistent consumer protection to the clients of regulated institutions. In the absence of a market-wide consumer protection law or authority, users of informal financial service providers lack protection entirely. As a result, Kenya falls short in providing comprehensive financial consumer protection and recourse, in policy and practice. The new Constitution commits the nation to protecting consumers and Vision 2030 proposes policy initiatives. An incremental approach offers the best way to build effective financial consumer protection.

Mass market financial services are growing at an impressive rate, generating significant benefits for consumers. Yet a growing body of evidence from on-the-ground research suggests that consumer welfare is compromised by lack of effective disclosure of prices and key terms, inadequate dispute resolution mechanisms, and abusive practices. For example, 25% of bank depositors in a 2010 FSD/CGAP survey expressed “surprise” at charges they did not know about. This is not surprising, given that a 2007 CBK survey found 53 different classes of charges that various banks levy on current accounts.

The best strategy for strengthening financial consumer protection in Kenya, as in any country, will be grounded in pragmatic solutions to problems that affect large numbers of consumers. The 2010 FSD/CGAP Consumer Protection Diagnostic analyzes key consumer protection issues and concludes that the financial sector regulators responsible for oversight of mass-market services – particularly the Central Bank of Kenya, the Insurance Regulatory Authority, SASRA and the Ministry of Finance -- have adequate authority to improve financial consumer protection through incremental improvements in regulation. This can be achieved by a coordinated approach to issuing and enforcing consistent rules governing disclosure, recourse and fair treatment.

The lack of comprehensive consumer protection legislation might seem to lend urgency to finalizing some combination of the draft Competition and Consumer Protection bills. The related Constitutional provisions make this outcome still more likely. Indeed, the diagnostic noted the advantages of such legislation, both in strengthening protection for users of regulated providers and offering protections to users of unregulated providers. However, any new agency would take time to set up and delaying consumer protection action until such a time risks undermining public confidence. Evidence compiled for the diagnostic suggests that current consumer protection problems merit attention. Gradual but continual progress is a more prudent strategy than relying on future legislation and the capacity of a brand-new regulator.

From this perspective, the diagnostic recommends an incremental course that builds on the practice of the financial sector regulators, and is eventually reinforced by a comprehensive consumer protection law and a market-wide regulator. These regulators currently have the strongest legal and indeed moral authority, combined with technical capacity, to introduce consistent basic directives for providers in their respective sectors. Harmonization of these rules across the sectors will foster clear expectations from both consumers and providers, establish credibility for the mandate, and create precedents that

then can be extended to the entire financial market through an agency with a broad remit.

The regulators are positioned to launch this strategy by establishing a basic protection regime covering 40% of the adult population, i.e., clients of banks, foreign exchange bureaus, deposit-taking microfinance institutions, mobile financial services, insurance companies, pension plans, investment brokers and advisors, and larger SACCOs.¹ Each sector regulator already has similar legal mandates to safeguard consumer interests. It is noteworthy that some regulators have put in place rules that can be adapted by their counterparts to create a harmonized protective regime related to the following core areas:

- **Minimum disclosure requirements for pricing and plain language in contracts.** The CBK is well advanced in reviewing credit price disclosure guide-lines, and the IRA is engaged with the insurance industry in the development of standardized, plain language policy wording for various insurance products.
- **Minimum requirements for provider-level dispute resolution mechanisms and independent third-party recourse.** The Credit Reference Bureau regulations, for example, establish clear guidelines for providers. The IRA and CMA are mandated to, and in practice provide recourse to consumers unable to resolve grievances through provider dispute channels. The other regulators may – with good reason – choose to delegate this function to a future entity with a market-wide recourse mandate.
- **Regulations that clarify provider liability and responsibility for oversight of third-party agents who play a role in service delivery.** The recent Agent Banking Guidelines serve as a model for other sectors in this respect. Ensuring clear provider liability for agents is particularly important in the insurance sector and with the mobile financial service providers. Where liability is limited for practical reasons, it is important that consumers are aware of that limitation.
- **Public reporting of provider performance in basic areas.** The regulators should ensure public disclosure including:
 - A list of providers that are subject to prudential and consumer protection regulations;
 - A description of the regulations including, specifically, the obligations of the providers; and,

¹ FinAccess 2009

- Periodic reporting on individual provider performance against the transparency and internal dispute mechanism rules to which they are subject.

Mobile financial services deserve particular attention, since users number over ten million Kenyans or 54% of the adult population. The number of users and service providers, and the range of services are expanding rapidly. The CBK has guided the sector well in its early phase. Formalizing regulation of these providers is now timely and prudent, to control risks to consumers while ensuring a solid foundation for the industry.

Enhanced consumer awareness and financial education are required for the incremental approach to succeed, since improvements in regulation and industry practices otherwise will not have their intended effect. For now, the 27% of the population that use unregulated providers must rely mainly on their own financial capability to assess providers and products and protect themselves against abusive or unfair practices. Extrapolating from the national survey conducted as part of the diagnostic, for example, just under 1 million adults lost roughly Kshs 31 billion in pyramid schemes (see section 12.3). Informed choice and knowledge of one's rights and responsibilities is also important for users of regulated providers.

Building the nation's financial capabilities is a formidable challenge. The Financial Education and Consumer Protection Partnership (FEPP) already convenes most key public and private sector players and provides a strong vehicle for implementing a credible strategy. Promising pilots are underway. The sector regulators created the Joint Regulators' Task Force with a memorandum of understanding for collective action on awareness and education. The diagnostic identifies a number of key short-term awareness and education priorities directly related to the proposed transparency, fair treatment and effective recourse measures. Although this will be a long-term process, successful pilot approaches can be scaled up rapidly to support core protection issues in the short to medium term.

These first-phase incremental efforts will cultivate the critical mass of political will and practical experience needed to drive development of a comprehensive financial consumer protection legal framework and a dedicated enforcement authority. A new authority of this type would complement the financial sector efforts in three important ways:

- An enforcement agency with a market-wide protection mandate could enforce consumer protection regulation across the entire financial market and thereby cover the clients of otherwise unregulated providers.
- It could address specific practices and products in ways that the more risk-based, prudential regulators typically do not.
- And finally, it could establish a recourse mechanism to function as a check and balance on providers' internal dispute resolution. The authority could also cooperate with the financial sector regulators for consistent market monitoring.

As for implementation, this proposal for incremental improvements leverages the existing capacity of established financial-sector regulatory entities, in advance of creating a new cross-market authority. It mitigates the high risk of regulatory dysfunction when a new regulatory agency is set up to enforce a new law. The sector regulators can lend capacity and credibility to the early stages of this incremental process. And their early success can create impetus for an eventual comprehensive consumer protection regime.

This strategy contemplates a pivotal role for the Ministry of Finance, which is best positioned to engage the financial sector regulators, monitor progress, and guide the policy dialogue. The Ministry is also uniquely positioned to secure the public sector resources required to sustain this effort over time.

Chapter 1

BACKGROUND AND OBJECTIVES

Financial consumer protection is about ensuring a fair exchange between providers and consumers of financial services. A deliberate policy framework is necessary to counterbalance the inherent disadvantage of financial service consumers vis-à-vis the power, information, and resources of their providers. Without a clear policy framework, retail consumers typically find it difficult or costly to obtain sufficient information or adequately understand the financial services or products that they purchase. Well informed and empowered consumers not only protect their own interests, they also provide an important source of market discipline to their financial service providers. They encourage financial institutions to compete on the basis of useful products and services. A comprehensive consumer protection framework can therefore improve efficiency of financial intermediation, build trust in financial systems, and reduce risks to financial stability.²

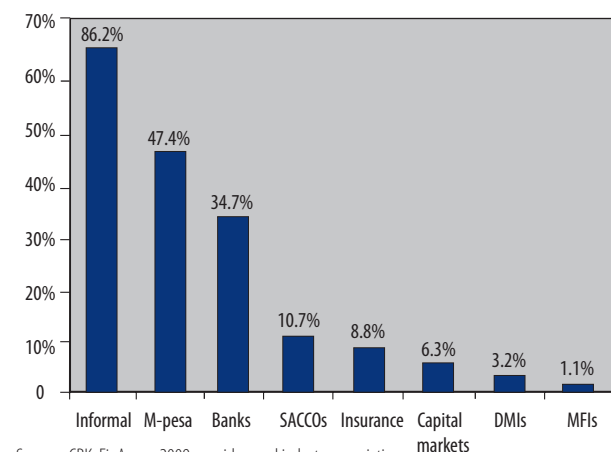
The Government of Kenya's (GoK) Vision 2030 Strategy assigns a critical development role to the Kenyan financial sector. Importantly, Vision 2030 objectives include promoting financial inclusion, increasing the transparency and affordability of banking and other financial services, and increasing competition in the sector to the benefit of customers and the broader economy. It is also noteworthy that the new Kenya constitution includes specific provisions on consumer rights. Legislation will be required to put this into practice and the transitional provisions set out that consumer protection legislation will be required within four years.³

The Ministry of Finance (MoF) has lead responsibility for providing an appropriate policy framework for the financial sector in Kenya. In this role, the MoF collaborates with the Central Bank of Kenya (CBK), the Capital Markets Authority (CMA), the Insurance Regulatory Authority (IRA), the Retirement Benefits Authority (RBA), the Commissioner of Cooperatives, and other stakeholders to provide an adequate regulatory and supervision regime for financial services. This includes a consumer protection agenda that encompasses the collective interest of these stakeholders in improving market conduct and business practices in the financial sector. This agenda has grown out of concerns related to the recent expansion of regulated financial services to large numbers of first-time retail consumers⁴, the large interest rate spread between lending and deposit rates, the exposure of consumers to substantial

losses through pyramid schemes, the introduction of increasingly complex financial products and the blurring of lines between types of financial service providers.

The Financial Education and Protection Program (FEPP)⁵ formed a Consumer Protection Task Force (CPT) to support this agenda.⁶ The MoF and CPT determined that it would be valuable to commission a rapid diagnostic study to identify the main consumer protection issues affecting the Kenya mass market and make recommendations for improving financial consumer protection and education. FSD-Kenya and CGAP joined forces to support this diagnostic effort, fielding a team of Kenyan and international staff and consultants that combined knowledge and understanding of the Kenyan financial sector with expertise in financial consumer protection laws and regulations, competition regulation, banking supervision, consumer research, financial education and financial inclusion. The team prepared this diagnostic report for the MoF and CPT, and consulted closely with these parties over the course of the process, including three formal stakeholder consultations between February and May 2010. The CPT will review this diagnostic report and carry out further stakeholder consultation as needed to finalize recommendations to advance the agenda of improving financial consumer protection in Kenya. The final report will be presented to the Minister of Finance for his consideration of options for advancing the agenda of improved financial consumer protection in Kenya.

Figure 1: Financial services usage by Kenyan adults (est. 18.5 Million)



Sources: CBK, FinAccess 2009, providers and industry associations
[Note that data does not permit easy estimation of the number of unique account holders]

This study focuses specifically on those services most commonly used by “mass-market” consumers, particularly low-income people. In Kenya, this means basic credit, savings, and payment services

² The Nobel Prize winning economist, Paul Krugman, makes a convincing case that a more robust consumer protection regime in the US would have detected the underlying instabilities in the sub-prime housing market that precipitated the 2008 banking crisis, and been able to warn regulators to take timely action. The US is now about to set up a financial consumer protection bureau.

³ The specific reference is as follows: “46.

(1) Consumers have the right:

(a) to goods and services of reasonable quality;
 (b) to the information necessary for them to gain full benefit from goods and services;
 (c) to the protection of their health, safety, and economic interests; and
 (d) to compensation for loss or injury arising from defects in goods or services.

(2) Parliament shall enact legislation to provide for consumer protection and for fair, honest and decent advertising.

(3) This Article applies to goods and services offered by public entities or private persons.

⁴ FinAccess 2009 shows an increase in adult population accessing finance from formal providers (mainly banks) from 18.9% to 22.6% between 2006 and 2009. The M-PESA mobile payments service offered by Safaricom also has brought many new users into the formal system.

⁵ FEPP is a public-private partnership that comprises those public bodies and private stakeholders that are most relevant to improving financial education and consumer protection. The Governor of the CBK is the official champion of the FEPP, and the Financial Sector Deepening Trust-Kenya (FSD Kenya) provides secretariat support.

⁶ CGAP is an independent policy and research center dedicated to advancing financial access for the world's poor. It is supported by over 30 development agencies and private foundations and is housed at the World Bank.

provided by banks, mobile financial service providers, savings and credit cooperatives (SACCOs), and microfinance institutions (MFIs). The diagnostic also includes an examination of services closely associated with these products (e.g., loan repayment or “credit protection” insurance, credit information), to the extent that data were available.

Using data from multiple sources, the diagnostic team estimated the relative use of different service providers by Kenyan financial consumers, so as to focus the analysis on the most important players and issues. The most commonly used services are informal – that is, money-lenders and very small saving-and-loan groups. More than nine million Kenyans use M-PESA and other mobile payment services, and over the past few years the number of users of these services has surpassed the number of bank account holders. Among formal and semi-formal financial institutions, banks serve the most customers, with SACCOs also playing an important role. Penetration into the mass market by private insurance companies, providers of capital markets services, deposit-taking microfinance institutions (DMIs) and credit-only microfinance institutions (MFIs) is relatively limited.

While information was gathered on capital markets, retirement products and other forms of insurance, a detailed review of these other financial services was postponed for future study because of their low penetration rates in the mass market.

Chapter 2

METHODOLOGY

The diagnostic is guided by the basic principle that consumers of financial services are entitled to transparency, fair treatment, and effective dispute resolution and recourse. The diagnostic exercise is a structured analysis of how well this principle is defined in policy and implemented in industry practice. The findings draw from multiple avenues of investigation:

1. Desk research on relevant laws, regulations, codes of conduct, institutions, and previous reports and research⁷ (see Annex 3 for sources);
2. Face-to-face interviews with regulators, supervisory staff, financial service providers and their industry associations, consumer advocacy organisations and researchers (see Annex 4 for the list of persons interviewed);
3. Direct consumer surveys and Focus Group Discussions (FGDs) to understand consumers' own perceptions of their experience with different products and providers⁸; and,
4. Identification of relevant experiences from other countries, with a particular focus on measures to improve transparency, fair treatment, recourse, and consumer awareness and financial education. The analysis also examined the interaction of financial sector laws and regulations with cross-cutting laws and regulations (e.g., to promote competition or consumer protection across the entire economy) in different jurisdictions.

The following chapter provides an overview of findings and recommendations. This is followed by a chapter synthesizing the qualitative and quantitative consumer research (Chapter 4, with the full findings to be found in Annex 2). The detailed gap analysis, findings and recommendations for each sub-sector (e.g., mobile payment service providers, banks, etc.) follow in subsequent chapters by sub-sector (Chapters 5-11). The report concludes with chapters on consumer education (Chapter 12) and cross-market consumer protection legislation (Chapter 13). The focus on mass-market financial services precluded an in-depth examination of some financial sectors and products that warrant further study. The most important areas for future investigation are summarized in the final chapter (Chapter 14). Finally, the annexes include more detailed recommendations for consumer awareness and financial capability interventions arising from the diagnostic's key findings and recommendations. Finally, Annex 1 outlines more detailed recommendations.

⁷ Note that the team did not include local counsel although Kenyan legal experts were consulted in-country on certain key matters and findings.

⁸ Surveys quoted in this report are FinAccess 2009; a survey of 3003 respondents, mainly M-PESA users, undertaken in 2008 by Tavneet Suri and William Jack for FSD Kenya, (FSD Kenya 2008); and a consumer protection survey of 1548 consumers undertaken in March/April 2010 by FSD Kenya and CGAP (FSD Kenya/CGAP 2010). Focus Group Discussions were commissioned for the diagnostic study by FSD Kenya and CGAP, and were performed across each province in February/March 2010 covering 14 focus groups and a total of 112 consumers of various socioeconomic backgrounds. See the final chapter of this report for detailed discussion of the consumer research methodology and key findings. The team also drew on data from recent focus groups commissioned by FSD Kenya examining micro-insurance access and issues.

Chapter 3

HIGHLIGHTS FROM DIAGNOSTIC FINDINGS AND RECOMMENDATIONS

Mass market financial services are growing at an impressive rate in Kenya, generating significant benefits for lower income consumers. Driving this expansion is a broad array of financial service providers. **The financial sector regulators provide some consumer protections to the clients of regulated institutions, but such provisions vary by financial institution type and are incomplete and inconsistent across the market as a whole. There is no general or marketwide consumer protection law or authority, and therefore users of informal financial service providers – 65% of the population – lack legal protection entirely.** As a result of the absence of an entity with market-wide jurisdiction, a comprehensive Kenyan approach to financial consumer protection and recourse has yet to find footing in policy or practice.

A growing body of evidence from consumer research in Kenya suggests that the welfare of consumers is compromised by the lack of effective price disclosure and dispute resolution mechanisms, and by abusive practices.

The findings of this diagnostic confirm a wide range of practice around disclosure of the prices and conditions of different financial services. For example, loan prices are quoted using a bewildering array of pricing formulas. The large number and type of added fees and commissions adds to the confusion for consumers, especially those new to formal finance. The report addresses these variations in practice in detail, by financial service sector (e.g., mobile payment service providers, banks, SACCOs, etc.). **The findings draw attention to the particular importance of improved transparency in mass market financial services.**

Financial services are inherently more complex than most goods or other, more tangible services. On the supply side, providers do not always provide clear information about their products through from the initial marketing and sales process to actual delivery of the service. On the demand side, many consumers that are new to formal finance and are challenged to learn a very different set of rules and structures from those used by the informal arrangements with which they are familiar. They find it difficult to comprehend the prices, key terms and conditions, and all the other details of formal contracts. This demand-side challenge is exacerbated when more than half of mass market consumers have limited numeracy skills.

In these circumstances, consistent and effective disclosure is a necessary preventive measure. It can reduce up-front the types of confusion that can easily lead to problems – problems such as misunderstandings about prices, consequences of late payments, or conditions for payment of insurance claims. Standardisation of wording and formats also merits further investigation. When financial access is growing rapidly, as in Kenya, consumers should be able to learn a single set of rules of the game, rather than having to wrestle with different disclosure formats for different providers and products.

The importance of readily accessible recourse and dispute resolution mechanisms emerged as a second priority from the diagnostic findings. Given the growth in access to finance and the number and diversity of providers and products, it is inevitable that some consumers will experience confusion or problems in the normal course of business. Consider that M-PESA customers conduct a total of 650,000 transactions per day, on their handsets and/or interacting with an agent. This suggests that in the mass market in particular, **dispute resolution mechanisms need to be built into daily operations so that providers can address consumers' questions and complaints quickly and efficiently.**

The diagnostic research reveals two aspects of fair treatment that raise concerns. First, consumers relate some specific experiences with abusive practices that result from incidents of fraud or carelessness on the part of provider staff. Second and equally important, consumers express anxiety about their experience with some industry practices such as that merit closer oversight than they now receive.

Consider, for example, the outsourcing of credit collections in banking and other sub-sectors. **Outsourced collections itself is not inherently abusive, but the collections process offers ample opportunity for abuse, and those opportunities increase when the behaviour of third-party debt collectors and auctioneers is not adequately supervised by the service provider or the sector regulator.** This is where consumer experience research can be particularly useful. Focus Group Discussions consistently revealed abusive collections practices and cases where those involved had no idea of their rights and whether what they were experiencing was appropriate or not. After seeing these FGD results, the team was particularly interested in seeing quantifiable figures from the consumer survey about how many respondents experienced these practices and concerns. However, the survey results showed very low incidence of abusive collections, in contradiction to the FGD evidence. Given the breadth of the FGDs across regions and communities, the team suspects that the discrepancy could be due to a disinclination of respondents to share their experiences in a short, impersonal survey but more willing to discuss these experiences and concerns in a supportive group setting. This would suggest that the FGD results could have more validity than those of the consumer survey. Closer investigation of actual practices by third-party debt collectors is also advisable.

This document presents the components of an incremental path to a comprehensive financial consumer protection regime in Kenya. The first phase consists of practical and pragmatic solutions that address the most immediate priorities and can be implemented under the existing mandate and oversight of the financial sector regulators. The rationale for this approach is based largely on practical considerations. The financial regulators currently have the strongest legal authority and technical capacity to introduce basic directives for providers in their respective sectors. And

significantly, some of the regulators have established regulations that can be adapted by their counterparts to create a harmonized regime of directives.

The key recommendations to improve consumer protection for mass-market financial consumers in Kenya relate to the following areas:

- **Minimum disclosure requirements for pricing and plain language in contracts.** The CBK is well advanced in its review on interest rate disclosure guidelines, and the IRA is engaged with the insurance industry in the development of standardized, plain language policy wording in contracts for various insurance products.
- **Regulations that clarify provider liability and responsibility for oversight of third party agents who play a role in the delivery of services.** In this respect, the recent Agent Banking Guidelines serve as a model for other sectors. This is particularly important in the insurance sector and for mobile financial service providers.
- **Minimum requirements for provider-level recourse and dispute resolution mechanisms.** Banks for instance do not have minimum standards for an industry-wide dispute resolution mechanism, whereas the Credit Reference Bureau regulations and agent regulations each establish clear guidelines. The M-PESA customer care story described in the diagnostic report illustrates how consumers are able to protect themselves when recourse mechanisms are simple and consistently executed.
- **Independent third-party recourse mechanisms beyond the provider level.** The IRA, RBA and CMA are mandated to, and in practice do, provide recourse to consumers unable to resolve their grievances through the provider dispute channels. However, other regulators may – with good reason – choose to delegate this function to a future entity with a sector or market-wide recourse mandate.
- **Public reporting of provider performance in basic areas of consumer protection.** The regulators can ensure public disclosure of:
 - A list of all providers that are subject to prudential and consumer protection regulations;
 - A description of the regulations including, specifically, the obligations of the providers; and,
 - A periodic report on the performance of individual providers against the transparency and internal dispute mechanism regulations.

Consumer education is an equally important component of this incremental approach. Armed with clear information about products and their rights and responsibilities, consumers can be the best watchdogs for financial consumer protection. And for the 65% of the population that use the services of unregulated providers, improved financial capability may be their most effective protection, even under the best of regulatory regimes. The financial sector regulators have created the Joint Regulators' Task Force with a

memorandum of understanding that commits them to concrete, coordinated action to improve consumer awareness and financial capability. The Financial Education and consumer Protection Partnership (FEPP) has already brought together most of the key players in Kenya from the public and private sector and provides a strong forum through which to develop and implement a credible strategy to reinforce collective action by the regulators.

The basic assumption of the incremental approach is that the first phase efforts will eventually cultivate a critical mass of political will and practical experience sufficient to drive the development of the second phase which would involve a comprehensive financial consumer protection legal framework including a dedicated enforcement authority.

The report also examines options for creating cross-market consumer protection legislation, and explores experiences from other countries for lessons that might inform policy choices in Kenya. An eventual cross-market regime will complement the sectoral efforts in three important ways:

- **The authority can enforce consumer protection regulation across the entire financial market and thereby cover the clients of otherwise unregulated providers.**
 - An enforcement agency with a market-wide consumer protection mandate can address specific practices and products in ways that the more risk-based, prudential regulators typically do not.
 - And an independent authority can establish a recourse mechanism that functions as a check and balance on the internal dispute resolution mechanisms of providers. This authority can also cooperate with the sector regulators to ensure consistent market monitoring.
- **Putting in place a cross-market consumer protection regime will yield another important benefit. It will facilitate consumers learning a single set of rules as the basis for their interaction with financial services providers.** Especially if simple and consistent disclosure requirements are implemented, consumers will be in a better position to understand pricing and conditions, avoid risks, report abuse, and resolve disputes with their financial services providers.

This in turn could play a key role in making financial markets work more efficiently, fairly and competitively.

Chapter 4

SUMMARY OF CONSUMER RESEARCH RESULTS

The diagnostic process included direct input from consumers through Focus Group Discussions (FGDs) and a national survey. These provided both a qualitative and quantitative understanding of consumers' usage of different products and service providers and their experience of consumer protection problems in the marketplace. Analyzing consumer experience was an important component of the diagnostic, as it permitted verification or rejection of assumptions regarding the most common or problematic abuses. It also helped assess the effectiveness of existing measures in protecting consumers or increasing their financial capability.

Consumer experience with financial services was measured through two tools:

- A series of FGDs commissioned by FSD provided a well-rounded understanding of consumer protection issues in the mass market. A total of 112 consumers from different provinces and of varied socioeconomic backgrounds were brought together into 14 separate FGDs conducted in February–March of 2010. The qualitative picture offered by the FGDs tested consumer protection priorities that had emerged from the early 2010 desk research and key informant interviews. It helped the team determine which questions to ask in the quantitative survey and how to ask them. The FGDs also provided valuable insight into the perspectives and knowledge of consumers around financial products and their rights as consumers.
- An FSD-commissioned quantitative survey (carried out by Synovate, with expert advice and analysis from Daryl Collins) gauged the experience of 1548 adult consumers with savings, loans, insurance, mobile payments, informal services and pyramid schemes. The survey also sought to assess respondents' financial capability and awareness of and response to measures intended to extend protection. The initial sample of 1000 was

selected proportionate to population size across provinces and districts. An additional 548 consumers were surveyed to ensure a minimum of 50 respondents for each financial instrument. This booster sample was necessary when a population-representative sample did not provide a sufficient number of respondents in certain product categories, such as long-term savings. As a result, the final sample reflects a population that is more engaged in the formal financial sector than the nationwide population.⁹

4.1 INFORMATION AND KNOWLEDGE ABOUT PRODUCT FEATURES AND PRACTICES

Obtaining information about diverse financial instruments appeared to be relatively easy. On average, 66% of survey respondents reported it was “very easy” to find information on different types of products and their charges and penalties across a range of formal and informal financial providers. Overall, FGDs revealed a surprisingly high awareness of issues such as the Central Bank issuing licenses, knowledge about the banking act and use of correct financial terms.

However, there was a lack of clarity about practices in banking. FGDs revealed some doubts amongst users as to whether their money was really safe in financial institutions, even in banks and SACCOs. In the words of one man from Ahero “... *at the end of the day, we don't know if our money is safe.* ...”

Respondents were also uncertain about available options for recourse, and were often unsure whether their specific problem had a legal basis or not. Furthermore, the recourse systems in place did not appear to be easy to use or timely, as many participants shared stories about seeking redress that ultimately required hiring a lawyer. Together, the FGDs reveal some weakness in both transparency and financial capability at play in the banking sector.

Table 1: How easy is it to get information about charges or penalties for each of these different savings products? (1 = very easy; 5=very difficult)

Difficulty rankings:	Bank savings	MFI	SACCO	ASCA	ROSCA / Merry go round	Across all financial institutions
1 (very easy)	54%	61%	63%	79%	81%	66%
2	28%	29%	28%	16%	15%	23%
3	9%	6%	7%	3%	2%	6%
4	6%	3%	2%	0%	0%	3%
5 (very difficult)	1%	1%	0%	0%	0%	0%
Refused/did not know	2%	0%	1%	2%	2%	2%
Number of respondents	949	238	303	266	723	2479

⁹ In FSD Kenya's FinAccess 2009 survey, for instance, only 12% of respondents are dependent upon financial remittances, compared to 21% in the 2010 national sample. Similarly, the survey contains an urban bias, with a rural-urban split of 63%-37%, compared to 79%-21% in the national sample.

4.2 SAVINGS

According to the consumer protection survey, 59% of the sample had a bank savings account, 20% had a SACCO account, 15% had an MFI account, 17% were members of an ASCA and 47% were members of a ROSCA merry-go round.¹⁰ Of those that had such savings devices, between 7% and 11% of respondents said that they had lost money in them. Of those that had lost money, 33% blamed the charges and penalties for “eating away” their money, although many also claim to have lost money when the institution closed down (21%), when money was misappropriated (12%) or there were errors in records (27%). Misappropriation of money was more prevalent with informal instruments such as ASCAs (56%) and ROSCAs (51%) than formal financial institutions.

Table 2: Respondents who say that they trust their savings instrument to keep their money safe

Type of institution	Bank savings account	SACCO	MFI	ASCA	ROSCA/ Merry go round
% responding yes	97%	93%	93%	92%	92%

Although banks are the most trusted savings vehicle among respondents (see Table 2), it is surprising that even 7% felt that they had lost money using them. This may be connected to unexplained charges, as banks were also the institution where users felt that charges, interest and penalties were least clearly explained. As Table 3 shows, nearly 12% of bank users felt charges, interest rates and penalties were not clearly explained compared to much lower percentages in other financial devices. As a man from Eldoret describes “The banks are doing very little to inform the public about the charges. They only talk about the advantages. . . Just like Bata would tell me a certain shoe is Kshs 399, I would prefer if it was Kshs 600 with all the charges involved in that.”

When questions or concerns did arise, 91%-93% of all users had their issue resolved after contacting the institution. However, between 5%-7% of users did not receive a satisfactory response after contacting the institution.

Table 3: Were the charges, interest and penalties explained clearly?

Type of institution	Bank savings account	SACCO	MFI	ASCA	ROSCA/ Merry go round
% responding yes	97%	93%	93%	92%	92%

¹⁰ These numbers are higher than those in the FinAccess 2009 survey, indicating that the consumer protection survey covered a population with more access to different types of savings products than the overall Kenyan population. Only 24% of the FinAccess respondents said they had a bank account, with 9% for SACCOs, 3% for MFIs, 8% for ASCAs and 32% for ROSCA merry-go round.

As a woman from Naivasha describes “There are times you might check your balance only to realize that they have made some deductions. When you inquire about it, they tell you to come back the following week. They might return the money and sometimes they might say they have no idea what happened to the missing money.” All of this evidence suggests that there could still be room for improvement in transparency and information.

4.3 LOANS

Respondents received loans from a variety of formal and informal institutions, including banks (10%), SACCOs (9%), MFIs (11%), ASCAs (8%), informal moneylenders (2%), employers (1%), through hire purchase (3%) and from local shop keeper credit (22%).¹¹

As Table 4 shows, not all users received a written loan agreement. While this is expected from an informal lender, only 93% of bank borrowers and 95% of SACCO borrowers said they had received a written agreement. Of those that did receive a written agreement, most but not all were able to take it away to study it before signing.

However, many were still pressured to sign the agreement immediately, even in formal institutions such as banks (10%), MFIs (10%), SACCOs (14%) and hire purchase (10%). Finally, many still found it difficult to completely understand loan documents. As one man describes “I have never understood why where you need to sign is in a bigger font and is not a headache but where they have their key information it is like seven pages but when you look at it, it is too small and repeated and it discourages you.”

Those who had taken a loan or credit often were required to offer some type of collateral. In 42% of cases, this involved the rights to a home or other asset; in 45%, this involved someone signing surety (i.e., providing a guarantee); and in 7%, the lender withheld the borrower’s ATM card and pin number, which is a highly improper lending practice that warrants further investigation. As Table 5 shows, most respondents also reported that loan terms were explained to them and many seemed aware in focus groups about what hidden charges could arise in loans, mentioning insurance, registration fees, standing order fees, negotiation fees, stamp charges and loan processing fees. Practically speaking, however, many respondents still found it difficult to completely understand loan documents and many were surprised by how much is actually charged for loans. About 6-9% of those surveyed reported that they were surprised after taking the loan by how long and how much they needed to pay after taking out a loan. Finally, FGD evidence suggests that repossession and auctioning off of goods appear to be the norm in instances where the user defaults on a loan. As one woman described “There was a person here in

¹¹ These numbers again reflect greater access to loans among the sample group than the FinAccess 2009 results would suggest. FinAccess respondents had received loans from banks (2.6%), SACCOs (3%), MFIs (1.8%), ASCAs (1.8%), informal lenders (0.4%), from employers (0.5%), through hire purchase (0.1%) and from local shop keeper credit (24.3%).

Table 4: Respondents who received a written loan agreement

	Bank loan	SACCO	MFI	ASCA	Shylock, money lender, or shopkeeper	Employer	Hire purchase
% responded yes	93%	95%	100%	77%	41%	80%	92%

Table 5: Did someone explain the terms of the loan before you signed?

	Bank loan	SACCO	MFI	ASCA	Shylock, money lender, or shopkeeper	Employer	Hire purchase
% of those with loan that responded yes	94%	93%	97%	97%	97%	83%	100%

Table 6: Once you started paying the loan were you surprised by how much you needed to pay, or how long you needed to pay for?

	Bank loan	SACCO	MFI	ASCA	Shylock, money lender, or shopkeeper	Employer	Hire purchase
% of those with loan/credit who responded yes	9%	8%	9%	6%	0%	0%	0%

Nyamithi who was unable to pay for the loan so (the MFI) went to their place to get the things so they could auction them. On hearing that since the person also owed (another MFI) some money they also decided to go to the home. So both groups met and took everything.” This was consistent across semi-formal and formal lenders.

4.4 INSURANCE

According to the consumer protection survey, 26% of respondents held life insurance, 3% medical insurance, 6% house-building or contents insurance and a negligible percentage auto insurance.¹²

Most FGD respondents did not have experience with insurance. Among those that did, the experience was often not positive. Most complaints that surfaced in the FGDs centered on salespeople not clearly explaining the products, resulting in users not receiving the package they had envisioned. As one man

from Mombasa explained “It is like they used anyone to sell insurance and they don’t know the products, so you sign for product and then when the policy comes you find that it is totally different.” As Table 6 shows, 13% of insurance users said the details were not explained in writing and 11% said they did not understand the details of the insurance, in terms of how much would be paid and what was and wasn’t covered by the policy. 17% reported that they felt pressured to sign right away. In one case, a man from Mombasa reported in a FGD that an insurance agent managed to sign him up for a policy he did not authorize and that he was only able to have the debit order reversed and his money refunded after hiring a lawyer. Finally, insurance users also reported that making claims was far from easy, with 26% of survey respondents saying that their claims were not processed quickly.

Table 7: Experiences of insurance users

	Were the details explained to you in writing?	Did you understand the details of the insurance?	Were you able to take the agreement away with you before	Have you made a claim?	In your opinion, was the claim processed quickly?
Yes	87%	89%	74%	19%	74%
No	13%	11%	17%	81%	26%
Total	194	190	191	457	86

¹² The share of 2010 survey respondents with life insurance was significantly higher than in the FinAccess 2009 results, where 1% of respondents had life insurance, 4.9% had medical insurance, 0.2% had house-building or contents insurance and 1.1% had auto insurance.

4.5 LONG TERM SAVINGS: INVESTMENTS, PENSIONS, RETIREMENT ANNUITIES

As shown in Table 7, very few respondents had long term investments.¹³ Of those that did have investments, many respondents reported that they were promised a certain return from a salesperson (25%), pressured to make an investment (14%), or were left without written documentation on the terms of the product (32%). When asked if she thought to complain in such situations, one woman noted “We did not know where to complain, the broker I used went under.”

Table 8: Respondents with various forms of long term savings

	Education Savings policy	Retirement annuity	Pension or provident fund	Investment portfolio, shares, or bonds
Number of respondents	63	52	46	113
% of respondents	4%	3%	3%	7%

Qualitative and quantitative data also show that there is a lack of adequate information about pensions. In FGDs, many respondents reported that they were unsure of whether or not they were receiving pensions. As Table 8 shows, 17% of the sample said they would receive a pension when they retired, but 12% were unsure and 69% said they would not. Of those that think they are receiving pensions, 21% felt uncomfortable asking their employers about it. This lack of clarity carries through to retirement payments. Of those who were receiving pensions at the time of the survey, 12% said they received less than they had expected and 4% said they were unsure whether they had received the right amount.

4.6 MOBILE PAYMENT SERVICES

Mobile money services like M-Pesa, Zain/Zap and Yu have become a central aspect of people’s financial lives. The consumer protection survey recorded that 84% of respondents have used a mobile money service.¹⁴ Quantitative data from the consumer protection survey shows just how popular mobile payment services are – 5% of all respondents claimed to use a mobile payment service every day, 33% at least once per week, 38% at least once per month and 24% once in a while. FGD participants also reported feeling safer using M-Pesa than having to walk around with cash. One woman from Naivasha describes the story: “The other day (a friend) was hijacked and they stole Kshs 17000 from her. But she got the money on the phone though they took the phone. She got the Kshs 5000 which was on her phone since she had blocked her M-Pesa account.”

¹³ FinAccess 2009 recorded that 1% of the population has an education savings plan and 2% have a pension or retirement plan.

¹⁴ This is significantly higher than the 40% reported by FinAccess 2009.

FGD findings suggested that M-Pesa charges were quite clear – for example, most respondents knew the charge to send and receive money. This contrasted somewhat with survey data, where 16% of users felt that charges were not clearly explained before starting to use the service. Moreover, although mobile payments are widely used, over 36% of users reported problems. As Table 9 shows, 22% have had a problem when there was no cash at the agent, 11% of users have made a mistake and sent money to the wrong account and 3% of users have had problems with either receiving money or having their recipient not receive money.

Table 9: Respondents who have used a mobile payments service

	Have you used a money transfer service like M-Pesa, Zain, etc?	Whose phone did you use?		
		My own phone	Phone of family or friend	Agent’s phone
Number of respondents	1,293	1137	131	33
% of respondents	84%	73%	8%	2%

M-Pesa users were very clear about what to do when problems arose and overwhelmingly reported that problems were resolved quickly. FGD participants were even able to recite the telephone number of customer care at M-Pesa, and many respondents noted that even when money was sent to the wrong person, it was often easy to recover the money. A man from Mombasa

Table 10: Problems users have had with mobile payment service

Problem (n=1,293 who’ve used mobile payment services)	No.	Percent
No problem	792	61%
You made a mistake; Sent to wrong account	136	11%
Payment you made wasn’t received (no error)	39	3%
Never received money	45	3%
Money not in MP account	7	1%
Robbed	7	1%
No cash at agent	279	22%
Network failure	99	8%
Couldn’t directly deposit money into another’s account	1	0%
I don’t have an account, so agent didn’t transact	2	0%
Entered wrong agents’ number when withdrawing money	1	0%

told us “I sent the money to the wrong number and luckily the person I had sent to had not withdrawn so they had to reverse . . . the reversal takes 72 hours.”

Table 10 shows the length of time it took to resolve problems.

Table 11: How long did it take to resolve the problem?

	Percent
Right away	61%
Within a day	11%
Within one month	3%
Total	3%

4.7 PYRAMID SCHEMES¹⁵

A very large number of respondents were approached about joining a pyramid scheme. At least one participant in every focus group had been a victim of a pyramid scheme, or had someone close who had fallen victim. Forty four percent of survey respondents reported that they had been approached to invest in a pyramid scheme. While the survey suggests that most of them ultimately did not invest – only 8% of those who reported being solicited – this figure may be low as participants might have been unwilling to self-report being fooled. The average loss reported was around Kshs 34,000 (US\$425). As one man from Kisumu explained “Most of the people (who lost money through a pyramid scheme (in which he was involved) were too ashamed to come up and say they lost a lot of money in such kind of things. . . .Most have gone to the court but the biggest percentages have just stayed behind sitting quietly and grinding their teeth....”

Table 12: Number of respondents approached about a pyramid scheme and invested

Approached about entering a pyramid scheme	Investing money in a scheme
44%	8%

There was little recourse for those who lost money. Of the victims, 22% did not complain because they did not know who to complain to and 40% did not complain because they did not think it would do any good. Most FGD participants who had been taken advantage of reported that they were too ashamed to admit having participated in a pyramid scheme.

Table 13: Did you complain to anyone, if you lost money?

Response	Percent
Yes	38%
No - wouldn't know who to complain to	22%
No - it wouldn't do any good	40%
Total	100%

¹⁵ Note: the statistics in this section report on survey data that have been weighted to be population representative.

Chapter 5

MOBILE FINANCIAL SERVICE PROVIDERS

5.1 SERVICE PROVIDERS

This sector is led by Safaricom's M-PESA, which pioneered the provision of mobile phone-based financial services in Kenya in March of 2007. M-PESA dominates the market, but the CBK has approved the launch of two competitors, Zain's Zap service and Essar Telecom Kenya's YuCash. The CBK reports a considerable volume of inquiries from other companies keen to launch similar services.

5.2 CONSUMERS AND THEIR EXPERIENCE

Safaricom's M-PESA has developed the largest customer base of any financial service provider in Kenya. At the end 2009, M-PESA reported 8.8 million customers, which is 65% of the estimated adult population. Moreover, M-PESA subscribers use the service frequently. In the 2010 FSD survey, 33% of users reported they used the service at least once a week, while 5% of users said they used it daily. Together, M-PESA subscribers were conducting over 650,000 transactions a day at the end of 2009.¹⁶ The value of person-to-person transfers alone was around KShs 25 billion (US\$337.8 million) per month.¹⁷ Zain reported 400,000 subscribers at the end of 2009.

M-PESA's investment in creating an agreeable customer experience is readily observable, and M-PESA customers are generally happy. 81% report M-PESA "easy to use" and 95% rate their happiness level at 7 out of 10 or higher.¹⁸ Interestingly, even those customers who have mistakenly sent money to the wrong recipient and lost money are only slightly less happy than the average user. The picture that emerges is that consumers feel in control of their money when using the service. However, subscribers do encounter problems. For example, on a daily basis, customers send money to the wrong party by entering the wrong phone number and not all of them are able to recover these funds. And given the volume of transactions and the fact that millions of customers are interacting with over 17,000 agents, it is not surprising that there are some cases of misunderstanding and agent fraud.

There have been several independent surveys of MPESA customers since 2007 that quantify unsatisfactory customer experiences. The overall survey results suggest that M-PESA customers appear to tolerate most of these as acceptable inconveniences, however, largely because customers are confident that they will be able to resolve problems in reasonably short order. While this reflects well on M-PESA's performance to date, it also underscores the importance - and challenges - of a robust approach to transparency and recourse mechanisms in mobile financial services.

5.3 LEGAL, REGULATORY AND SUPERVISION FRAMEWORK

In Kenya, mobile financial services have evolved in a largely undefined regulatory space. The CBK has been informed and watchful, and has provided oversight and deliberate guidance from the very beginning of the industry. The relationship between the CBK and M-PESA has evolved through willing collaboration and innovation in an entirely new domain in financial services. In this context, the CBK and M-PESA have addressed emerging challenges in introduction of mobile payments services as well as consumer protection that have attracted international interest and recognition. However, the consumer protection measures that exist are as yet not codified in law or regulation in the industry.

This situation arises from the broader legal and regulatory framework for MFSPs. Kenya has no laws or regulations that address specifically the activities of non-bank companies that offer mobile financial services. The CBK has taken the view that these activities are not covered under the legal definition of "banking business" as long as the MFSP does not place the subscribers' funds at risk and does not earn interest on the funds. As a safeguard, however, CBK exercises full supervisory oversight over the trust accounts for mobile financial services providers which are held at commercial banks. By mutual agreement with the CBK, the M-PESA float is held in trust by commercial banks. This effectively sequesters the float and protects it against any eventual financial failure of M-PESA. This also precludes M-PESA from earning the interest on the float. Consequently, the CBK Banking Supervision Department exercises no formal licensing or regulatory authority over M-PESA as a non-bank MFSP.

The CBK does have a broad mandate to "formulate and implement such policies as best promote the establishment, regulation and supervision of efficient and effective payment, clearing and settlement systems."¹⁹ Acting on this mandate, the National Payment System Division (NPSD) of the CBK has provided oversight to M-PESA and the other MFSPs. As noted previously, the NPSD's oversight of the MFSPs has been based largely on moral suasion and mutual cooperation. The NPSD does not issue regulations for the MFSPs and does not have the authority to inspect them.

It is important to note that NPSD oversight is focused mainly on the integrity of the information technology platform and the service delivery systems. In this regard, the NPSD adheres to a traditional interpretation of Bank of International Settlement standards for payment systems oversight. Consistent with those standards, the NPSD stresses the importance of evaluating the operating capacity and technology platform during the approval process, and monitoring transaction flows and operations on a continual basis. The NPSD also watches that the mobile services do not evolve over time into banking services, particularly credit and savings.

¹⁶ CBK National Payment System Division

¹⁷ Customer and transfer volumes generated from M-PESA reports.

¹⁸ All of the following customer experience data comes from the results of a survey published in *Mobile Payments in Kenya: Findings from a survey of users, agents and operators*. CGAP and FSD Kenya, 2009.

¹⁹ Section 4A (1) (d) of the Central Bank of Kenya Act.

The NPSD asserts that its focus on these areas provides a basic foundation for consumer protection. System oversight protects customers from operational failures, and the trust arrangement protects consumers against financial failure of the MFSPs. While systemically and operationally sound, this approach to oversight does not typically address all areas of transparency, fair conduct and recourse with formal instruments of regulations and enforcement.

All of the MFSPs in Kenya are owned by mobile telephone operators and are licensed by the Communication Commission of Kenya (CCK), which regulates the sector with the Kenya Communications Regulation of 2001 under the authority of the Kenya Communication Act of 1998.²⁰ The CCK has been willing to license MTOs to carry out mobile financial services as long as they list the service in their license agreement.²¹ In 2008, the CCK created a Consumers Affairs Division. In May of 2010, the CCK issued the Kenya Information and Communications Consumer Protection Regulations. The regulations are recent and untested but they do represent the most comprehensive set of consumer protection regulations issued by a regulator in Kenya.

Kenya example: The Kenya Information and Communications Consumer Protection Regulations

The regulations outline the rights and responsibilities of consumers and contain specific provisions that define the obligations of service providers related to complaint handling, information disclosure, billing practices, data privacy, and other issues. The rules also require service providers to submit for approval a commercial code of practice that defines the service provider's policies and procedures related to compliance with the provisions.

5.4 GAP ANALYSIS

In the particular case of the MFSP industry, it is very important to distinguish between the state of regulation and the state of practice. As already noted, neither the regulations nor the authority to regulate the sector are formally established in law. The CBK and the MFSPs have worked under the understanding that the regulatory structure of the industry will be clarified in the future with the expected passage of the National Payments Bill 2010 and subsequent regulation. In the meantime, the MFSPs, M-PESA in particular, have developed their respective approaches to disclosure, fair conduct and dispute resolution with deliberate but nevertheless informal guidance of the CBK. Noteworthy aspects of this evolving consumer protection practice are treated below. However, it is also important to note that the lack of formality in the currently regulatory framework also has implications for consumers.

The MFSP sector, driven by rapid advances in technology and sustained uptake by the massive mobile telephony subscriber base, is evolving in ways that will become increasingly problematic in the absence of more formal and comprehensive legislation and regulation. The regulatory authorities will be challenged to maintain consistent application of policy as the sector becomes populated with new entrants with different products, systems and capacity. At the same time, consumers are already adapting the M-PESA service to uses that exceed the current regulatory definition of the MFSP channel. For example, 38% of subscribers in 2010 claim to be using M-PESA to store value for a short time.²² This is similar to the way a bank customer uses a current account. Moreover, other supporting service providers in the value chain are building and deploying new services based on the M-PESA platform. Banks, for example, are linking physical bank accounts with the “virtual” M-PESA mobile accounts. Zain is also enabling providers to link subscribers’ e-wallet accounts to their bank accounts. All of these developments are signs of a dynamic industry that has significantly extended the reach of financial services to the mass market. However, the risks of system problems, performance issues and even company failures will likely increase, with negative implication for consumers, unless the regulatory framework keeps pace with the rapid evolution of the industry.

5.4.1 Transparency

M-PESA’s experience with pricing disclosure reveals some of the complexities of consumer protection measures in this area. M-PESA has one of the most transparent pricing schedules of any financial service provider in Kenya. The company expends significant effort to ensure that customers have access to consistent pricing information at the time of inscription and at every agent’s place of business.²³ In the FSD/CGAP 2010 survey, 84% of mobile money users said that the charges and penalties were clearly explained to them, and most users said that it was very easy to get information about the charges. This is an improvement over the FSD 2008 survey, in which only 72% of subscribers claim to understand the tariffs. In the same survey, 76% of users who sent remittances could answer correctly what tariff they would pay, whereas only 57% of receivers could answer correctly what tariff they would pay.

This raises interesting questions about how to assess the effectiveness of pricing transparency regulation. M-PESA has a readily observable track record of publishing its tariffs and supporting multiple, third-party customer surveys. While there may well be room for improvement in M-PESA operations, the gaps in consumer awareness and understanding of the tariffs are perhaps not surprising in light of financial literacy issues documented by other research. M-PESA agents explain that most customers only make transactions in the lower two tariff tiers and therefore don’t pay attention to other parts of the tariff structure. Some agents also explain that many subscribers simply avoid

²⁰ Amended by the Kenya Communications (Amendment) Act of 2008.

²¹ According to Section 2(1) and Section 34 of the Kenya Communication Act, mobile banking falls under the definition of a telecommunication service.

²² FSD Kenya/CGAP Consumer Survey 2010

²³ M-PESA contracts a private firm to monitor agent compliance with company specifications for display of tariff sheet and other operating procedures.

some of the M-PESA services, such as mobile top up, for example, because they don't want to bother with something that looks complicated to them. Financial services and terms tend to be inherently complex. The 2009 FinAccess study found in fact that many consumers are challenged in fully understanding financial concepts and characteristics of formal financial services: only about 37% of respondents could correctly solve basic numeracy problems. It is not easy to make pricing understandable to mass market consumers. Broader consumer education efforts can help.

5.4.2 Fair treatment

While M-PESA users that participated in the 2010 FSD/CGAP survey reported an array of problems, as indicated earlier their overall level of satisfaction was generally high. Twenty-two percent of users reported at least once experience with agents not having enough cash, 3% reported not receiving money sent to them and another 3% reported sending a transfer that did not arrive to the intended recipient. The most common customer error is sending funds to the unintended recipient, reported by 11% of FGD user-respondents. Each of these respondents reported that they ultimately recovered the money.

Survey participants also commented on their fears about new frauds. Levels of fraud and abuse are low, but they do exist. M-PESA reports that it handles about 50 cases a month of fraud, most of which are customers defrauding customers. M-PESA also deals with agents defrauding customers and claims to have recourse channels. For its part, the NPSD claims to monitor fraud incident reports. Neither entity publishes reports on this activity so all information about the recourse channels is gathered from interviews with M-PESA and NPSD staff.

The liability of the MFSPs for their agents is a matter that deserves legal and regulatory clarification. The NPSD reports that it reviews and approves the agreement between the MFSPs and their agents. However, since its launch, M-PESA has asserted in its customer contract that M-PESA bears no legal responsibility for its agents, and that in fact M-PESA agents are not legal agents of the company. (There is open speculation in the industry that this assertion would not stand up in the court of law.)

Kenya example: M-PESA monitoring of agents

The regulations outline the rights and responsibilities of consumers and contain specific provisions that define the obligations of service providers related to complaint handling, information disclosure, billing practices, data privacy, and other issues. The rules also require service providers to submit for approval a commercial code of practice that defines the service provider's policies and procedures related to compliance with the provisions.

In practice, M-PESA does manage these agents with rules of conduct and with procedures for resolving consumer complaints against agents. However, the assertion that M-PESA bears no responsibility for the agents that deliver core aspects of the service sets a troublesome precedent in the market. In a long term view, M-PESA's current practice of claiming legal exoneration for agents' actions, if upheld, could evolve into an industry-wide practice with perverse incentives and negative outcomes for consumers. For example, other MFSP market players might choose to attend to customer queries and complaints or oversee their agent network with less care than that demonstrated to date by Safaricom; competitive pressures could, in turn, undermine incentives for more responsible practices.²⁴ Establishing clear provider liability for the actions of agents in delivering mobile payments services would avoid this "race to the bottom" scenario.

5.4.3 Dispute resolution

M-PESA provides customer service through its agents, its stores, and through the telephone help line, the number for which is published on almost every poster or brochure that a customer sees. As discussed above, customers do experience difficulties with their M-PESA accounts, and they do make use of these channels to correct problems. There is some evidence that subscriber understanding of their internal problem resolution options is increasing. The FSD 2008 M-PESA survey reported that 75% of users did not know how to access customer service. Yet in the FSD/CGAP 2010 FGDs, participants were ubiquitously clear how to resolve problems ("You call customer care") as well as conveying a clear sense of how long it will take for the problem to be resolved ("72 hours"). Moreover, the same survey showed that 92% of problems are resolved within a day. In February 2009, Safaricom reported fielding 17,000 calls per day on the M-PESA help line. More recent data reflects even more frequent use of the customer care line. Safaricom has also launched a state of the art call centre to scale up its customer care operations. In sum, it appears that consumers are quickly learning to access customer care to get their problems resolved.

Unfortunately, M-PESA does not publicize the recourse options for lodging complaints against agents with the same clarity or ubiquity as the pricing structure or customer service channels. M-PESA claims to intervene on customers' behalf in complaints against agents, nevertheless. And M-PESA does employ systems that allow for dispute resolution. Agents are required to enter every transaction into the daily logbook. This is an otherwise cumbersome procedure that provides a basis for resolving disputes between agents and customers.

²⁴ See discussion on agent liability in CGAP Focus Note 64, "Protecting Branchless Banking Consumers: Policy Objectives and Regulatory Options," 2010.

5.5 RECOMMENDATIONS

The broader regulatory framework for the mobile financial services industry will no doubt evolve and take definite shape through enactment of the National Payment Systems law. Fundamental decisions about who will regulate the non-bank MFSPs and the scope of their activities will have a profound effect on consumer experience and protection. In the meantime, the CBK does have the option of issuing regulations to govern the aspects of the industry directly related to the basic consumer protection domains of transparency, fair conduct, and recourse. The following list of priorities is meant to inform the deliberation around those regulations.

- Issue regulations on the basic licensing requirements, technology capacity required to ensure safe and sound mobile financial service operations, and float management.
- Tariff structures will be easiest for agents to explain and customers to understand if basic conventions are used across all providers. M-PESA and ZAIN have already set a very solid benchmark for industry practice and this could be translated into regulation in a way that is flexible but that guarantees a minimum level of tariff transparency.
- The regulations on agent banking could be translated into a similar regulation for the mobile financial service industry. This would clarify the responsibility of the MFSPs for the actions of their agents in delivering mobile payments services. Such rules should be developed in close consultation with industry, to ensure that their costs and enforcement arrangements are proportional to the risks involved.
- Minimum requirements for establishing recourse mechanisms, making consumers aware of them, and reporting on complaint follow up could be codified in regulation.

Chapter 6

BANKING

6.1 SECTOR OVERVIEW

At the end of 2009, the Kenyan banking sector had 44 banks.²⁵ The collective infrastructure of the sector is sparse. At 5.3 branches per 100,000 adults, branch infrastructure is higher than neighbouring countries but lower than Asian and Latin American countries with lower GDP per capita. There are approximately 8.5 million accounts in the banking system.²⁶

6.2 LEGAL, REGULATORY AND SUPERVISION FRAMEWORK

The Central Bank of Kenya Act assigns authority to the CBK as the regulator of banking activities, a role the CBK carries out according to the Banking Act. Prudential guidelines were last published collectively in 2006, and have been amended or supplemented with individual regulations since then.

The CBK Act does not define a specific mandate for consumer protection. The Banking Act²⁷, however, appears to establish the authority of the CBK to regulate the conduct of banks in the interest of consumer protection. Section 33, paragraph (a) grants the CBK authority to exercise a range of intervention options if the business of a bank is conducted *“in any manner detrimental to or not in the best interest of its depositors or members of the public.”* Even more specifically, Section 11 of the Banking Act prohibits, and holds bank officers accountable for fraudulent and reckless behaviour. The term *“fraudulent”* is defined under the Banking Act to include *“intentional deception, false and material representation, concealment or non-disclosure of a material fact or misleading conduct, device or contrivance that results in loss and injury to the institution with an intended gain to the officer of the institution or to a customer of the institution.”*

The Banking Act also provides specific guidelines on practices that affect consumers. Section 44A (1)-(3) restricts the maximum amount banks can recover on non performing loans under the In-Duplum rule. Section 16A prohibits the charging of fees on savings and fixed deposit accounts. Article 44 instructs that *“no institution shall increase its rate of banking or other charges except with the prior approval of the Minister.”* And Article 55(2) states that *The Central Bank may, at any time direct any person to withdraw, amend or refrain from issuing any advertisement, brochure, circular or other document relating to deposits which, in its sole discretion, it considers to be misleading.*

6.3. GAP ANALYSIS

6.3.1 Transparency

The FSD/CGAP 2010 survey reveals some deficiencies in bank disclosure of prices and service terms. A small but not insignificant number of respondents, about 6%, report that they did not have someone from the bank explain

the loan terms, and the same percentage reports that they did not receive a written loan agreement. Twelve percent said they did not have savings charges explained to them clearly. But the most telling response is that 25% of bank users were levied loan charges of which they were unaware and 8% were surprised by the repayment amount. FGD respondents could list many potential *“hidden charges”* they might find on a loan but were still discouraged about being sure they understood fully the loan documents. The consumer quoted in this box illustrates the issue. Together, these responses reflect a gap between what consumers think they will pay and what the banks in fact charge them.

Focus group respondent

“It is only after realizing that we have been charged so much from our pay slip that we start to ask then they will be like they explained that to you and during that argument also called negotiation, we take 2%.”

Teacher from Ahero

A scoping study carried out by Genesis Analytics of South Africa uncovered similar information and concluded that the level and quality of rate and tariff disclosure in the Kenyan banking sector is generally low.²⁸ They found that consumers view the process of obtaining a loan from a bank as complex and lacking transparency and that there are too many documents and not enough time or explanation to understand terms and conditions.²⁹ Respondents could list all the potential *“hidden charges”* that they might theoretically find in the loan payment but when it came to understanding their own, very real loan repayments, they were consistently befuddled about what they were being charged. Consumers often know the level of a rate or fee, but not how it affects their repayment obligation.

Providing consumers with pricing information improve competition and enables consumers to make informed choices when interacting with the financial sector. FSD Kenya has provided support to the Central Bank of Kenya to generate and disseminate clear information to end users through the Survey on Bank Charges and Lending rates initiative. The objectives of the survey are to provide current and potential bank customers with regular, consistent and easily understood information on bank charges and lending rates; encourage customers to use this information and; to foster competition on the basis of price among commercial banks. The Central Bank carries out a bi-annual survey to monitor the charges across 900 banks. Banks also submit monthly returns and the CBK reports that these are verified during on-site

²⁵ The CBK also licenses and regulates two mortgage finance companies, 130 foreign exchange bureaux and two deposit taking microfinance institution. It also has licensing and regulatory authority over credit reference bureaux.

²⁶ 2009 CBK Supervision Report.

²⁷ The Banking Act, Chapter 488. Revised 2010.

²⁸ This conclusion is supported independently by the research published in *Definition of a Standard Measure for Consumer Interest Rates in Kenya: A Scoping Study*. FSD Kenya. 2009.

²⁹ The Interest Rate Advisory Centre (IRAC) is a for-profit consultancy that assists consumers in calculating the actual interest rate they are paying. The consultancy recalculates interest rate charges for consumers. IRAC states in the thousands of cases IRAC has handled so far, the interest charged by banks on different types of loans (personal loans, mortgages and overdrafts) is wrongly calculated in more than 99% of the cases.

examinations. Between 2003 and 2006, the CBK published bank rates in the newspapers. The practice was suspended in 2006 after an evaluation found that while consumers seemed better informed on bank charges, there were not being reached by the media publication. A subsequent 2007 CBK Pricing Survey revealed a complex array of charges across the sector, with 53 classes of charges for current accounts and 8 different fees associated with loans. However, there are no regulations that govern standards for rate and tariff disclosure or that obligate banks to publish them on-site, in contracts with customers, or in the media.

Focus group respondent

"I have never understood why where you need to sign is in a bigger font and is not a headache but where they have their key information it is like seven pages but when you look at it is too small and repeated and it discourages you."

Man from Eldoret

There is a growing body of research showing that rate and fee disclosure alone does not necessarily create more transparency, especially for low income consumers. Disclosure guidelines have proven difficult to enforce. But perhaps even more important, disclosures are often too complicated for consumers to understand, with fine print and disclaimers, as observed by the respondent quoted in the box and the FSD-CGAP 2010 FGD participants.³⁰ This underscores the need for disclosure guidelines requiring plain language and simple formats.³¹

CGAP has observed evidence from around the world that mass market consumers generally find it difficult to understand interest rates.³² The Microfinance Transparency exercise calculated the effect of the aforementioned credit add-on fees in 10 banks and 30 microfinance institutions.³³ The use of flat interest rates, and extensive use of add-on fees, forced savings and obligatory insurance in loan contracts, results in an *annual percentage rate* that is typically

much higher than the quoted rate, making it difficult even for knowledgeable consumers to understand.³⁴

This has been the subject of a CBK 2008 Supervision Report states that this very issue has been the object of a Joint Taskforce of the Kenya Bankers Association (KBA) and CBK since 2007, which has been supported by FSD Kenya. In 2009 FSD undertook a study (implemented by the consulting firm, Genesis Analytics) on behalf of the Taskforce to identify appropriate indicators for credit price disclosure. Based on empirical research with consumers, the report found that Kenyan consumers struggle with understanding rates (consistent with the international findings noted above), and recommended the use of the Total Cost of Credit (TCC) calculation together with a repayment schedule (RS) as an appropriate disclosure method for the Kenyan market. The TCC was found to be more readily understood and used by less experienced consumers than the APR.

An industry-regulator workshop discussed the findings and agreement was reached on implementation of the recommendations. However, implementation failed. CBK decided to start with an industry-led approach. Unfortunately little actually happened on the ground beyond a circular from KBA to its members proposing the use of an APR measure. This was not consistent with the findings of the study and workshop (which suggested use of TCC and RS), and did not specify how to calculate the APR (which is important to ensure consistency, as there are a number of different methodologies) or how information was to be provided. There has been no obvious result from this, suggesting that the voluntary approach has failed and that CBK should now look to mandate disclosure, with clear specification of how this should be achieved (as is the case in many other jurisdictions).

6.3.2 Fair practice

As noted above, the Banking Act gives the CBK authority to enforce a general prohibition against abusive or fraudulent conduct. Banks report incidents of fraud to the CBK and the CBK reported that it reviews all fraud cases during the examination process. Its Banking Fraud Investigation Department is mandated to investigate and prosecute fraudulent activity, including where such fraud affects consumers.

The welfare of bank customers may be unfairly compromised in ways that are not fraudulent, however. Many jurisdictions regulate certain practices to control inherent prejudices against consumer interests. A recent CGAP global survey of financial sector regulators³⁵ explored the current legal-regulatory framework and emerging practice along four dimensions of unfair treatment: deceptive advertising, abusive collections practices, unauthorised use of client data/

³⁰ Financial Access 2009: Measuring Access to Financial Services Around the World, CGAP 2009.

³¹ CGAP's Financial Access 2010: The State of Financial Inclusion Through the Crisis survey of 147 countries found that 81% of respondents required banks to disclose key information at account opening; 73% of respondents mandated up-front disclosure by all regulated financial institutions, and interestingly, 25% require this of unregulated financial institutions. Just over two-thirds of respondents require disclosure of annual percentage yield, interest rate and fees and penalties for deposit accounts; the rate is slightly higher for credit (APR and fees). Forty one percent of respondents require some type of simplified disclosure such as a "Key Facts" document, summarizing key terms and conditions in a clear and transparent manner. Required disclosure of dispute resolution channels was present in only 35% of countries.

³² Tiwari et al. (2008), South Africa fieldwork in Collins et al. (2009), FSD Kenya (2009), cited in "Consumer Protection Regulation in Low-Access Environments: Opportunities to Promote Responsible Finance".

³³ MFT led a voluntary exercise with 10 banks and 30 MFIs in which the institutions provided the terms and conditions of all of their loan products (for amounts less than Kshs 500,000, or US\$ 6,700) and MFT calculated the resulting annual percentage rates and effective interest rates. Results are available on www.mfttransparency.org.

³⁴ The Annual Percentage Rate is used in the US and the UK to express all loan costs in a periodic interest rate calculated over the principal balance outstanding.

³⁵ Financial Access 2010: The State of Financial Inclusion Through the Crisis, CGAP.

breach of client confidentiality, and unfair or high-pressure selling practices. Practice is most established concerning deceptive advertising and data confidentiality (which are covered in about three-quarters of respondents). Attention to inappropriate selling and collections practices is growing, with rules in place in about half of the countries.

Another broad area of fair treatment is unfair contract provisions, such as hidden fees, punitive pre-payment penalties, unilateral and undisclosed changes in terms, or waiving of customer rights. Fair treatment laws or regulations also sometimes address bundling or tying of products, particularly as part of competition frameworks.

In Kenya, some specific practices are already addressed in law and regulation. However, there are some key areas that do not appear to be subject to specific treatment. The key areas are reviewed in the following paragraphs.

There are no regulations that govern the use of charges related to current accounts, add-on fees associated with loans, and the widespread practice of bundling “loan protection insurance” (that is, life and sometimes disability insurance).³⁶ The challenges of making these costs intelligible to the consumer have been discussed in the transparency section above. Here it is relevant to raise the more fundamental question of whether there is a point at which the total costs associated with charges and product bundling becomes so unintelligible that the practice becomes inherently unfair to the consumer. The diagnostic exercise cannot offer a definitive response to this question but it is flagged as an area that merits further investigation.

Kenya example: 2010 Agent Banking Guidelines

The guidelines introduce a framework for the regulation of bank outsourcing of operational functions, which includes specific conventions related to bank responsibility for the agent’s conduct and consumer protection measures.

In Kenya, the potential for abusive practice is increased by the widespread practice of outsourcing collection of delinquent loans. The CBK indicates that it reviews the contracts with third-party collection agencies, but does not supervise their activities. At this time, there are no regulations governing bank responsibilities for ensuring fair treatment and monitoring the practice of third-party collection agencies. There is one large company that manages the non-performing loan portfolios of 11 banks with a combined value of more than Kshs 1.5 billion (US\$ 20 million). These are typically unsecured retail loans to

consumers with an average size of Kshs 100,000 (US\$1,350). The company reports that the most common reasons cited by delinquent borrowers for their problems are unemployment or misunderstandings with the bank. There do not appear to be any regulations that govern the responsibility of banks for the action of third-party collection agencies, and even the recent Agent Banking Guidelines do not appear to apply to this particular agency relationship.³⁷ Finally, when loans are secured by physical collateral, it is common practice for banks (or their contract collection agency) to seize the collateral and liquidate it by auction.

FGD respondents as well as service providers in the industry voiced their greatest concerns about this auction process. To be clear, the focus group and survey results revealed that Kenyan consumers seem to accept the practice of seizing collateral in the event of default. They understand this is a condition of their loan. However, there is widespread suspicion of violation of due process, particularly related to collusion between auctioneers and buyers. The surveys also revealed how difficult it is to rely on reported cases of abuse as a way to monitor practice in this area. In interviews or surveys, people who have experienced a foreclosure are disinclined to report that they defaulted on their loan obligation and triggered the collection process.

Data privacy rules are also undeveloped, with the notable exception of credit reporting regulations.³⁸ Credit reporting is nascent in Kenya. As of May 2010, there was one licensed credit reference bureau, which had conducted a pilot data exchange project. Two more credit reporting agencies planned to apply for a license. There were only about 200,000 credit records in the system.

Kenya example: 2008 Credit Reference Bureau Regulations

The CBK issued the Banking (Credit Reference Bureau) Regulations in 2008. This regulation drew from other jurisdictions including the U.S. Fair Credit Reporting Act. The regulation addresses credit reporting-related issues of transparency, fair practice and recourse in a comprehensive way.

Though the industry is just starting with a robust regulatory framework regarding information-sharing among banks, one emerging initiative merits careful consideration. This is the plan to complement CBK’s oversight with creation of a Kenya Credit Providers Association (KCPA) that would perform a self-regulatory function for the industry.³⁹ The proposal would consider eventual inclusion of non-bank lenders such as MFIs and consumer lenders. Sharing of data across the legally recognized silos would require careful

³⁶ The article “Insurance firms now target low income earners,” in *The Business Daily* May 14, 2010, documents the increasing importance of “micro-insurance” to the revenue growth of the insurance industry. The practice of embedding insurance products in microloans of the leading MFIs is identified as a vehicle for reaching the mass market.

³⁷ “Loan collection” does not appear in the list of permissible practices in section 4.3.

³⁸ Data privacy standards and practice were not evaluated in depth in this diagnostic exercise.

³⁹ After the team had finished its analysis, a new report was issued by FSD Kenya, *Kenya Credit Provider Association – Roadmap 2010 – 2015*, September 2010, http://www.fsdkenya.org/pdf_documents/10-09-22_KCPA_roadmap.pdf

consideration of all legal implications and amendment of the regulation, which permits sharing of information from CBK-supervised institutions only among those institutions. Another potential concern is conflicts of interest that could arise in such an arrangement. Further, there might be certain compliance issues or anti-competitive behaviour where the interests of credit bureaus and banks (i.e., the clients of credit bureaus) are aligned with one another but not with those of consumers. Such an expansion might be more appropriate to consider once the system of information sharing among the banks is fully operational and robust data protections have been put in place for borrowers from non-bank institutions.

The regulation assigns CBK ownership of the data and mandates it to supervise the information sharing mechanism in the banking sector. It will need to monitor the self-regulatory activities of KCPA, given the uneven history of self-regulatory organisations. If the new arrangement proves not fully effective or unsustainable over time the authorities would need to take appropriate action. The proposed industry code of conduct covers consumer interests under section 4 ('Duties to Customers'). These provisions should be benchmarked and revised (if necessary) against global best practices and lessons emerging from regulatory oversight of the credit industry's implementation of consumer protection practices in Kenya.

Deposit protection is one of the most basic forms of consumer protection in the banking industry. The limits on deposit insurance appear low at Kshs 100,000 (US\$1,350) and may require upward revision. In addition, depositors do not appear to have a more privileged claim than other unsecured creditors in bank liquidation.

6.3.3 Recourse

There are no specific regulations that set standards for or govern internal dispute resolution mechanisms for banks. Many banks have customer care desks in branches, report that they have dispute resolution mechanisms and can cite cases of managers attending to consumer complaints. Some banks have invested in call centres. However, actual practice in this area could not be confirmed during the diagnostic. In general consumers must navigate a patchwork of ad hoc internal dispute resolution procedures and external recourse mechanisms to resolve complaints and disputes with banks.

The CBK reports that it expects banks to have a dispute resolution mechanism. Examiners review the complaint log, which also includes an explanation of the problem and how it was handled. The CBK also responds to consumers that call with complaints on their own initiative. The off-site examiners handle these cases on an ad hoc basis and rely on moral suasion to encourage banks to resolve issues.

The KBA reports that it has a recourse mechanism for consumers that cannot resolve their issues with their bank, although it did not provide specific information on the number of cases it considers. The fact that the KBA

committee is comprised of bank CEOs suggests that this recourse mechanism is only convened for significant cases.

The scope of the diagnostic did not include an assessment of the effectiveness of any of the aforementioned internal dispute resolution or external third-party recourse mechanisms. However, the lack of regulation and oversight of these functions is sufficient grounds for further reflection on current practice.

Focus group respondent

"There are times you might check your balance only to realize that they have made some deductions. When you inquire about it, they tell you to come back the following week. They might return the money and sometimes they might say they have no idea what happened to the missing money."

Woman from Naivasha

In the FSD/CGAP 2010 survey, 91% of respondents reported they were able to get satisfactory answers to queries made about their savings account at their bank. When asked if they contacted someone with concerns about the amount of payments or length of their loan, 8% responded that they called but were not able to get someone to speak with them (see boxed quote) and 8% said that they did not even try to call. However, FGD respondents were more vocal in their frustrations with having to inquire about problems with their accounts than the survey findings report.

Perhaps more importantly, the overall findings of the surveys suggest that consumers have low expectations of how banks will treat them – and also weigh carefully the amounts in dispute against the likely costs of following up. The findings point to the need to better understand whether consumers even believe they have a right to dispute resolution, whether they know how to exercise that right, and whether they expect the process to be effective, all of which affect their trust in the overall system.

A comparison with the incidence of complaints in other sectors might also suggest that the low number of complaints in the banking sector could be due to dysfunction in the internal dispute resolution and third-party recourse mechanisms. For example, the IRA has an explicit mandate to operate a recourse mechanism and reports that it handles about 3,000 cases per year. The Cooperative Tribunal handled 568 cases in 2006, in addition to a flow of about 15 complaints a month that are escalated above the level of the District and Provincial Cooperative officers to the federal Ministry of Cooperatives, Development and Marketing (MOCDM). The M-PESA customer care hotline handles at least 17,000 queries per day. The insurance and SACCO sectors have far fewer consumers than the banks, and yet the CBK only handles around 40-50 cases per year. M-PESA has the most organized and accessible system and the volume of queries it handles suggests that the incidence of consumer disputes in the banking sector might well be significantly underrepresented in available

figures. However, the actual effectiveness of bank recourse mechanisms cannot be analyzed adequately without improved information and data (at each level of the recourse system – banks, KBA and CBK) on the current volume and nature of queries and complaints, and on their disposition.

6.4 RECOMMENDATIONS

These recommendations reflect a preference for creating incentives for providers to resolve issues with their customers as the first line of consumer protection. This means making providers responsible, defining minimum measures, enforcing the rules, and ensuring that consumers have enough information to use available channels.

- Issue regulations on minimum disclosure requirements for credit and savings services, as previously agreed through the Taskforce process. In the case of credit, the regulations should specify the calculation method (i.e., Total Cost of Credit) and minimum documentation requirements such as a contract and repayment schedule. Consumers are also likely to benefit from a simple one page summary of any financial services contract that they sign (in a so-called *Key Facts Document*), to help them understand and compare offers. Standardization of plain language in contracts also deserves further analysis.⁴⁰
- The use of add-on fees and account charges, as well as the practice of product bundling (particularly credit protection insurance) merit careful study. These practices may well require regulatory guidelines to prohibit practices that generate inherently unintelligible costs for the consumer.
- Regulation and oversight of outsourced collections and collateral liquidation should be strengthened. The Agent Banking Guidelines provide a framework for clarifying the respective roles of the regulator and the banks for oversight of third parties acting on banks' behalf in these areas. The auction process appears to pose the greatest potential threat to consumer interests, and it is the least subject to oversight.
- Issue regulations on minimum requirements for internal bank dispute resolution mechanisms that include requirements for instructing consumers about how to access the process and service standards. The recent CGAP survey of financial regulatory authorities found that sixty percent of economies responding (82) have at least one third-party recourse mechanism in place, and many of these also required financial institutions to put procedures in place for addressing customer complaints and resolving disputes. Some also set standards for timeliness

of response and required specific measures to ensure accessibility of internal dispute resolution.⁴¹

- The credibility of provider-based recourse mechanisms will be significantly enhanced if there is also an independent third-party recourse mechanism to address problems that consumers cannot solve at the provider level.⁴² In principle, it is possible that the KBA could develop an industry-wide external recourse mechanism (serving a similar function as the Central Complaints Handling Unit in the capital markets) if the KBA were able to create an image of independence, e.g., by including consumer representatives from outside the banking industry in the recourse process.
- The CBK can encourage competition and leverage market forces to the benefit of consumers by publishing information about provider performance in basic areas:
 - A list of all providers that are subject to prudential and consumer protection regulations;
 - A description of the regulations including, specifically, the obligations of the providers;
 - A periodic report on the performance of individual providers against the transparency and recourse regulations; and,
 - Data on the internal dispute resolution performance of each provider.
- If the proposed package of recommendations is to be effective, in the banking sector and the other regulated sectors, compliance monitoring and enforcement deserves careful attention. A recent CGAP survey of financial sector regulators found that 64 percent of agencies responsible for financial consumer protection use on-site inspection, 40 percent monitor providers' advertisements and websites, and roughly one-third operate a hot line or call centre to receive complaints and reports of impermissible conduct. Further measures include requiring publication of financial institutions' data on complaints and resolution, mystery shopping, and conducting research directly with consumers.⁴³

⁴⁰ Respondents to CGAP's annual financial access survey report that the most frequent area of complaint received through third-party recourse providers is rates and fees beyond those permitted by law and regulation. The FEPP taskforce particularly emphasised the importance of adopting this recommendation as a key step towards increasing pricing transparency and disclosure.

⁴¹ *Financial Access 2010: The State of Financial Inclusion Through the Crisis*, CGAP.

⁴² In the CGAP financial access survey, 82 economies reported some type of third-party recourse, in the form of a general Ombudsman, one or more financial Ombudsman, or a mediation service. In countries including Pakistan and Ecuador, the Central Bank can receive appeals in the event that the customer is not satisfied with the decision of the Ombudsman. Ibid.

⁴³ Ibid

Chapter 7

SAVINGS AND CREDIT CO-OPERATIVES (SACCOs)

7.1 SECTOR OVERVIEW

Estimates of the size of the SACCO sector vary widely, with little support from reliable and comprehensive data. The Ministry of Cooperative Development and Marketing (MOCDM) has reported estimates of around 5,000 SACCOs. However, the Kenyan Union of Savings and Credit Cooperatives (KUSCCO), the apex SACCO membership organisation, estimates that no more than 3,000 SACCOs are active. In any case, the industry is highly segmented. As of May 2010, the Ministry has collected the audited 2009 financial statements from 179 of the 220 that the Ministry believes will apply for a license under the SACCO law, and estimates that the total assets of the 220 will be around Kshs 160 billion (US\$2.1 billion). This can be extrapolated to an estimate of around Kshs 200 billion (US\$ 2.7 billion) for the entire sector.⁴⁴

In recent years, as many as 215 SACCOs have developed bank like services that are commonly referred to as “front office service activities” (FOSAs). These are generally the largest SACCOs, which also offer more sophisticated financial products and are the SACCOs most likely to apply for the new license. The thousands of SACCOs that will not apply for a license under the SACCO Societies Act of 2008 are almost all very small, and mostly rural, cooperatives that operate with minimal organisational structure and management capacity. The simplest SACCOs may in practice be indistinguishable from informal accumulating savings and credit associations (ASCAs) or even revolving savings and credit associations (ROSCAs). A very large percentage of SACCOs and most of the largest associations serve employees from a single employer.

Estimates of SACCO membership range from as high as 6.2 million (reported and published by MOCDM in official documents) to more conservative estimates of 2 million. The latter estimate is more consistent with extrapolation of MOCDM data on the 220 largest SACCOs in 2009 and the FinAccess 2009 survey results.

The development of the FOSAs appears to have been an important impetus for the new SACCO Act. The SACCOs with FOSA operations are perceived to be reaching out beyond their previously closed membership base to the public with more sophisticated services and operations. The SACCO Societies Act and the regulatory framework created under the Act for the larger SACCOs specifically seek to address the higher levels of risk and broader field of membership associated with these activities.

7.2 LEGAL, REGULATORY AND SUPERVISION FRAMEWORK

All of the SACCOs in existence today in Kenya were constituted under the Cooperative Societies Act and registered with the Cooperative Registrar in the MOCDM. The Ministry has registered the SACCOs as cooperatives, but has

not issued any specialized regulation related to their financial intermediation activities. The Ministry does not publish data on the SACCOs, and does not supervise with either off-site or on-site examination.

The SACCO act established for the first time a comprehensive framework, creating the SACCO Societies Regulatory Authority (SASRA) as the regulation and supervision agency for the sector. The MOCDM assumes that many of the 215 SACCOs offering FOSAs will apply for the new SACCO licence, though only around 75 are likely to meet eligibility requirements immediately. This latter figure may be optimistic based on analysis undertaken by FSD Kenya and the World Council of Credit Unions (WOCCU). SASRA has now formally been established and the new regulations gazetted. The regulations address certain aspects of disclosure and credit and collection practices with more detail than either the Banking Act or Microfinance Act. These are addressed below.

7.3 GAP ANALYSIS

For members of SACCOs covered by SASRA, the establishment of prudential regulation and supervision will make the single most significant contribution to consumer protection. This addresses a longstanding gap in the basic protection of members and depositors against the insolvency of a deposit taking institution. In addition, SASRA will be able to regulate and supervise consumer protection measures with the same authority as other financial sector regulators.

There are still, however, two conditions that leave large areas of consumer protection unaddressed in the SACCO sector. First, SASRA faces the significant challenge of creating an effective supervisory agency in a sector that has been unsupervised since its founding. Appropriately, prudential oversight is likely to be the highest priority for the new agency. It may well take considerable time for SASRA to develop the capacity to address consumer protection with effective regulation and supervision, and for the providers to incorporate more consumer friendly practices while they themselves are undergoing a significant organisational transformation. Second, there is the matter of the approximately 2,800 SACCOs that are not expected to apply for, or qualify for, licensing. Based on data from the FSD Kenya/WOCCU/MOCDM Regulatory Impact Assessment of 2007, the SACCOs operating FOSAs that are expected to apply for the new license are the largest institutions with a combined membership that accounts for at least 80% of total SACCO membership. However, this will leave a large number of SACCOs, and their membership, without any prudential or consumer protection regulation or supervision.

7.3.1 Transparency

There is very little reliable data on the SACCO sector. The MOCDM does not systematically collect or publish information about SACCO membership, the actual number of SACCOs, or their financial position. Like all cooperatives, MOCDM regulations require the SACCOs to make a financial disclosure to the membership once a year. However, there are no regulations that govern SACCO

⁴⁴ An FSD Kenya commissioned study of 2004 financial data estimated that the 148 largest SACCOs comprised somewhere between 70% and 80% of total system assets. The 2009 estimate assumes that the assets of the 220 constitute 80% of total system assets.

responsibilities regarding disclosure of rates and charges associated with their financial services. The MOCDM has addressed consumer complaints for many years, but does not gather statistics that would enable analysis of trends.

The new regulations mandate disclosure of all fees, terms and conditions associated with savings accounts (Article 26) and loans (Article 29). However, the regulations in both cases are not specific about the method for presenting the information. Some industry participants made the observation that SACCO members are more comfortable with their institutions than providers such as banks or MFIs because SACCOs have simpler products, charge fewer fees and have more uniform interest rates. However, the FSD/CGAP 2010 survey results revealed that SACCO customers were surprised by add-on credit fees as often as bank customers (25%), and more often than MFI customers (18%). It is also relevant to note that that loan protection [life] insurance is commonly required in the SACCO sector. SACCO members may well have different expectations and comfort levels with their organisations, but the survey results suggest that there is still justification for better disclosure practice.

7.3.2 Fair treatment

The new regulations also address several areas of fair treatment with immediate relevance to consumer protection. They limit the amount of interest charged on delinquent accounts (Article 31; similar to the in duplum rule for banks). They require SACCOs to ensure that members do not “over guarantee” their loans (Article 32), and provide detailed rules on credit collection practices (Article 38).

The largest number of SACCO-related complaints that reach the tribunal or the MOCDM are related to members who wish to exit and redeem their shares, expulsions, or non-payment of dividends, all problems associated with the membership ownership nature of SACCOs. In some cases these problems arise from the SACCO's weak financial condition or lack of liquidity.

The SACCO Societies Act of 2008 establishes a deposit guarantee fund for SACCO members, adding an important component of protection, although individual coverage is limited to Kshs 100,000.

7.3.3 Recourse

The SACCO sector has an external recourse mechanism with some unique features not found in other segments of the financial market.

As in the other sectors, currently there are no regulations that govern the obligation of SACCOs to provide their members with recourse channels. However, SACCO members may take a complaint to the District or Provincial Cooperative Officer, who may facilitate a solution or forward the case to the MOCDM Inquiries and Inspectorate Division. The Division has no enforcement authority, but contacts the SACCO regarding the case. The Division then refers unresolved cases to the Cooperative Tribunal.

The Cooperative Tribunal is independent of the MOCDM and presided over by a Magistrate. Decisions carry the force of a court of law, and may be appealed to the High Court, and even the Court of Appeals. Industry stakeholders describe the process as slow, but more effective and less cumbersome than the general court system. The Cooperative Tribunal processed 546 cases in 2006 (numbers for subsequent years were not available).

7.4 RECOMMENDATIONS

All of the recommendations presented for the banking sector apply as well to the SACCO sector. In a cooperative effort, the CBK and SASRA have the ability to unify regulations related to disclosure, recourse and fair practice across all of the regulated providers of savings and credit services. This would address a substantial portion of the consumers of regulated providers in the market (i.e., banks, deposit taking MFIs, and SASRA-overseen SACCOs), and establish clear guidelines that may influence non-supervised service providers (i.e., other SACCOs and credit-only MFIs) in the future.

The MOCDM may also elect to issue regulations requiring the unlicensed SACCOs to comply with the same disclosure guidelines as their licensed counterparts. Effective implementation will likely be challenging without technical support to these smaller SACCOs, or some supervision capacity in the MOCDM. Nevertheless, regulation could establish a clear policy regarding harmonized disclosure among all financial service providers. This would at least provide guidance to the members of the unlicensed SACCOs, who may insist that their managers bring their SACCO into compliance.

SASRA and the MOCDM also have the opportunity to develop the existing recourse channels to complement internal SACCO recourse facilities. The MOCDM recourse channels can also be accessible to members of the unlicensed SACCOs. The experience will be relevant to the banking sector as well as they consider options for third-party recourse mechanisms.

Chapter 8

INSURANCE

The diagnostic did not examine the overall insurance sector in detail, given the relatively low use of private sector insurance by mass-market consumers. The following section provides a basic overview of the sector, but does not reflect a detailed examination of industry data, regulation, or the recourse role of the regulator. The review was sufficient, however, to identify issues that warrant more in-depth research at a future date and to identify consumer protection measures in this sector that could have broader relevance for other sectors.

8.1 SECTOR OVERVIEW

According to the Insurance Regulatory Authority (IRA), there are 44 insurance companies, 4 re-insurers, over 250 licensed brokers and about three thousand registered insurance agents (which can be individual firms or appointed agents). The IRA reports fewer than 450,000 life insurance policies in effect at the end of 2009. The IRA does not publish indicators on other policies. But estimates based on IRA staff opinions and FinAccess 2009 extrapolations suggest that the total of all other private insurance policies is less than one million. In the FinAccess 2009 survey, the highest usage of insurance products was with the government-run National Hospital Insurance Fund (NHIF) and the National Social Security Fund (NSSF), which are serving 4.2% (777,000) and 2.9% (536,000) of consumers, respectively. However, both the NHIF and NSSF are government-run programs and currently are not subject to the jurisdiction, respectively, of the IRA or RBA.

The industry has a clear self-interest in improving its practices, and industry players freely acknowledge that the mistrust of Kenyan consumers poses a fundamental constraint on expansion of insurance in Kenya. According to the Association of Kenya Insurers (AKI), the poor reputation is caused mainly by agent misrepresentation of insurance products, hidden charges and non-payment of claims.

8.2 LEGAL, REGULATORY AND SUPERVISION FRAMEWORK

The insurance industry is governed by the Insurance (Amendment) Act of 2006 Cap 487. The Act established the IRA as well as detailed guidelines that are typically set out in separate prudential guidelines. The IRA indicated that it issues additional regulations, but these were not available to the team during the diagnostic exercise.

The Act empowers the IRA to formulate and enforce standards, license providers and “protect the interests of insurance policy holders and insurance beneficiaries in any insurance contract.”⁴⁵ IRA inspects insurance companies as part of the supervision regime and reports that examiners review the complaints register during on-site examinations. In its Annual Reports (available through 2006) the IRA reports on the number of complaints in the aggregate for the insurance industry.

The Act also established the Policy Holders Compensation Fund (PHCF) to compensate individual policyholders upon the insolvency of an insurer up to the statutory compensation limit on any one claim of Kshs .100,000. It only covers claims arising from the inception of the Fund from 1 January 2005. The Retirement Benefits Authority (RBA) manages the PHCF as Managing Trustee. Insured policyholders and insurers contribute 0.25% of monthly premiums to the Fund.

Kenya example:

The IRA consumer protection mandate

The Insurance Act defines a detailed consumer protection mandate for the IRA. The Act contains specific guidelines related to transparency, pricing, prohibited practices and consumer rights, and establishes a recourse role for the IRA.

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8.3 GAP ANALYSIS

8.3.1 Transparency

A broad range of industry participants seem to agree that public mistrust of insurance products is widespread and related in various ways to misunderstandings between consumers and insurance companies. Allegations of agents “mis-selling products” (this includes selling someone a product that is not appropriate for their circumstances as well as misrepresenting what is in the policy) or insurance companies “refusing” to settle claims are frequent enough to justify closer examination of why consumers are purchasing insurance products with expectations that are not met over the life of the policy. The question of whether policies and contracts are presented in clear, plain English language appropriate for the Kenyan population merits further investigation. The level of popular mistrust suggests that a uniform disclosure form for pricing and policy conditions, especially conditions related to claims settlement, is indicated for each key type of policy.

The multi-tiered structure of the industry presents various challenges for consumers. Consumers can easily form erroneous expectations, or be misled willfully or by negligence, in an industry where over 3,000 intermediaries stand between the consumers and the insurers.

The Insurance Act does address basic issues of transparency. Part XVII (Advertisement and Statements) prohibits deceptive or dishonest statements in

⁴⁵ [Sect. 3A, (d)].

Kenya example: Standard plain language policy wordings

The joint IRA and industry contract committee is developing uniform, easy-to-understand policy documents for the 12 classes of insurance in the Kenyan market.⁴⁶

advertising insurance. This includes concealment of material facts, misleading promises or forecasts and other deceptive practices to entice a consumer to enter into a contract. The question of how the IRA monitors compliance with these regulations merits further study. The Act only imposes a nominal fine “not exceeding five thousand shillings” for a violation, a sum small relative to the potential gains of a violation, which calls into question whether the IRA has a sufficient range of enforcement mechanisms for dealing with non-compliant entities. In any case, the IRA does not publish information about complaints, resolution, or violations by individual company.

The AKI’s voluntary Code of Conduct for Life Insurance Agents, currently under revision, also addresses basic transparency and conduct issues. The agent is instructed to act at all times professionally in his or her dealings with policyholders and potential policyholders and to respect their confidence. Further, agents are prohibited from making any false, deceptive or misleading statements or illustrations pertaining to any insurer’s product and benefits. However, no information was available during the diagnostic to confirm enforcement or violations of the code.

8.3.2 Fair treatment

Focus group respondent

“It is like they have used anyone to sell insurance and they don’t know the products so you sign for a product. Then when the policy comes you find that it is totally different.”

Man from Mombasa

According to the AKI, there are three main causes for the negative perception about insurance: mis-selling among agents, non-transparent financial charges, and non-payment or slow payment of insurance claims. The level of consumer dissatisfaction (see typical quote in box) justifies further assessment of basic industry practice in these areas. The conduct of agents merits particular attention. Regulations regarding insurance company responsibility for broker

or agent conduct need strengthening.⁴⁷ The fragmentation of the industry creates significant opportunity for agents to misrepresent products or fail to provide the consumer with full disclosure.

There appears to be some level of informal sharing between insurers of data on policy holders with high claims. In the past, the companies have reportedly shared medical history information on individuals. There are plans to build up a database on motor vehicle claims. While some level of information sharing is reasonable, the personal information of policy holders also needs to be protected. Currently, consumers are not informed that their information might be shared. Most importantly, however, is that information exchange needs to be organized in a way that information can be verified and even challenged by a consumer. This ensures accuracy and protects consumers and insurers against false information on customers.

The practice of bundling insurance products with loans made by banks, DTMs, SACCOs and MFIs also merits further study. Borrowers are often required to purchase a credit life policy, creating a bundled product that adds complexity to the contract and increases the total cost of credit. This practice may be reasonable, but it is important that the consumer understands the policy and receives clear information on its prices, terms and conditions. The issue of whether borrowers have some choice as to the policy provider also warrants further investigation. Industry participants and consumers indicate that the practice is widespread, but no reliable data was available during the diagnostic to confirm the actual volume of this business and the incidence of consumer protection problems.

8.3.3 Recourse

The Act creates two third-party recourse mechanisms for insurance consumers. Policyholders may elect to refer claims and disputes on life insurance policies of less than Kshs 100,000 (US\$1,333) to the Office of the Insurance Commissioner for a decision (that is deemed under the Act to be as binding as a decision of a lower court). In addition, the IRA is mandated to manage the complaints of other aggrieved consumers. Consumers first lodge complaints at the company. If this is not successful, the complaint may be directed in writing to the IRA, which provides advice and contacts the firm. However, the IRA does not have arbitration authority and cannot make binding decisions in cases outside the confines of life insurance and the defined claim limits. The IRA reports that it handled about 3,000 cases in 2009.

The AKI also reports that it receives around 20–30 complaints per month from consumers, primarily related to auto insurance.

⁴⁶ Some countries have gone so far as to mandate the offer of standardized simple products for mass-market consumers. India and South Africa, for example, have obliged regulated service providers to offer simplified bank accounts as a strategy for increasing access for lower income populations. Part of the rationale for such products is the ease of use for new consumers. Some observers question whether this could have unintended effects, by limiting innovation to develop profitable and scalable products that meet needs of these consumers.

⁴⁷ A new working group of the International Association of Insurance Supervisors is examining market conduct issues of this type.

8.4 RECOMMENDATIONS

The following recommendations reflect the preliminary work conducted during the diagnostic. Further appraisal of the insurance sector is recommended.

- As in the banking industry, transparency regulations that require disclosure and specify the calculations and language used to explain the prices, terms and conditions of services would enable consumers to make informed choices.
- The obligation of insurance companies to provide internal dispute resolution mechanisms should be standardized through regulation and enforced through supervision.
- The basic tenets of the agent banking regulation should be adapted to regulation in the insurance industry to clarify the responsibility of insurance companies vis-à-vis their agents.
- The IRA ought to draft regulations on insurance policies, risk and claims information sharing in the insurance industry (similar in concept to credit information sharing in banking). There could be the formal set-up of a database on insurance fraud information under a code of conduct with data protection protocols in place. In general data protection protocols ought to be strengthened in the industry specifically with respect to transparency of information sharing and processing.
- The recommendations regarding publication by the CBK apply as well to the IRA, in regards to :
 - A list of all providers that are subject to consumer protection regulations;
 - A description of the regulations including, specifically, the obligations of the providers;
 - A periodic report on the performance of individual providers against the transparency and recourse regulations; and,
 - Data on the dispute resolution statistics and performance of each provider.

Chapter 9

DEPOSIT TAKING MFIs

9.1 SECTOR OVERVIEW

There are presently two licensed deposit-taking microfinance institutions (DTMs) in Kenya and a further two expected to be licensed in the latter half of 2010. The two DTMs had a combined client base of around 600,000 at the end of 2009. Both institutions serve a population with lower income levels than typical bank customers, evidenced by their average loan balances of US\$410 – 430.

9.2 LEGAL, REGULATORY AND SUPERVISION FRAMEWORK

The Microfinance Act of 2006 established a clear distinction between credit granting microfinance organisations and licensed deposit-taking microfinance institutions. The Act established the CBK as the authority for licensing, regulating and supervising the DTMs, and empowers the MoF to issue regulations regarding the non-deposit taking microfinance providers.

The CBK issued the DTM Regulations in 2008. These include most of the same conventions found in the banking regulations regarding the authority of the CBK to take action against any fraudulent and reckless behaviour that results in loss or injury to a customer of the institution.⁴⁸

9.3 GAP ANALYSIS

The consumer research reveals that MFI customers (making no distinction between deposit and non deposit-taking MFIs) suffer frustrations with hidden fees and understanding the terms and conditions of their loan with a frequency that is somewhat lower than with banks and SACCOs. For example, while 11 percent of respondents had loans with MFIs and 10 percent with banks, MFIs performed better on giving written loan documentation (100% vs. 93%) and 18% of MFI customers (vs. 25% of bank customers) reported being surprised by extra charges.

The observations regarding consumer protection for banking customers extend as well to customers of the DTMs. Though the CBK uses distinct regulations and a specialized examination unit for the DTMs, the same basic regulatory regime applies to all regulated financial institutions.

9.4 RECOMMENDATIONS

All of the recommendations regarding disclosure practices and recourse mechanisms in the banking sector apply as well to the DTMs.

⁴⁸ See Section 32.

Chapter 10

FORMAL, UNSUPERVISED FINANCIAL SERVICE PROVIDERS

10.1 SECTOR OVERVIEW

The [non deposit-taking or “credit-only”] MFIs and those SACCOs unlikely to be regulated under the SACCO Societies Act are the two main groups of formal organisations that provide financial services but are not subject to prudential regulation and supervision. This category, while not prudentially regulated, are either at least registered already as credit providers with some statutory authority (e.g., non deposit-taking SACCOs – see chapter 6 – or hire-purchase companies, which were not included in the study) or potentially so (non deposit-taking MFIs). The number of such organisations providing some kind of unregulated financial services to low-income populations is unknown in Kenya. Almost all of them are small and their total consumer base does not appear to be significant. The ten Kenyan credit-only MFIs that report to The MIX Market (www.themix.org) had a combined clientele of around 210,000 at the end of 2009. SACCOs outside the regulation and supervision of SASRA are treated in the chapter on the SACCOs because they are subject to their own law and answer to the Ministry of Cooperatives.

Unregulated consumer credit companies have also entered the market and appear to be growing rapidly.

10.2 LEGAL, REGULATORY AND SUPERVISION FRAMEWORK

The Microfinance Act assigns responsibility for regulation of the non deposit-taking MFIs to the Ministry of Finance. The MoF has not developed or issued regulations for credit only MFIs as provided for under section 3(2) of the Act.

10.3 GAP ANALYSIS

The absence of regulation and a supervision agency for this sector reduces the opportunities for enforcing consumer protections related to transparency, fair practice, and recourse. As noted above, the MoF does have the authority to issue regulations, but without supervision capacity to monitor compliance the effect of any such regulation will be difficult to judge.

As mentioned previously, the consumer surveys reveal that MFI customers (no distinction between deposit and non deposit-taking MFIs) suffer frustrations with hidden fees and understanding the terms and conditions of their loan with a frequency that is only marginally lower than with banks and SACCOs. The previously referenced MFT APR calculation exercise revealed a widespread use of flat interest rates, fees, obligatory insurance policies, and obligatory cash deposit requirements that elevate the effective interest rate well above the rates that are quoted to clients. Moreover, the level of understanding about the cost impact of these practices on the consumer varied significantly among the providers. In general, the MFIs appear to be especially challenged in understanding the effect of their fees and charges on the total cost of credit to the borrower.

10.4 RECOMMENDATIONS

The MoF is encouraged to consider the potential benefits of using the regulatory and supervisory authority granted in the Microfinance Act to issue regulations for the MFIs that harmonize eventual disclosure and dispute resolution guidelines with those recommended for the supervised institutions. This action could be beneficial, even if the MoF does not dedicate resources to enforcing compliance with the regulations or delegates supervision to sector regulators or other public agencies. From a policy standpoint, the action would establish a level regulatory playing field across all formal providers. And in the MFI sector, there are market forces that may well provide significant incentive for compliance, even in the absence of supervision. The best of the credit-only MFIs (who also serve the majority of the sub-sector’s clients) are likely to comply with the regulations as they prepare to apply for a DTM license. To the extent they have investors, these funders are also likely to expect adherence to better practices in client protection.

In addition, the Association of Microfinance Institutions of Kenya (AMFI) encourages its members to align their consumer protection procedures with industry-wide practice, through upholding the AMFI voluntary code of conduct.⁴⁹ The code sets standards for good banking and microfinance business practices while allowing competition and market forces to work, encouraging higher standards and better service provision. By signing the code, service providers commit to transparency and disclosure, fair practices, plain language contracts, financial educate, non-discriminatory behavior and the establishment of formal and informal dispute resolution channels and client feedback mechanism. This provides valuable protections for the MFI clients who are mainly the poor, low-income households and small and micro scale enterprises.

⁴⁹ The AMFI Code of Conduct – Setting the standards for Microfinance best practices in Kenya, August 2010.

Chapter 11

INFORMAL FINANCIAL SERVICES

11.1 MARKET OVERVIEW

This category of service providers encompasses those that are not legally organized or licensed to provide financial services. The largest segments are accumulating savings and credit associations (ASCAs), rotating savings and credit associations (ROSCAs), merchants who sell on credit, and money lenders, also known as “shylocks” in Kenya. The number of these providers is unknown, but it is substantially larger than the combined total of all of the regulated providers. The 2009 FinAccess survey estimates that 12.2 million adults avail themselves of financial services from informal providers. The recent proliferation of pyramid investment schemes is also included in this category.

11.2 LEGAL, REGULATORY AND SUPERVISION FRAMEWORK

The informal nature of these service providers places their activities outside the mandate of any of the sector regulators. Whatever prohibitions exist in the Kenyan legal code against fraud presumably apply to some cases but the most practical barrier is that consumers have no channel of recourse and there is no agency that takes action on consumers’ behalf.

11.3 CONSUMERS AND THEIR EXPERIENCES

Consumer responses in the FSD/CGAP 2010 surveys reveal mixed experiences with informal providers. Interestingly, ASCA, ROSCA and moneylender users reported the highest rate of positive experiences with having the fees and charges explained to them prior to the service. However, the number of consumers who reported being surprised by charges and other conditions of their loan were highest for ASCA (37%) and moneylender customers (40%). Another interesting (and perhaps surprising) finding was that 41% of people that borrowed money from money lenders or shop keepers signed a contract for the agreement. The extent to which consumers understand the possibility of losing money in a ROSCA or ASCA is unclear.

The practice of seizing and auctioning collateral is fairly common among moneylenders as well as formal lenders. The 114 participants in the 14 FGDs reported stories of goods being taken away for loans that were in default. Some consumers express concern about whether this practice is actually legal and whether auctioneers were following the correct process (which is meant to provide some safeguards to borrowers). However, it is clear to most consumers that the collateral was seized because the borrower committed it as security for the loan.

The consumer surveys also revealed a high incidence of pyramid schemes.⁵⁰ Forty-four percent of the interviewees reported that they had been approached about participating in a pyramid scheme, and 8% did in fact invest. The

proportion of interviewees who said they lost money was 6.4%. If we can assume that the 1548 sample of 18 or older adults are similar to the population of adults in Kenya as a whole, this would translate into just under 1 million adults who have lost money in pyramid schemes in Kenya. Respondents in the sample reported an average loss of around Kshs 34,000 (US\$425), which, assuming that every person who lost money lost a similar amount, would mean a total of Kshs 31 billion has been lost to pyramid scheme. Most of these losses are not reported. Only 38% of those who lost money complained, as 22% said they did not know where to address a complaint and 40% felt it would not do any good anyway.⁵¹

11.4 RECOMMENDATIONS

It is unlikely that sector-based regulatory enforcement would have any effect on the conduct of informal sector financial services. The potential for creating protection through a cross-cutting law is discussed in Chapter 13. The most effective policy instrument for this sector will be enhanced consumer awareness and education, which is explained in greater detail in the following chapter.

A cross-market regulator may be able to govern retailers providing credit and moneylenders. In India, for example, the states regulate money-lending, and the South Africa National Credit Act creates broad protections for borrowers, including those using store credit and traditional money-lenders. There may also be mechanisms for addressing large scale and relatively organized forms of fraud such as pyramid schemes. Establishing clear penalties in the penal code for embezzlement and fraud would set up a legal framework for prosecution of these initiatives. This would enable the authorities to appoint special investigation, prosecution and/or judicial units to deal with such problems when they erupt on a large scale. Punishing the wrong-doers in a well-publicized fashion would help build consumer trust that there is some measure of protection. Here again, consumer awareness will be an important policy instrument, since consumer complaints to a hotline or some other centralized channel are likely to provide the tip-off to emerging schemes.

Another potential solution worthy of further investigation and research would be to classify any group investment schemes above an amount such as Kshs 7 million as falling under the ambit of the capital markets authority.

⁵⁰ Pyramid schemes are essentially fraud schemes which are also called “unregulated financial investment schemes”. See Central bank of Kenya, Notice to the public on unregulated investment schemes (e.g. Pyramid Schemes) Feb 26, 2007. Some financial pyramids are registered, first as investment entities and later as co-operatives (such as Sasanet Investment Co-operative Society Ltd.)

⁵¹ These numbers tie closely with estimated losses reported in the press of only 200,000 people affected, with total losses of Kshs 4 billion (US\$54 million). Given how few people report their losses officially, it makes sense that the actual number of people affected and the value of losses are much higher. [One newspaper article puts the estimate much higher, reporting that Kenyans lost over Kshs 34 billion (US\$436 million) within two years to at least 160 pyramid schemes (Nairobi Chronicle, Why Pyramids conned Kenyans, posted 7 July, 2009)].

Chapter 12

CONSUMER ADVOCACY, AWARENESS AND EDUCATION

Measures to improve financial consumer awareness and education will be a critical component of any consumer protection regime in Kenya. Consumers need a basic level of financial literacy and sufficient understanding of their rights and responsibilities to interpret contractual terms and conditions, to recognize unfair practice, and to make effective use of recourse channels when necessary. For the majority of the population that uses unsupervised or informal financial services, their own knowledge will be their only reliable defence against services that are unaffordable, deceptive, abusive or outright fraudulent. Over time it is also necessary to improve the capacity of Kenya's nascent consumer advocacy organisations, as these can play a useful role in pushing for effective implementation of financial consumer protection measures and help identify and address problems in the market.

The consumer research revealed key gaps in consumer awareness and financial capability. As noted, the FinAccess 2009 survey found that only 37% of respondents could correctly solve two basic math problems. The rapid spread of pyramids is yet another indication that a large portion of the population may not readily identify fraud schemes.

In the FSD/CGAP 2010 research, many consumers said they were aware of key information about their providers and products; they thought they understood it up-front but were then surprised at the actual product features (e.g., charges) and practices. Their knowledge of their rights was often incomplete and they expressed confusion or lack of confidence about addressing certain problems. The boxed quote typifies this situation. FGD respondents were not always clear whether their problems had a legal basis and whether they had something legitimate to complain about, let alone to whom they could complain.

Focus group respondent

"I think we are lacking some information, like [I] don't know if I am wronged by a bank or micro finance [institution] . . . or if there is any set mechanism which can follow up things on my behalf."

Man from Eldoret

12.1 CURRENT INITIATIVES

The Financial Education and consumer Protection Program (FEPP) is the public-private partnership formed to drive implementation of financial education and consumer protection initiatives and eventual development of a comprehensive national strategy. The 2008 FEPP scoping study⁵² surveyed existing initiatives, identified priorities and examined initial pilot activities to identify cost-effective measures in the Kenyan context.

For example, the IRA uses FM stations to educate consumers on features of insurance products and the CBK has activities to raise awareness about deposit

safety. The RBA has undertaken numerous consumer awareness drives country-wide to encourage employees (including those in the informal sector) to take up pension products. FSD is supporting a pilot project to relay financial literacy messages through a TV soap opera dubbed "Makutano Junction." One recent episode generated over 2000 requests for a family budgeting template in less than half an hour, and another that featured money lost to a pyramid scheme created a similar response.

Faulu Kenya, Post Bank, Co-operative Bank and Equity Bank are among the financial service providers that have initiatives in financial education to increase their customers' knowledge and skills. Equity Bank has established a call centre which is advertised through plasma screens in banking halls, leaflets, face-to-face communication with customers, and the ATM network including bold-face notices on ATM cards. Safaricom/M-PESA's call centre is another example of a large scale mechanism for providing information to customers. Many observers assert that technology-assisted awareness efforts could help bridge the gap. Real-time POS messages or SMS texts at the point of transaction, for example, could remind consumers to protect their PIN or obtain a receipt. An independent call-in line or SMS text service could answer consumers' queries about the new price disclosure regime and help them compare loan options.

Civil-society activity in the consumer advocacy and education sphere is nascent and under-resourced. The Consumer Information Network of Kenya (CIN) was founded in 1994. It is a member of Consumers International, an umbrella organisation of consumer associations around the world. It has three regional offices and is headquartered in Nairobi. The main activities are campaigning and lobbying, providing consumer advice, and publishing. CIN represents consumer interests in a number of boards or committees, including Kenya Bureau of Standards and the trade policy review with the National Committee on World Trade Organisation. The association has also raised some grants and receives some indirect government support.⁵³ This organisation does not have a legal desk and can therefore not support consumers in litigation.

CIN offers consumers assistance with seeking recourse with their service provider. CIN reports that it first tries to understand the nature of the complaint and whether consumer rights have been breached. CIN then contacts the service provider to understand their view of the matter. If matters cannot be settled this way, the association contacts the regulator. The association advises consumers to first try to settle the complaint with the provider in question.

CIN has expertise mainly in the areas of food safety, health and trade. However, they received 1,251 complaints from financial consumers in 2009.

⁵² Nelson, Candace and Wambugu, Angela, *Financial Education in Kenya*, FSD Kenya, August 2008.

⁵³ The website of the association is www.consumerupdate.org

Table 14: Financial services complaints received at CIN

Total number (financial services)	1251
Male	728
Female	523
Insurance	274
Banking	129
Investments (IPOs)	362
SACCOs	188
Mobile Banking	72
Retirement benefits	21
Others	205

Notes: Sources are CIN (2010) for time period of 1 January 2009 to 31 December 2009

12.2 RECOMMENDATIONS

The FSD 2008 Scoping Study outlines a course forward that provides a basic framework for a coordinated national financial education policy: *the proposed vision for financial education is national; its delivery is multifaceted; the implementation will be the product of a public/private partnership between government, the corporate sector and civic organisations.*

The consumer research suggests that effective measures to improve consumers' knowledge and behaviour could bring meaningful consumer protection gains relatively quickly.

A central element of any financial consumer protection strategy should be raising mass-market consumers' awareness about, and ability to exercise their rights. In the near term, this effort should focus on the key areas identified in the diagnostic – transparency in prices, terms and conditions; fair practices; methods of dispute resolution and third-party recourse; and key risks such as illegal investment schemes. A consumer awareness campaign focused on the right to internal dispute resolution, how to bring complaints effectively, and avenues for third-party recourse would be timely following issuance of the regulations. Implementation of the new banking agent regulations creates a timely opportunity for a focused awareness campaign, conducted by the relevant regulators working in concert with industry.⁵⁴ The CMA followed up disclosure requirements with awareness creation, and their experience might offer lessons for other sectors.

Consumer testing will be critical in advance of large-scale roll-out of awareness and education campaigns (e.g., around new transparency rules such as plain

language and local-language disclosures, Key Facts sheets available prior to sale, and standard documentation for credit or insurance products), to assess whether consumers actually use them as intended. Testing multiple delivery channels (e.g., print media, radio, television) will help establish which methods work best for different messages and market segments. Incorporating new content into the ongoing road shows and other awareness activities already undertaken by regulators could offer one sensible approach. The joint regulators' task force could provide a vehicle and framework for implementation and coordination.⁵⁵

As noted, there are no easy short-term legal or regulatory "fixes" for the problem of pyramid schemes. Promoters usually disguise them as MFIs or SACCOs. Consumers are challenged to know the difference between them and legitimate financial service providers or investment vehicles. A consumer awareness campaign, led by the regulators and/or Ministry of Finance, could provide specific guidance to consumers on how to detect a pyramid scheme, alert them when one is uncovered, and make crystal clear that such schemes are illegal and will be prosecuted. Putting in place a widely-publicized toll-free hotline has been useful in other countries. A Key Facts document could outline the common features that provide a tip-off that a deposit or investment deal is too good to be true. Dissemination through such innovative channels, civil society organisations, provincial administrations, etc. as well as standard media and vernacular radio would help get the word out more widely. Tanzania took measures recently to reduce the impact of pyramid schemes, and its experience might offer some lessons.

A policy initiative of this scope will require budget support and a public sector champion capable of sustaining the general policy commitment as well as coordinating the development and implementation of a multi-faceted action plan. The Ministry of Finance, the financial sector regulators' Task Force and the judiciary could for example develop a mechanism that enables the public to report suspected pyramid schemes (e.g. hot line) and provide tougher sanctions and law enforcement against promoters of such illegal investment vehicles. Inquiry reports on such schemes should be made public. Please see Annex 1 for specific activities associated with implementing the report's recommendations. Both the private and public entities as well as consumer advocacy organisations will be required to invest resources to undertake basic activities such as:

- Staff training on legislation and regulation;
- Public awareness and information campaigns;
- Development of access channels that consumers can use to contact the appropriate authorities;

⁵⁴ If successful, these awareness and education efforts also will raise awareness about the general advantages of formal services relative to informal (which are better understood by consumers), in such areas as price and safety of deposits.

⁵⁵ The regulatory and consumer awareness experience of countries including Peru, South Africa, Ghana, India, Indonesia and Malaysia could be instructive. For example, South Africa has industry-wide financial education initiatives, with modest coordination and facilitation provided by the Treasury. The general experience in raising consumer awareness and capability in parallel with implementation of the Credit Act could be relevant to the Kenya situation

- Development of appropriate financial education content and delivery channels that contribute to building consumers' capabilities.

In the longer term, the capacity of consumer advocates to assist financial consumers with the complaints and recourse process needs to be strengthened, especially in light of the specific responsibilities described for them in the pending Competition Bill.

Chapter 13

CROSS-MARKET CONSUMER PROTECTION

This section summarizes the rationale for cross-market legislation and enforcement, provides a brief overview of the current legal landscape, and explores key issues with references to experiences in other countries.⁵⁶

13.1 RATIONALE

While Kenyan authorities can make initial incremental progress through the actions of financial sector regulators, there are important aspects of a comprehensive financial consumer protection legal and regulatory regime that may need to be addressed through a cross-market law with consumer protection provisions and one or more corresponding oversight authority(ies).

The most important current gaps that could be addressed in this manner are the following:

- **Coverage for consumers of unsupervised and informal service providers**

This is the most significant gap that cannot be addressed through sectoral regulation. As noted previously, 65% of the adult population uses informal financial service providers. In addition, non deposit-taking SACCOs and MFIs are subject to little or no direct supervision and have a combined customer base of an estimated further 3% of the adult population. A cross-market law and enforcement authority could extend equal consumer rights across many of these service providers, provide a level playing field for all providers, and create a recourse channel for consumers who currently lack one.

- **Consistent coverage for market conduct related to specific products and practices**

A cross-market regulator may be best positioned to regulate, enforce and monitor specific market practices that are central to consumer protection, such as deceptive advertising, pressure sales, unfair contract provisions, data privacy or collections practices. As prudential regulators have adopted risk-based regulation models, they have tended to focus on providers' risk-management capacity and have abandoned many of the specific regulations associated with the former rules-based approach. Therefore, neither the core mandate nor the regulatory approach of sectoral (prudential) regulators is well-suited to focused oversight of these specific market conduct problems. Furthermore, consumers should be able to expect some consistency of fair treatment, no matter which type of service provider they use.

- **Third-party recourse and market monitoring**

As noted, the most efficient and effective mechanism for dispute

resolution is at the provider level. The sub-sector regulators are best positioned to ensure that regulated providers make such a mechanism available to and workable for their clients. The cross-market Ombudsman authorized under pending legislation could reinforce existing internal dispute resolution and third-party recourse mechanisms in three ways. First, it would create incentive for providers to resolve issues before they escalate to public view. Second, a cross-market external recourse mechanism could also protect consumers in sub-sectors where such a mechanism does not currently exist (through the regulator, Tribunal, etc.). Finally, a cross-market authority could monitor consumer welfare issues market-wide and provide regular information for public use and policy making. This includes identifying specific problem spots for attention by the consumer protection authority and/or sub-sector regulators.

13.2 LEGAL AND REGULATORY FRAMEWORK

Kenya does not have cross-market consumer protection legislation or a competition law with substantial consumer protection provisions.

The *Restrictive Trade Practices, Monopolies and Price Control Act (Cap 504)* is currently the most comprehensive legislation related to competition in Kenya. The Monopolies and Prices Commission functions as a department of the Ministry of Finance under the authority of the Act, with an enforcement mandate generally exercised through, or with the concurrence of, the Minister. The Act seeks to encourage competition in the economy by prohibiting restrictive trade practices and controlling monopolies and concentrations of economic power that it deems harmful to consumer interests. In this regard its provisions on competition may set controls on the market conduct of financial intermediaries and limit abuse of dominant market positions and, indirectly, protect the collective interests of consumers. While the Act was not designed *primarily* for application to services in general, and financial services in particular, it contains provisions that apply to, or are relevant to, financial services.

Under the Act the Commission has a mandate to review market structure and conduct (including abusive market practices and collusive bidding). However, the Commission has not investigated the banking sector, based on the perception of low levels of market dominance in the sector.⁵⁷ The Act empowers consumer advocacy organisations to lodge complaints, but this has occurred only in an unrelated area.⁵⁸ The Act does not contain provisions on consumer welfare.

⁵⁶ In CGAP's annual survey of financial regulators, respondents from 118 economies (more than 80%) reported having laws and regulations addressing financial consumer protection in some fashion. This includes 67 countries with a general consumer protection law with explicit reference to financial services, 77 countries with consumer protection regulations within the framework of financial sector legislation, and 42 countries with another type of consumer protection legislation. Financial Access 2010, CGAP.

⁵⁷ In insurance, misconduct was detected in the AKI, where insurance companies conducted fixing for premium rates on mega-risks (high values, fire, group life, etc.).

⁵⁸ CIN has lodged a complaint with the Monopolies and Prices Commission in the area of dairy products and edible oils markets, which was unsuccessful (see Office of the Deputy Prime Minister and Ministry of Finance/Monopolies and Prices Commission, Annual Report for the Financial Year 2008/ 2009, p. 14)

The Public Complaints Commission provides third-party recourse for consumers of public sector services. The Commissioner reported receiving complaints for financial services outside that mandate, such as pyramid schemes, and then referring these complaints to the CBK.

The most relevant and advanced legislative initiative available to the diagnostic team was the pending Competition Bill-2009. The team reviewed the latest version, which has general provisions that would promote consumer interests through enhanced competition as well as a specific section concerning consumer welfare that focuses directly on consumer protection. One of the bill's principal objectives is "to protect consumers from unfair and misleading market conduct." The scope of the bill encompasses all goods and services, with explicit reference to financial services (e.g., insurance, banking, lending of money and consultancy, Section 2).

The Competition Bill would establish the Competition Authority, outlaw restrictive and unfair trade practices and regulate mergers as well as unwarranted concentration of economic power. It would also create cross-market market conduct standards in areas such as fair contract provisions, deceptive advertising, and unconscionable behaviour. Among the relevant provisions are the following:

- Part III of the bill defines horizontal (i.e., among competitors) as well as vertical (i.e., among firms located at different steps of the value chain), restrictive trade practices. These include issues such as price-fixing, allocating markets and consumers, bundling and tying, collusive tendering, discrimination on a non-economic basis, etc.
- Part VI applies to consumer welfare, i.e., the benefits an individual enjoys from the consumption of goods and services including financial services.
- Sections 55-60 cover false or misleading representation and prohibit those engaged in the sale of goods and services from engaging in unconscionable behaviour. This part of the bill also lays out information standards, requires that consumers be informed of all charges and fees, and prohibits providers of banking, micro-finance and insurance services from imposing unilateral charges and fees, if the consumer has not been notified. The provisions require that information is presented in such a manner that the consumer is able to understand fully the terms and conditions.
- For third-party recourse, the bill sets up a Competition Tribunal (part VII). Recognized consumer bodies are entitled to notify the authority of any infringements of the law.

In its current form, the Competition bill addresses some of the aspects of a comprehensive, cross-market consumer protection regime. In addition, the Kenya Law Reform Commission informed team members about the pending market-wide general consumer protection bill (which differs in substantial

respects from the private member's bill tabled in 2007). However, the team did not have access to this document.

Collectively, these two legislative initiatives could provide the key elements of a coordinated and comprehensive competition and consumer protection regime in Kenya. The diagnostic team concludes that if enacted and implemented effectively, these two legislative initiatives could improve financial consumer protection but would not fully substitute the financial sector regulatory measures as recommended in this report. The following section treats issues that merit consideration in the policy decisions that will inform the final version of these bills.

13.3 KEY IMPLEMENTATION ISSUES FOR CROSS-MARKET AUTHORITY(IES)

▪ How to establish capacity and enforcement authority in a new regulatory agency

An existing agency faces significant challenges in taking on new mandates. Creating a new agency to implement and enforce newly established legal mandates effectively is still more difficult. The new Constitution establishes a clear mandate for a new consumer protection agency. Setting it up is likely to take some time. Its start-up process and learning curve will be faster and more effective to the extent that the existing sub-sectoral regulators have already provided a foundation of basic consumer protection regulation and practice. Their action over the next several years will lend credibility to the new agency's mandate and practical lessons for its operations. Thus, the diagnostic team's central recommendation is that the financial regulators undertake a serious and coordinated approach to consumer protection now, using their existing mandates.

▪ Jurisdictional boundaries with sector regulators

The draft competition and consumer protection laws are both under legislative review. When the new cross-market agency(ies) are created, it will be important to clarify the consumer protection jurisdiction and responsibility boundaries between them and the financial sector regulators. International experience offers some models for addressing this.

When South Africa enacted a new consumer protection bill that applies to financial services as well as other goods and services it was critical to clarify jurisdictional responsibilities and put in place effective co-ordination mechanisms between the different authorities, both to avoid conflicts between different regulators and to reduce uncertainty for regulated entities. The new authority (in the Department of Trade and Industry) is responsible for overseeing consumer protection matters in financial services. However, the bank supervision department in the South Africa Reserve Bank retains responsibility for prudential oversight. For consumer credit, the National Credit

Regulator (NCR) retains responsibility to oversee the market conduct of all credit providers, including banks. The various laws contain specific provisions to address jurisdictional overlap,⁵⁹ and the roles and responsibilities of the other financial sub-sector regulators vis-à-vis the new consumer protection authority are being worked out. A standing committee convenes all regulators with responsibility in the financial sector to address policy issues and coordinate their mandates and activities.

Peru provides another case where multiple actors have consumer protection responsibilities: the Superintendent of Banks and Insurance, a combined consumer protection and competition authority, and multiple statutory third-party recourse providers. They have worked out protocols and coordination procedures over the years. Another relevant example could be Botswana, where the Consumer Protection Unit in the Ministry of Trade and Industry and the Bank of Botswana's Banking Supervision Department share responsibility for financial consumer protection.

Many countries have faced this challenge. Nearly 50 countries in the recent CGAP survey of financial authorities have both a general cross-market consumer protection law that refers to financial services, and consumer protection regulation within the financial sector legal framework. Drawing clear lines of jurisdiction, coordination and information exchange between the various entities responsible for implementation and enforcement can be a key barrier to effectiveness. The international examples cited illustrate modalities for achieving this.

▪ **Integration of consumer protection and competition policy and authorities**

Opportunities exist to reinforce links between the pending consumer protection and competition bills in Kenya. Competition and consumer protection measures play complementary roles in a market economy, they address many of the same areas of market practice, and they tend to use complementary indicators for acceptable market behaviour and consumer welfare.

Countries can benefit from a well-structured interface between competition and consumer policies.⁶⁰ Several countries have a single authority carrying out these mandates (for example, the UK Office of Fair Trading and the US Fair Trade Commission). Australia has a single Competition and Consumer Protection Agency. South Africa has opted for separate authorities with distinct but complementary roles: the South Africa Consumer Protection Authority and Competition Commission. The latter undertook a very comprehensive Banking

Enquiry into bank charges, bundling, access to the payments system and other matters of relevance to consumer protection.

▪ **Coordination of recourse mechanisms**

In Kenya, coordination of recourse mechanisms is especially important because some of the financial sub-sector regulators already have a legal mandate and provide third-party recourse to consumers. One option would be for each of the current recourse providers (e.g., the IRA, CMA, and Co-operative Tribunal) to retain that function, with a new cross-market tribunal serving those consumers without such an avenue. Such a body could also provide a last recourse avenue of appeal before court action for all consumers. An alternative approach would be to establish a new cross-market tribunal whose mandate supersedes those of the sub-sector regulators. Mexico and Peru, for example, have agencies (CONDUSEF and INDECOPI, respectively) that serve as the overall Ombudsman (for financial services only in the first case and for all goods and services in the second). South Africa has an Ombudsman for virtually every financial sector, as well as the Tribunals for credit and consumer protection. This institutional landscape raises coordination and jurisdiction challenges and can be bewildering for consumers.

⁵⁹ For example: (a) a requirement that the NCR consult with Bank Supervision prior to taking enforcement action against banks, and (b) an exemption in the Consumer Protection Act for the credit component of any transaction where an item is purchased on credit.

⁶⁰ OECD (2008). *The Interface between Competition and Consumer Policies*, Global Forum on Competition, DAF/COMP/GF/WD(2008)37.

Chapter 14

AREAS FOR FUTURE INVESTIGATION

This initial diagnostic study focused on a limited range of financial services that are most used by mass-market consumers in Kenya – basic credit, deposit and payments products. A comprehensive approach to financial consumer protection will require in-depth appraisal of other products and sectors. In addition, the research revealed sufficient anecdotal information about some areas or practices in the mass market that warrant further monitoring and research. Areas for further investigation include:

- **Other products and providers**

A similar analysis of providers, consumers, legal-regulatory framework and gaps is necessary to develop key findings and recommendations that will strengthen financial consumer protection in investment services (capital markets), pensions, foreign exchange bureaus, money transfer operators and the insurance industry as a whole.
- **Consumer lending**

The rapid increase in consumer lending is readily observable. Banks are increasing consumer loan products such as salary loans, SACCOs are offering similar products through their FOSA operations, and new non-bank lenders are entering the market with aggressive marketing of “salary check-off loans” and automatic roll-over payday loans aimed at mass-market consumers. The rapid growth in consumer credit, the entry of new lenders, and the rapidly increasing number of new and lower income borrowers is sufficient cause for caution. These products deserve particularly close scrutiny. There exist a number of regulatory and non-regulatory measures that could be considered in Kenya to address any emerging practices that are cause for concern, including unfair contract provisions (e.g., cooling-off periods, prohibition of excessive penalty interest or waiving of consumer rights), aggressive sales and collections practices or reckless lending (e.g., mandatory affordability assessment).
- **Fair treatment**

The diagnostic process did not allow for a thorough investigation of the full range of contract provisions, product features and market practices that could raise consumer protection concerns. The consumer research and key informant interviews did suggest that collections practices need further investigation, including the behaviour of auctioneers and providers of outsourced collections. Another area that merits more in-depth attention is unfair or abusive contract provisions; careful analysis of typical contracts for credit and other services could help identify significant problem spots that might need attention. Further research could provide a more measured assessment of the prevalence of deceptive advertising and aggressive sales practices as well. Another potential trouble area that surfaced in the diagnostic process is insurance claims settlement processes and outcomes.
- **Data privacy and security**

The diagnostic did not review data privacy and security practices among service providers, nor supervision measures among the regulators. These two areas deserve further attention and on-going monitoring.
- **Alternative Dispute Resolution Mechanisms**

The Kenyan judicial system clearly does not offer mass market consumers an accessible and affordable mechanism for third-party recourse against a financial service provider. A small claims court (proposed under the Small Claims Court Bill) and alternative dispute resolution (ADR) mechanisms including court-mandated arbitration could offer effective and complementary recourse options for financial service-related complaints when internal dispute resolution is inadequate.

Chapter 15

EXPLORING THE CONSUMER RESEARCH FURTHER

Qualitative and quantitative data collection and analysis informed the findings and recommendations in this report. The qualitative findings were generated from a total of 14 Focus Group Discussions (FGDs) commissioned by FSD. The FGDs were performed in February/March 2010 and covered a total of 112 consumers of various socioeconomic backgrounds across the provinces.

The quantitative findings are based on a survey of 1548 adult consumers (18 or older). The initial sample of 1000 was selected proportionate to population size across the provinces and districts. An additional 548 respondents were selected in a booster sample to ensure a minimum of 50 respondents for each of the key products in the survey questionnaire. The purpose of the boost sample was to ensure that there were enough (at least 50) users of each type of financial instrument. For certain products, such as long terms savings for example, a population representative sample would not provide a high enough number of respondents.

Because of the boost sample in the quantitative survey, the population sampled is better off and more engaged in the formal financial sector than FinAccess 2009 shows the nationwide population to be. For example, there is a higher percentage employed in the private sector (just over 15%) and less (about 12% compared to 21% in FinAccess) are dependent on family remittances. Likewise, a larger proportion of the sample have access to more sophisticated financial instruments, as described in each of the sections below. Part of these differences can be attributed to the slightly more urban bias of the consumer protection sample. In the consumer protection survey, the rural urban split is 63%:37%. In FinAccess 2009, the rural urban split is 79%:21%

15.1 KEY FINDINGS

The following information can be considered preliminary findings on the state of consumer protection within the Kenyan financial services sector.

Table 15: Consumer protection within the Kenyan financial services sector

Type of financial service	Problem	Data
Financial capability	FinAccess 2009 suggests that a high percentage of the population is NOT effectively numerate.	Only 37% of the population could solve 2 math problems, but 47.5% responded that they did not know the answer to the questions, perhaps reflecting discomfort rather than a lack of knowledge.
	Generally, users find it easy to get information on charges and penalties across formal and informal products, although more say it is easier to get information from informal services.	Overall, 66% of users said that they found it very easy to get information on charges and penalties for the products they use.
	But users are not sure about whether an incident is worthy of redress or not, let alone how to pursue a problem.	Qualitative data
Savings	Users have a lower incidence of losing money in formal than informal instruments.	7% in bank savings/8% in MFI/7% in Sacco/9% in ASCA/11% in ROSCA.
	However, consumers still report relatively high levels of loss due to institutions closing down, errors in records and misappropriation.	Loss in banks through: <ul style="list-style-type: none"> • Institution closing 21% • Misappropriation 12% • Errors in records 27%
	Transparency and information is not as good as it should be, particularly at banks.	12% of users of banks said they did not have charges/interest/penalties explained to them clearly. This compares to 4% and 5% with ASCAs and ROSCAs.
	Users were aware of the concept of hidden charges but still had trouble detecting them.	Qualitative data
Loans/credit	There should always be a written agreement from a bank, MFI or SACCO, but banks and SACCOs are not consistently providing written documentation.	6% of bank loan users and 5% of Sacco loan users did not receive a written loan agreement.

Type of financial service	Problem	Data
	Too much pressure to sign the loan agreement right away, across the board	10% of the users of formal credit, i.e. bank loans, MFI, hire purchase, Sacco, are pressured to sign right away. This is not much worse than 14% of moneylenders.
	Terms and conditions should be clearly explained but are not.	6% of bank loan users, 3% of MFI loan users and 7% of Sacco loan users did not have someone explain the terms of the loan. That is not much better than an ASCA or money lender, both at 3%.
	Respondents are still surprised by various charges even for formal institutions.	25% of bank loan users, 18% of MFI loan users, 25% of Sacco loan users, 20% of hire purchase users are unaware of various changes on loans. This is quite close to 37% of ASCA users and 40% of moneylender loans.
	Respondents are surprised by the repayment amounts or term length	More users of formal credit, i.e. bank, MFI, SACCO (8%–9% of users) were surprised, while only 6% of ASCA and 0% of moneylender users were surprised.
	Not a lot of attempts to restructure loans that have been defaulted on	Data is challenged, but it looks like, of those who defaulted, a significant number did not try to restructure their loans.
	There appears to be a common practice of attaching and auctioning goods in the event of default, among formal and informal lenders alike. Respondents, for the most part, believe this is legal and take it as a matter of course.	Qualitative data
Insurance	Lots of life insurance being sold	26% of the sample
	Details were not explained in writing.	13% of users said details were not explained in writing.
	Respondents were concerned about various problems they had encountered, from fraudulent sales by agents to unfair charges.	Qualitative data
Long term savings	Investments — being sold with a promise of a certain return.	30% of users (users are 7% of sample) responded they are sold with a promise of return.
	Pressured to make investment.	15% of users said they were pressured to make investment.
	There seems to be a lack of information about pensions.	12% of sample are unsure if they will have a pension; 21% are uncomfortable asking their employer about their pension; 12% received less than expected in their pension; most of those asked their employer; only 17% of those who asked got a satisfactory answer.

Type of financial service	Problem	Data
Mobile payment services	Very well used, and also by vulnerable	84% of sample; 71% of vulnerable in sample
	Used frequently	5% said daily, 33% said once a week; 38% said once a month
	Problems are somewhat frequent	11% said they miss-sent; 3% said they never received money being sent to them; 3% said a payment was not received and it was not their error; 22% said there was no cash at the agent.
	But resolved quickly	29% said right away, 63% said within a day
	Respondents seemed to be avid and enthusiastic users. Although most had encountered problems, they generally knew how to get these resolved and learned by experience that the resolution happened quickly.	Qualitative data
Pyramid schemes	Lots of people get approached about investing in pyramid schemes	44% of sample has been approached; 41% of the vulnerable sub-sample has been approached.
	Not many invest, but those who do have lost money	85% of those who invested have lost money; average amount lost is Kshs. 37,013; of these, 26% are vulnerable and lost an average of Kshs.15,613.
	Those who lose money, don't complain	Of those that lost money, over half (69%) would not complain, either because it would not do any good or because they did not know who to complain to.
	At least one participant in every focus group had been touched by a pyramid scheme and lost money.	Qualitative data.

Annex 1

IMPLICATIONS OF KEY DIAGNOSTIC FINDINGS AND RECOMMENDATIONS FOR CONSUMER AWARENESS AND FINANCIAL EDUCATION

Consumer protection objective	Key recommendations	Which providers covered	Consumer awareness needs	Consumer education needs	Comments on implementation and roles
Disclosure and transparency	Require by regulation standardized credit price disclosure across all regulated service providers – i.e., Total Cost of Credit (TCC) and Repayment Schedule (RS), incl. standard calculation and disclosure methods.	Regulated service providers (i.e., banks, DMIs, SASRA SACCOs; credit-only MFIs and non SASRA SACCOs.	Public information campaign using multiple media regarding right to receive this information (when, how, format).	Outreach to consumers through multiple channels using simple materials and practical techniques - regarding understanding and using TCC & RS including for comparison shopping.	Providers are to display and explain this information during credit process; consumer hotline and mystery shopping are tools for monitoring compliance; future potential for central repository and price comparison service, SMS communication to consumers, etc.
	Disclosure of pricing, terms and conditions for non-credit products.	Regulated service providers (i.e., banks, DMIs, SASRA SACCOs); credit-only MFIs and non- SASRA SACCOs.	Public information campaign regarding the right to this information, how to use it, and the importance of careful product selection and comparing pricing.	Outreach to consumers through multiple channels using simple materials and practical techniques – how to be sure you understand what you are getting, how to seek out good value-for-money.	Providers are required to display and explain this information. Use of on-site inspection by regulators, consumer hotline and mystery shopping to monitor compliance. Potential for dissemination through vernacular radio (like agricultural prices).
	“Plain language” and standard contract provisions for simple products (e.g., IRA ongoing project on “standardisation of policy wordings”).	Regulated service providers (i.e., banks, DMIs, SASRA SACCOs); – credit-only MFIs and non- SASRA SACCOs.	Public information campaign re the right to understand your financial service and the tools available to do so pre contract quotation, which can be read out aloud and also provided in the local language.	Multiple FinEd Initiatives & techniques to help consumers understand agreements and use the info for decision-making (incl. taking documents home to study and seek advice before signing).	Key fact documents provided as cover sheet on agreements or through a pre-contract quotation to be signed by both parties. Industry role in developing effective plain language and standard contract provisions is highly desirable.

Consumer protection objective	Key recommendations	Which providers covered	Consumer awareness needs	Consumer education needs	Comments on implementation and roles
	Deposit/policy protection consumer awareness enhancement.	Banks, SASRA SACCOs & insurance companies.	Public information campaigns regarding the benefits of this protection, which institutions are covered, how to know if your service provider is covered (or how to seek out one that is if yours is not).	Educate consumers on benefits of shopping around and checking the lists of covered providers before placing deposits or acquiring insurance policy.	Use of broad range of media and outlets, including vernacular radio, churches, local officials.
Fair practices	Service provider (principal) liability for agent behaviour.	Regulated service providers (banks, MPSPs, insurance companies).	Incorporate relevant content into public information campaigns about rights to transparent disclosure and recourse).	Incorporate into financial education initiatives on right to recourse and how to pursue a complaint.	Agents provide bold signage at premises; clear disclosures in agreements/contracts.
	Key Fact Documents about products and services.	Relevant to all formal financial service providers.	Incorporate the key facts documents as part of product and service marketing to enable consumer to select appropriate services and make across the board comparisons.	Incorporate as part of awareness campaigns and financial education programmes to ensure consumers request and use them.	Service provider associations to set standards for these documents and take part in campaigns.
Effective dispute resolution and third-party recourse	Internal dispute resolution.	Regulated service providers (i.e., banks, DMIs, SASRA SACCOs) ; credit-only MFIs and non-SASRA SACCOs.	Incorporate information regarding internal dispute resolution rights and procedures into public information campaigns.	Integrate knowledge and skills regarding effective dispute resolution into financial education. initiatives for consumers.	Providers post procedures prominently in premises and on contracts. Surveillance by regulators to monitor compliance with standards.

Consumer protection objective	Key recommendations	Which providers covered	Consumer awareness needs	Consumer education needs	Comments on implementation and roles
	Third party recourse.	Regulators, Tribunals, potentially industry associations (depending on the sector and its institutional arrangements).	Integrate information about available resource mechanisms for the different sectors into public information campaigns.	Consumers are educated on their rights to receive redress and mechanisms by reporting to regulators through the provincial administration where their disputes have not been settled internally.	Each sector regulator can provide information to the public about the recourse options within their sector. The multi-regulator Task Force can provide coordination. Sector regulators publish dispute resolution statistics (e.g., volume and nature of complaints, outcomes for consumers) for the providers they regulate, to build confidence that the system works. In the longer-term, set up third-party recourse mechanisms for sectors where there are none or for the entire market (e.g., through a new Financial Ombudsman).
	Regulators publish information on providers' financial and consumer protection performance against set guidelines.	Regulated financial service providers.	Consumers aware on the existence of this reports to enable them select the most preferred and complying provider.	Consumer needs to be educated on their rights and responsibilities of providers.	Media coverage to raise consumer awareness and performance. Publish as part of the usual annual supervision report.

Consumer protection objective	Key recommendations	Which providers covered	Consumer awareness needs	Consumer education needs	Comments on implementation and roles
Avoidance of pyramid schemes	Ministry of Finance, regulators' Task Force and judiciary to prepare a strategy including mechanism for public to report suspected schemes (e.g., hot line) and tougher sanctions and enforcement against promoters of illegal investment schemes. Publish the pyramid schemes inquiry reports.	Mainly informal financial provider, Non SASRA Sacco's and investment groups.	Develop Key Facts documents outlining what to look out for to avoid getting caught in a pyramid scheme. Organize public information campaign around the Key Facts document.	Integrate content on avoiding pyramid schemes into ongoing financial education initiatives.	Outreach and awareness-building through credible sources such as the church and provincial administration. Create a hot line where consumers can report such schemes. Punishment by law of perpetrators of pyramid schemes.

Annex 2

DETAILED FINDINGS

2.1 FINANCIAL CAPABILITY

Measuring financial capability and understanding is a difficult exercise. Looking at one set of evidence may indicate that consumers seem confused. According to FinAccess 2009, only 37% of respondents could correctly solve two math problems involving division and multiplication. However, there were also a high number of respondents (47.5%) who said that they did not know the answer to the questions, which suggests that respondents might have been self-conscious, more than ignorant.

For the most part, respondents appeared to find it relatively easy to obtain information across many different types of instruments. Table 16 shows how respondents ranked how easy it was to get information on different types of savings instruments. Naturally, informal instruments such as ROSCAs and ASCAs were considered easier to get information, and banks, MFIs and SACCOs more difficult, but overall, most respondents found it very easy to get information about the products they used. This was also reflected in surprising bits of knowledge that would come up in the focus groups – awareness that the Central Bank issues banking licenses, knowledge about a banking act, use of the correct financial terms.

What was less clear was the bigger picture. For example, the focus groups reflected an impression that people don't really know where their money is safe. There were doubts expressed about all types of institutions – in banks, in SACCOs even in M-Pesa. In the words of one man from Ahero "... at the end of the day, we don't know if our money is not safe. ..."

Moreover, there was a lack of clarity about recourse. Respondents in the focus groups were not certain whether, in practice, they were dealing with problems that had a legal basis or not, and they were not always sure whether they had something legitimate to complain about or not, let alone who to complain to.

One man from Eldoret explains "I think we are lacking some information like we don't know if I am wronged by a bank or micro finance. I don't know if there is a certain mechanism which I need to address and one thing that comes to my mind if I am wronged is my relative who is an advocate and then you go report so that he can follow it for you but we don't know, okay I don't know whether there is any set mechanism which can follow up things on my behalf or when I am wronged by a financial institution." His views are not uncommon, and most stories about how find redress to a problem ultimately involved personally hiring a lawyer.

2.2 SAVINGS

The consumer protection survey covered a population with more access to different types of savings products than the national population. As Table 17 below shows, 59% of the sample has a bank account of some sort, while FinAccess 2009 suggests that only 24% have a bank account. The percentages for the consumer protection are also higher for SACCOs, MFIs, ASCAs and ROSCAs.

Table 17: Number and percent of respondents that have the following types of savings devices

	Bank savings account	SACCO	MFI	ASCA	ROSCA merry-go round
Consumer protection survey 2010	54%	20%	15%	17%	47%
FinAccess 2009	24% ⁶¹	9%	3%	8%	32%

Table 16: How easy is it to get informal about charges or penalties for each of these different savings products? (1 = very easy; 5=very difficult)

Difficulty rankings	Bank savings	MFI	Sacco	ASCA	Rosca	Share across all types of financial institutions
1 (very easy)	54%	61%	63%	79%	81%	66%
2	28%	29%	28%	16%	15%	23%
3	9%	6%	7%	3%	2%	6%
4	6%	3%	2%	0%	0%	3%
5 (very difficult)	1%	1%	0%	0%	0%	0%
Refused/ did not know	2%	0%	1%	2%	2%	2%
Number of respondents	949	238	303	266	723	2479

⁶¹ For FinAccess 2009, we counted respondents who had any of these types of accounts: Postbank account, bank savings account, current account, bank account that meets every day needs and ATM card.

Table 18: Respondents who have lost money in savings instruments

	Bank savings account	SACCO	MFI	ASCA	ROSCA merry-go round
% responding yes	7%	7%	8%	9%	11%
Number	67	20	19	25	76
% that lost money					
Institution closed	21%	21%	5%	12%	8%
Money eaten by charges and penalties	33%	55%	10%	0%	3%
Misappropriation of money	12%	21%	20%	56%	51%
Errors in records	27%	16%	20%	0%	4%
Cannot access because account is now dormant	0%	0%	0%	0%	0%
Members did not pay their contributions	NA	NA	20%	28%	22%
Did not receive payments I was meant to receive	NA	5%	NA	NA	NA
Did not answer	12%	42%	25%	12%	20%

Note: Multiple responses possible.

Between 7% and 11% of respondents who have used these devices say that they have indeed lost money in them. Of those that lost money in banks, most blame the charges and penalties for “eating away” their money, although many say that they lost money when the institution closed down (21%), money was misappropriated (12%) or errors in records (27%). When one compares this to money being lost within informal devices, the reasons are more due to misappropriation of funds and other members not paying their contributions. Over half of those who lost money in ASCAs and ROSCAs did so because of misappropriation of money.

These relatively low levels of loss may be one reason why most respondents seem to feel that these savings devices keep their money safe, and why banks appear to be the most trusted. However, comparatively speaking, we would expect banks to have a much low rate of loss compared to informal savings devices, and particularly to see very low incidence of errors in records, misappropriation and institution closings. These figures are relatively high and would perhaps suggest a more in-depth look at how concerns on accounts are handled.

With the exception of banks, most respondents felt that the charges, interest and penalties were explained clearly. However, 12% of users of banks felt that this was not explained clearly. This was also reflected in the focus groups. Participants in focus groups reported frequent problems with bank charges that they did not understand. As a man from Eldoret describes “The banks are doing very little to inform the public about the charges. They only talk about the advantages. . . Just like Bata would tell me a certain shoe is Kshs. 399, I would prefer if it was Kshs.s. 600 with all the charges involved in that.”

Table 19: Respondents who say that they trust their savings instrument to keep their money safe

	Bank savings account	SACCO	MFI	ASCA	ROSCA merry-go round
% responding yes	97%	93%	93%	92%	92%

To try to resolve questions on savings devices, Table 21 suggests that most respondents said that they contacted the institution and had their questions resolved. However, there are a high number of respondents, particularly with banks and SACCOs that attempt to have their questions but do not get satisfaction.

Table 20: Were the charges, interest and penalties explained clearly?

	Bank savings account	SACCO	MFI	ASCA	ROSCA merry-go round
% responding yes	97%	93%	93%	92%	92%

Table 21: Did you speak to anyone when you had questions on your account?

	Bank	SACCO	MFI	ASCA	ROSCA
Contact institution, and question is resolved	91%	91%	93%	92%	93%
Contact institution, but no satisfactory answer	7%	7%	6%	7%	5%
Contact institution, but no one will speak with me	1%	1%	0%	0%	1%
I don't know how to contact the institution	1%	1%	1%	0%	1%
I won't try to contact the institution because they won't listen	0%	0%	0%	0%	0%
Total	100%	100%	100%	100%	100%

This in part may reflect a confusion about what should be a resolvable problem and what should not. A woman in Naivasha, for example, explained “As I had said earlier there was a time some money had been withheld from my account. I took the issue to the credit manager and on following it up they told me somebody senior had withheld the money and he did not have any explanation why that happened. I have heard many people complaining about (one of the large banks) that if you are not careful you will find certain amounts missing from your account and there are no explanations as to where the money had disappeared to. You have to keep on checking your balances to ensure that no money is missing.”

This woman was able to sort out this trouble, but others were not so lucky. As another woman from Naivasha describes “There are times you might check your balance only to realize that they have made some deductions. When you inquire about it, they tell you to come back the following week. They might return the

money and sometimes they might say they have no idea what happened to the missing money.”

2.3 LOANS

Again, across the consumer protection survey sample, more respondents had access to loans than FinAccess 2009 would suggest for the population.

Not all users of loans received a written loan agreement. For user of informal services, such as a loan from an employer, a money lender, shop keeper or ASCA, this is to be expected, although many of these borrowers did indeed have a written agreement with these informal lenders. In the formal sector, however, one would expect borrowers to have a written loan agreement all of the time. Yet this was not the case. Only in hire purchase and with MFIs did all users respond that they had written loan agreements, while only 93% of bank borrowers and 95% of SACCO borrowers said they had a written agreement.

Table 22: Respondents with loans from various formal and informal institutions

	Bank	SACCO	MFI	ASCA	Informal lender/shylock	Loan from employer	Hire purchase	Local shop keeper credit
Consumer protection 2010	10%	9%	11%	8%	2%	1%	3%	22%
FinAccess 2009	2.6%	3%	1.8%	1.8%	0.4%	0.5%	0.1%	24.3%

Table 23: Respondents who received a written loan agreement

	Bank loan	SACCO	MFI	ASCA	Shylock, money lender, or shop keeper	Employer	Hire purchase
% responded yes	93%	95%	100%	77%	41%	80%	100%

Table 24: Were you able to take the loan agreement away to study it? (% of those with written agreement)

	Bank loan	SACCO	MFI	ASCA	Shylock, money lender, or shop keeper	Employer	Hire purchase
I was able to take agreement; terms remained the same for a period of days	87%	85%	86%	75%	78%	83%	88%
I was able to take agreement; terms changed	3%	2%	4%	4%	8%	17%	3%
I was pressured to sign right away	10%	14%	10%	21%	14%	0%	10%
Total	100%	100%	100%	100%	100%	100%	100%

Of those that did have a written agreement, most but not all were able to take it away to study it. As Table 24 shows, many were pressured to sign away, even in banks (10%), MFIs (10%), SACCOs (14%) and hire purchase (10%).

Those who had taken a loan or credit often did need to offer up some type of collateral. This was often the rights to a home or other asset or to have someone sign surety. Oftentimes, it was a payslip or a certain amount of savings. Sometimes (7%) the lender withheld the borrower's ATM card and pin number.

In focus groups, participants appeared to be quite aware of what hidden charges *could* arise in loans, mentioning insurance, registration fees, standing order fees, negotiation fees, stamp charges and loan processing fees. In the quantitative survey as well, most respondent said that the loan terms were explained to them.

However, practically speaking, many respondents still found it difficult to completely understand the loan documents. They are aware that loan agreements contain important information and that they should take the time to read them, but they find it difficult to do so. As one man from Eldoret describes "I have never understood why where you need to sign is in a bigger font

and is not a headache but where they have their key information it is like seven pages but when you look at it, it is too small and repeated and it discourages you." Another man in the same group describes "I think the way those forms are arranged; those forms are drafted carefully so that by the time you are getting to the clauses about risk you are already tired. For example on those loan forms there is a clause that says if you fail to pay for one day, if in arrears the company will demand all the outstanding arrears."

Moreover, many are surprised by how much is actually charged for the loan. As one teacher from Ahero described "It is only after realizing that we have been charged so much from our pay slip that we start to ask then they will be like they explained that to you and during that argument also called negotiation, we take 2%."

This pattern played out across the quantitative survey as well. When asked whether borrowers were aware of extra charges besides interest on their loan, a very high number of respondents said no, even for loans from the same institutions where they said they were able to read documents and had charges explained to them. Moreover, as Table 28 shows, a high number of respondents said that they were surprised by how much they needed to pay and how long.

Table 25: Type of collateral required (multiple responses allowed, % of those with loan/credit)

	Rights to home/ assets	Someone to sign in surety	Certain amount of money in account	Card and pin	Payslip	Nothing
% of those with a loan/ credit	42%	45%	25%	7%	21%	24%

Table 26: Did someone explain the terms of the loan before you signed?

	Bank loan	SACCO	MFI	ASCA	Shylock, money lender, or shop keeper	Employer	Hire purchase
% of those with loan that responded yes	94%	93%	97%	97%	97%	83%	100%

Table 27: Were you aware of the extra charges besides interest on the loan?

	Bank	SACCO	MFI	ASCA	Shylock, money lender, or shop keeper	Employer	Hire purchase
% of those with loan/credit that responded no	25%	25%	18%	37%	40%	40%	20%

Table 28: Once you started paying the loan were you surprised by how much you needed to pay, or how long you needed to pay?

	Bank	SACCO	MFI	ASCA	Shylock, money lender, or shop keeper	Employer	Hire purchase
% of those with loan/credit who responded yes	9%	8%	9%	6%	0%	0%	0%

Focus group evidence suggests that repossession and auctioning off goods appears to be the norm. As one woman described *“There was a person here in Nyamithi who was unable to pay for the loan so (the MFI) went to their place to get his things so they could auction them. On hearing that since the person also owed (another MFI) some money they also decided to go to the home. So both groups met and took everything.”* The effect of such repossessions can be traumatic. This same group reported that there was recently a suicide in the area by a person who found herself in this situation – *“She was buried on Wednesday. . . she died saying that you should not do like me.”*

Despite concerns about these problems, it does not seem to occur to the participants that they have any grounds on which to have these practices changes. Even when it comes to having goods attached and auctions, they are really not sure if this is a legal practice or not. When asked, we heard different responses, for example, from a group of woman in Naivasha:

“They have to come with the letter from the chief.”

“When they come with the chief, and the member of the group, to my place if they cannot enter they come with the police.”

When asked whether it is legal for them to come and get your things, we heard:

“Yes, because you had committed yourself when you failed to pay, they can take.”

The practice of attaching and auctioning off goods does not only occur in the semi-formal sector, but is consistent for loans taken from chamas and moneylenders as well. Participants consistently have stories about goods being taken away for various loans that were in default.

The quantitative survey was not particularly helpful in providing good evidence on the experience of default, only about 1%-6% of respondents admitted not

paying their loans. That said, of those that did stop paying, very few attempted to reach the institution to try to negotiate settlement terms.

2.4 INSURANCE

The consumer protection sample, with the exception of auto insurance, held much more insurance than the population-representative figures from FinAccess 2009 suggest. This is particularly true of life insurance, in part reflecting a higher number of respondents employed in the private and government sectors.

Table 29: Types of insurance held by sample

	Life	Medical	House-building or contents	Auto
Consumer protection survey 2010	26%	3%	6%	0%
FinAccess 2009	1%	4.9%	0.2%	1.1%

Most respondents in the focus groups did not have experience with insurance, reflecting the quantitative survey results, but those that did had not had very good experiences. The complaints were mostly centred on salespeople not clearly explaining the products themselves. As one man from Mombasa explained *“It is like they have used anyone to sell insurance and they don’t know the products so you sign for a product then when the policy comes you find that it is totally different.”* This view is largely reflected in the quantitative survey, where 13% of insurance users said the details were not explained in writing and 11% said they did not understand the details of the insurance, in terms of how much would be paid and how much was and wasn’t covered. And certainly, many users did not get a chance to take agreements away to read them carefully. 17% said they felt pressured to sign right away.

Table 30: Experiences of insurance users

	Were the details explained to you in writing? 1.2	Did you understand the details of the insurance? 1.3	Were you able to take the agreement away with you before you signed? 1.4	Have you made a claim? 1.5	In your opinion, was the claim processed quickly? 1.6
Yes	87%	89%	74%	19%	74%
No	13%	11%	9%	81%	26%
			17% (pressured to sign)		
Total	194	190	191	457	86

Even worse, one man in Mombasa had a problem with fraud when an insurance agent managed to sign him up for a policy he didn't authorize. "They send people on commission and some of them come and tell you that sign these papers that you are going to buy a policy next year and they use those documents, forge your signature and claim that you had endorsed for a policy. . ." This man claimed that he had to hire a lawyer before he could have the debit order reversed and his money refunded.

Those who have made claims also have not had a good experience. Respondents also have run into problems when making claims. For example, one man found that after another car had run into him, his vehicle insurance premiums went up, even though the accident was not his fault. The survey shows that 26% of those who made a claim did not have the claim processed quickly.

2.5 LONG TERM SAVINGS: INVESTMENTS, PENSIONS, RETIREMENT ANNUITIES

As shown in Table 31, very few of the respondents of the consumer protection survey had long term investments, a result similar to FinAccess 2009 , so this area does not appear to be an appropriate short term focus. However, in the longer term, there is evidence that there are significant troubles.

In focus groups, people seem more aware of stock investing, particularly in Safaricom and Kengen. This is perhaps sparked by greater communications and a greater ability to buy shares. A self-described businesswoman from Kiambu, for example, explained that "I just heard from media and Safaricom was sending texts about Safaricom shares so I applied for the same." This purchase did not seem to be accompanied by any particular advice, as she says, ". . . I just

followed the crowd as everyone was buying so I also just bought."

However, there doesn't seem to be great understanding of what these shares will pay out. There was a lot of disappointment in the dividends, but little clear understanding of what would happen when the shares were sold. The woman from Kiambu said "I have no good experience as the Safaricom shares did not give me good dividends. So I got a cheque notification and the amount was not worth and they told me that they will send me through M-Pesa but I have not bothered. . . .I was just disappointed by Safaricom as we were looking forward to big things, and people had taken loans and even banks were giving people loans." When asked whether the banks had explained the pros and cons of buying shares, we were told "They were just encouraging people to take knowing that the securities are your shares."

When we asked if she thought to complain to anyone, she said "We did not know where to complain, the broker I used went under."

Moreover, as Table 32 suggests, many user have experiences such as a salesperson promising a certain return, pressure to buy and were left without written documentation on the terms of the product.

With respect to pensions, this is also an area that might receive more attention in the future. Many are unsure of whether they are receiving a pension and many of those that are, are not comfortable asking their employer about it. As Table 33 shows, 17% of the sample said they would receive a pension when they retired, but 12% were unsure. Table 34 shows that, of those that are sure they are receiving a pension, 21% are uncomfortable asking their employer about it.

Table 31: Respondents with various forms of long-term savings

	Education savings policy	Retirement annuity	Pension or provident fund	Investment portfolio, shares, or bonds
Number of respondents	63	52	46	113
% of respondents	4%	3%	3%	7%

Table 32: Consumer experience with investments

	Has anyone ever sold you a stock or bond and promised a certain return?	Have you felt pressured to buy such an investment?	Were you given written documentation on the terms of this product?
% of users who responded yes	25%	14%	68%

Table 33: Responses when asked if would receive a pension when retire

	Number of respondents	Percent
Yes	263	17%
No	1075	69%
Unsure	179	12%
Did not/ refused to answer	31	2%
Total	1548	100%

Table 34: Do you feel comfortable asking your employer about your pension?

	Number of respondents	Percent
Yes, and I have received satisfactory answers	103	38%
Yes, I have asked but have not received satisfactory answers	19	7%
Yes I feel comfortable, but I haven't asked	87	33%
No, I don't feel comfortable asking	54	21%
Total	263	100%

This misunderstanding carries through to retirement. Of those who are receiving a pension at the time of the survey, 12% said that they received less than they expected (Table 35).

Table 35: Responses when asked whether they received the amount they expected

	Number of respondents	Percent
Yes	95	84%
No	13	12%
Unsure	5	4%
Total	113	100%

2.6 MOBILE PAYMENT SERVICES

Mobile money services like M-Pesa, Zain/Zap and Yu are central to people's lives. The consumer protection survey recorded that 84% of the sample have used a mobile money service, much higher than the 40% reported by FinAccess 2009. Moreover, they use it for different reasons, as show in Table 22. Fewer than 40% keep a balance on their phone at least for a short period. And last, just under 40% of users, use this service at least once per week.

Table 36: Respondents who have used a mobile payment service

	Have you used a money transfer service like M-Pesa, Zain, etc?	Whose phone did you use?		
		My own phone	Phone of family or friend	Agent's phone
Number of respondents	1,293	1137	131	33
Percent	84%	73%	8%	2%

Table 37: How respondents use mobile payment services

	Purchase amount to be sent from agent;	Keeps a balance for at least a short period
Percent	43%	38%

Table 38: How often do you use M-Pesa, Zain/Zap, etc?

	%
Every day	5%
At least once per week	33%
At least once per month	38%
Once in a while	24%
Total	100%

The appeal of mobile payment services was apparent from the focus groups. Participants reported several ways in which they feel safe using M-Pesa. As one focus group of woman from Busia described:

"It is cheap."

"Customers send me money to my M-Pesa."

"It is fast and private."

"Even as we speak right now I can receive money and go and withdraw without raising any alarm as it comes to my phone."

"I like it because my money stays safe unless I withdraw and I only pay for withdrawal charges but the banks have so many charges that they deduct from your money when you bank with them."

There is certainly a feeling of safety particularly when using M-Pesa. One woman from Naivasha tells the story *"The other day (a friend) was hi-jacked and they stole Kshs. 17000 from her but she got the money on the phone though they took the phone she got the Kshs.s 5000 which was on her phone since she had blocked her M-Pesa account."* Another man in Kisumu said that he paid at the bar through M-Pesa. Really, we asked him? *"Yes, that is what we are doing nowadays. We don't walk with money."*

Respondents in the focus groups seem to suggest that charges for M-Pesa are quite clear - most respondents knew what it cost to send and receive money. They say that they know the rates because they are indicated on a poster on the wall and because *"it is one page"* and *"it is also a bright colour thus it gives you morale to read through."*

However, this contradicts some of the evidence captured in the survey. 16% of users felt that charges were not clearly explained before starting to use the service. And compared to similar questions asked about savings in Table 16, users did not appear to find it easy to get information about charges.

Moreover, although mobile payments are used widely and often, and with apparent enthusiasm, this is not to say that users don't have problems. Table 41 shows that 61% of users have never had a problem. Many (22%) have had a problem when there was no cash at the agent. 11% of users made a mistake

Table 39: Do you feel that the charges were clearly explained to you before you started using M-Pesa, Zain-ZAP, etc.?

	Number of respondents	Percent
Yes	1092	84%
No	201	16%
Refused/ did not know	0	0%
Totals	1293	100%

Table 40: How easy was it to get information about the charges? (1=very easy; 5=very hard)

Ranking	No.	Percent
1	599	46%
2	467	36%
3	147	11%
4	48	4%
5	12	1%
Refused/ did not know	20	2%
Totals	1293	100%

and sent money to the wrong account. And 3% have had problems with either receiving or their recipient not receiving money.

Even when there are problems, participants were very clear about what to do (*"You call customer care"*) and could even tell us the number. We heard frequent stories of money being mistakenly sent to the wrong person, but we were quite surprised by how often and easy it was to recover the money. A man from Mombasa told us *"I sent money to the wrong number and luckily the person I had sent to had not withdrawn so they had to reverse but luckily the reversal takes 72 hours."* Perhaps one reason why users seem happy to use the service despite a relatively high rate of problems is that they are resolved so quickly. Table 42 shows that most problems are resolved within a day.

This is not to say that users have no concerns about M-Pesa. Focus group respondents mentioned that they were still concerned about safety, in terms of new ways that people can dream up to commit fraud. Their fears were not so much based on agent fraud but on others who might look over their shoulder to get their pin, or somehow hack into the Safaricom system.

Table 41: Problems users have had with mobile payment systems

Problem (n=1,293 who've used mobile payment services)	No.	Percent
No problem	792	61%
You made a mistake; Sent to wrong account	136	11%
Payment you made wasn't received (no error)	39	3%
Never received money	45	3%
Money not in MP account	7	1%
Robbed	7	1%
No cash at agent	279	22%
Network failure	99	8%
Couldn't directly deposit money into another's account	1	0%
I don't have an account, so agent didn't transact	2	0%
Entered wrong agents' number when withdrawing money	1	0%
Not a 24 hour service	1	0%
Agents reserve cash to their account	1	0%
Someone sent money into my account by mistake	1	0%

Table 42: How long did it take to resolve the problem?

	Percent
Right away	29%
Within a day	63%
Within one month	8%
Total	100%

2.7 PYRAMID SCHEMES

A very large number of respondents had been approached about joining a pyramid scheme. At least one participant out of every focus group had been a victim of a pyramid scheme, or had someone close to him fall victim. This is reflected as well in the consumer survey where 44% of respondents had been approached to invest in a pyramid scheme.

The survey suggests that most did not invest, only 9%, but this may mask respondents being ashamed to admit that they were fooled. In focus groups, the story is more nuanced and less reassuring – many were about to invest

money but the offices had closed before they were able to do so. Of those who invested, the average amount lost was Kshs.37,013.

One man from Mombasa told us his experience with Daisy: *"I was influenced by a friend - he told me that he deposited money and then after thirty days your money triples and I was wondering how it was possible. So he deposited the first time and he got the interest, then the second time again and then he deposited the third time a large sum of money but unfortunately the thing collapsed before he got his money. So he convinced me during the third time and I tried but unfortunately we lost the money together."*

Table 43: Number of respondents approached about a pyramid scheme and invested

	Approached about entering a pyramid scheme	Investing money in a scheme
Number of respondents	685	144
Percent	44%	9%

And clearly, there was little recourse for such events. Often people do not complain at all because, as one man in Kisumu explained *"Most of the people (who lost money through a pyramid scheme he was involved in) were too ashamed to come up and say they lost a lot of money in such kind of things. . . . Most have gone to the court but the biggest percentages have just stayed behind sitting quietly and grinding."* The consumer survey reported that, of those that lost money, 25% didn't complain because they didn't know who to complain to and 34% didn't complain because they didn't think it would do any good.

Table 44: Did you complain to anyone, if you lost money?

Response	Number	Percent
Yes	50	41%
No- wouldn't know who to complain to	31	25%
No- it wouldn't do any good	42	34%
Total	123	100%

Though many people know about them, pyramid schemes are not always easy to detect at first, as one woman from Naivasha told us: *"It can be a challenge to identify a pyramid scheme. It begins for instance as a merry-go-round and then someone comes up with the idea that when it reaches a certain point this is what we will do. You can be able to recognize one because they usually start a wave as in all of a sudden everyone is excited about it and wants to join it."*

Annex 3

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Annex 4

LIST OF KEY SECTOR INFORMANTS INTERVIEWED

Organisation	Official	Title	Location
Microsave	George Muruka	Financial Services Consultant	4th Flr Shelter Afrique Hse. Mamlaka road.
	Angela Wambugu	Financial System Consultant	
Ministry of Finance	George Omino	Deputy Director	Treasury Building 10th floor
Central Bank of Kenya	Matu Mugo	Assistant Director, Bank Supervision	CBK Building 4th floor
	Reuben Chepn'gar	Bank Supervision	
	Evelyn Kilonzo	Microfinance Division	
	Daniel Tallam	Research	
	Steve Mwaura	Payments Systems	
	Asogwingo O. Kayodeh		
	Simon G. Gichuki	IT Department	
Capital Markets Authority	Stella Kilonzo	CEO	Reinsurance Plaza 4th floor
	Samuel Njoroge		
Decentralised Financial Services	Kuria Wanjau	Project Manager	2nd Flr Shelter Afrique Hse. Mamlaka road.
Equity Bank	James Mwangi	CEO	Equity Centre, N.H.I.F Building 14th floor
	Dr. Wahome Gakuru	Director, Marketing, Advocacy & Policy	
	Gerald Warui	Director, Operations & Customer Service	
	Mary Wangari	Director , Company strategy & Secretary	
	Jeane W. Mathenge	Program Manager	
Credit Reference Bureau Africa	Wachira Ndege	Group Operations Director	Prosperity Building CRB Centre - off Museum Hill
	Steven Kamau	Debt Collection Unit	
SASRA Ministry of Co-operatives	Aaron Omwenga	Assistant Commissioner	N.S.S.F Building Block B room 1023
Pyramid Schemes Commission	Francis Nyenze	Commissioner	
Interest Rate Advisory Centre	Wilfred Onono	Executive Consultant	IRAC
Public complaints Commission	Kenneth Mwige	Executive Director	Shell/BP House
KUSSCO	George Ototo	Managing Director	KUSSCO Building Kilimanjaro Avenue, off Mara rd, Upper Hill
Association of Kenya Insurance	Joseph Jamwaka	Senior Live Manager	Victoria Towers 3rd floor – Upper Hill, Kilimanjaro Avenue
Kenya Commercial Bank	Joseph Tiampati	Head of Credit	Kencom Hse, entrance Hillton side 5th floor
Kenya Association of Investment Groups	Tabitha Mwathi	CEO	Mercantile Hse Koinange Street 1st floor room 103

Organisation	Official	Title	Location
Africa Retail Traders	Amin Abudalla	CEO	ART behind CMC Motors Industrial Area
Safaricom - MPESA	Pauline Vaughan	Head of M-PESA Department	Safaricom House Waiyaki Way
CMPC	Beldine Omolo	Chief Monopoly Officer	CMPC Bima Building 9th floor
	James Mutisya	Senior Monopoly Prices Officer	
Ukulima Co-operative Society	Daniel Ndambuki	CEO	Ukulima Co-op Hse
IEA	Kwame Owino	CEO	ACK Garden hse wing D 5th
Jamii Bora	Philip Ochola	Head of Microfinance/Operations Manager	Funzi road, off Enterprise rd Industrial Area
Faulu Kenya	Anne Kamari	Legal officer	Ngong lane , off Ngong rd
Pesa Point	Richard Coate	Head of Service Delivery	Ambank Hse 10th floor
KERUSSU	Kariuki Karuri		Rose Avenue flats, Next to Kwality Hotel, off Argwings Kodhek rd, Hurlingham
Yaya Foreaux	Roy Mutungi	MD	2nd floor, Yaya Centre
NIC Bank	Sam Atandi	Relationship Manager- institutional banking	NIC House, Masaba road
Retirement Benefits Authority	Edward Odundo	CEO	Rahimtulla Towers, 14th floor
	Mutuku Nzomo		
	Daisy Onguti	Co-operate Communication Officer	
	Salome Chirchir	Asst. Manager Research Development	
Insurance Regulatory Authority	Evans Kibagendi	Consumer Protection Officer	
Consumer Information Network	Samuel Ochieng	Chief Executive	



