Digital credit audit report

Evaluating the conduct and practice of digital lending in Kenya

November 2019

fsd Kenya

Creating value through **inclusive finance**

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The Kenya Financial Sector Deepening (FSD) programme was established by the UK's Department for International Development (DFID) programme in 2001 to support the development of financial markets in Kenya. In 2005 we were constituted as an independent trust under the supervision of professional trustees, KPMG Kenya, with policy guidance from a Programme Investment Committee (PIC). Our aim today is to help realise a vision of an inclusive financial system to support Kenya's goals for economic and social transformation. We work closely with government, financial services industry and other partners across key economic and social sectors. The core development partners in FSD Kenya are currently the Bill and Melinda Gates Foundation and the Swedish International Development Agency (SIDA).

Government of Kenya

UKaid from the British people

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Bill & Melinda Gates foundation

Table of Contents

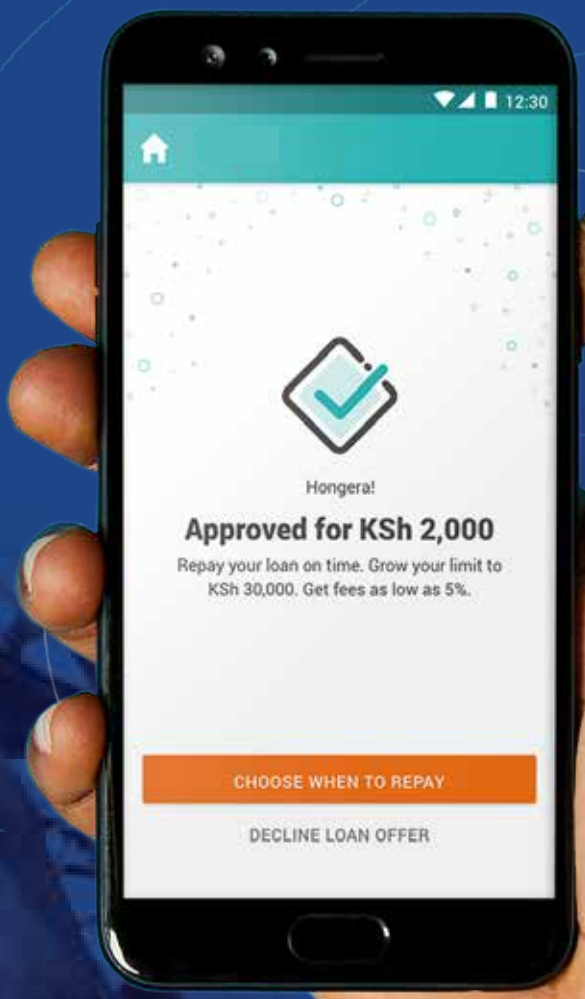
List of figures and tables

Figures

Tables

Abbreviations

APR	Annual Percentage Rate
CAK	Competition Authority of Kenya
CBA	Commercial Bank of Africa
CRB	Credit Reference Bureau
DTS	Deposit taking SACCOs
EU	European Union
ICT	Information and Communication Technologies
GDPR	General Data Protection Regulations
GPS	Global Positioning System
KCB	Kenya Commercial Bank
KYC	Know your customer
MNO	Mobile Network Operators
NPS	National Payment Systems
SACCO	Savings and Credit Co-operative
T&C	Terms and Conditions
TCC	Total Cost of Credit



> The absence of an overarching regulatory framework means anyone can lend. When credit is easy to access without safeguards, cases of debt stress begin to surface.

Executive summary

Digital credit has been instrumental in granting formal credit in ways that were not conceivable a decade ago. It has provided individuals with the tools to manage their day-to-day needs and working capital for small enterprises. Survey data reveals that over six million Kenyans have borrowed at least one digital loan. Beyond these daily use-cases, digital credit is increasingly used to finance non-routine needs such as school fees and pay for healthcare. However, while there are any bright spots, expanding access is just the first step towards realising the potential of credit to create long-term sustainable value.

The expansion of digital credit and the proliferation of digital lenders has increased attention to wider consumer protection issues. Pricing continues to be a concern, even in the presence of market infrastructure that mitigates part of the risk inherent in lending decisions. Access to infrastructure, such as credit information sharing, is disparate across lenders. Data privacy and ownership is starting to emerge as a concern. The absence of an overarching regulatory framework means anyone can lend. When credit is easy to access without safeguards, cases of debt stress begin to surface. Inevitably, there have been growing concerns to regulate the sector with concerns that some of the gains made are being eroded. However, regulation is frequently misrepresented as simply being about restricting what market actors can do. Often, carefully crafted regulation can actually support effective market function.

Research and analysis can play a role in generating a clear case for policy action, providing ex post evidence for success or the need for change in a regulatory area.

Picture / Tala homepage

Chapter 1

Context

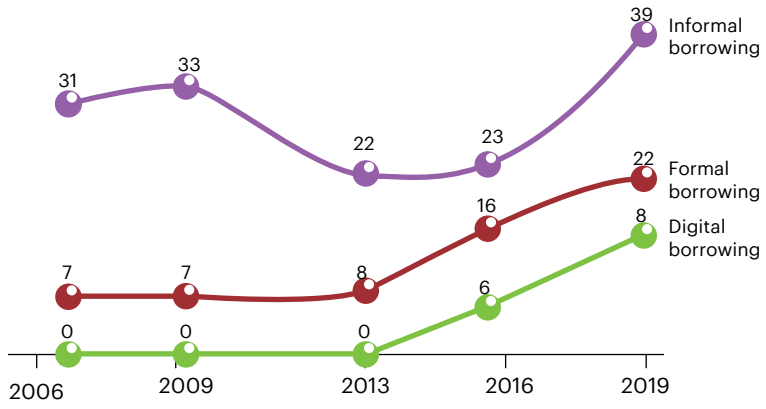
Over the last 7 years, digital credit has undoubtedly been the fastest growing financial innovation in Kenya. Recent developments, especially those enabled by mobile money, have attracted large numbers of first-time users of financial services into the market.

Overall access to formal financial services now stands at 83%, up from 67% in 2016, and 88% of the adult population has access to a mobile money account[1]. Digital credit has been instrumental in granting formal credit to previously excluded segments of the economy. Demand-side survey data reveals that over six million Kenyans have borrowed at least one digital loan for meeting day-to-day household needs and working capital for small enterprises[2]. At the same time, usage of non-regulated digital credit has grown from 0.6% in 2016 to 8.3% in 2019[3]. On the supply-side, Commercial Bank of Africa (CBA) is now the largest bank in terms of number of deposit account and loan accounts, holding 46.16% and 54.8% market share respectively largely on account of its mobile savings and loans product, M-Shwari[4].

While it is clear that the uptake of digital credit is high, there is less clarity on the size and composition of the supply-side. The digital credit market has developed very rapidly. Since the introduction of M-Shwari in 2012, new entrants from outside the prudentially regulated sectors have emerged. The largest digital lenders comprise a few banks and financial technology (fintech) companies. However, anecdotal evidence suggests that the scale of the supply-side has expanded beyond these few well-known lenders.

Regulation of lending in Kenya (for which licensing is a part) is done by institutional form and not by activity. Examples are the Banking Act for commercial banks; the Sacco Societies Act for deposit taking saccos (DTS); and the Microfinance Act for deposit taking microfinance institutions. The majority of digital credit providers do not take deposits, but instead lend their own funds against their balance sheets. As a result, most of these lenders are neither licensed nor regulated. On the other hand, almost all the digital credit lenders leverage mobile money services that are regulated under the National Payments Systems (NPS) Act. The Competition Authority of Kenya (CAK) does provide oversight over

Figure 1: Percentage of adults (18+) borrowing from formal, informal and digital sources



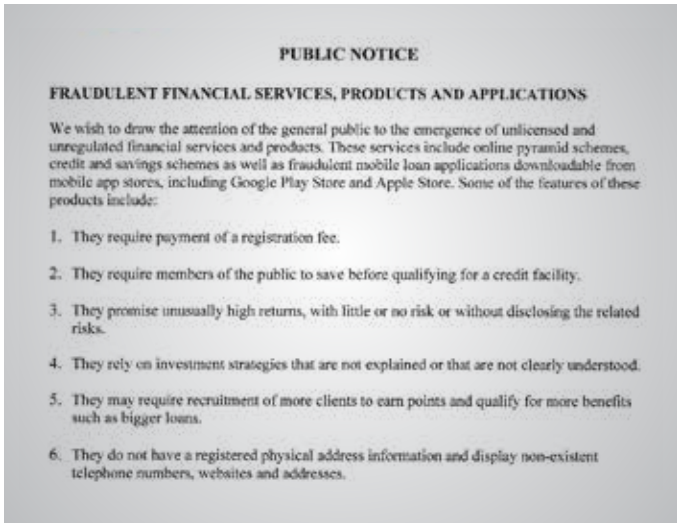
> **Digital loans are mainly used for everyday consumption and are the most used source of credit for emergencies due to their ease of access**
> – FinAccess 2019

1. Central Bank of Kenya (CBK), Kenya National Bureau of Statistics (KNBS) & FSD Kenya. (2019). 2019 FinAccess household survey. Nairobi, Kenya. https://www.centralbank.go.ke/uploads/financial_inclusion/2050404730_FinAccess 2019 Household Survey- Jun. 14 Version.pdf.
2. Kaffenberger, Michelle, and Edoardo Totolo. 2018. "A Digital Credit Revolution: Insights from Borrowers in Kenya and Tanzania." Working Paper. Washington, D.C.: CGAP.
3. FSD Kenya. 2018. Digital credit in Kenya: evidence from demand-side surveys. https://s3-eu-central-1.amazonaws.com/fsd-circle/wp-content/uploads/2018/10/18162055/Digital-Credit-in-Kenya.pdf.; 2019 FinAccess.
4. 2019 Bank Supervision Annual report, Central Bank of Kenya.

market conduct aspects such as price transparency and consumer recourse. In 2016, for instance, CAK issued a directive to all digital financial services to disclose the cost of transactions prior to consumers running the transactions on their devices. However, the scale of the nascent digital credit market and the fast-evolving nature of information and communication technologies (ICT) means that this oversight is limited by the CAK's economy-wide mandate.

The proliferation of digital lenders has increased attention to wider consumer protection issues. In July 2018, five financial sector regulators, together with the Ministry of Industry, Trade and Cooperatives, issued a joint public notice warning the public against unlicensed and unregulated financial service providers[5]. The notice cautioned that the providers included fraudulent mobile loan applications downloadable from mobile App Stores. Data privacy and ownership is starting to emerge as a concern with lender seeking to utilize consumers' digital footprints with little oversight over how the data is mined and stored[6]. Mobile loans rank second in the proportion of defaulters by loan types, with survey data revealing emerging signs of debt stress[7]. The law permits lenders to submit the names of borrowers with any non-performing loans to credit reference bureaus (CRB), yet only 30% of Kenyans are aware of CRBs[8]. Equally, there have been long running debates on the cost of digital credit, with a comparison of the annualised percentage rates of digital credit products revealing potential consumer protection concerns[9].

Box 1: Excerpt of notice on fraudulent financial services, products and applications



PUBLIC NOTICE

FRAUDULENT FINANCIAL SERVICES, PRODUCTS AND APPLICATIONS

We wish to draw the attention of the general public to the emergence of unlicensed and unregulated financial services and products. These services include online pyramid schemes, credit and savings schemes as well as fraudulent mobile loan applications downloadable from mobile app stores, including Google Play Store and Apple Store. Some of the features of these products include:

1. They require payment of a registration fee.
2. They require members of the public to save before qualifying for a credit facility.
3. They promise unusually high returns, with little or no risk or without disclosing the related risks.
4. They rely on investment strategies that are not explained or that are not clearly understood.
5. They may require recruitment of more clients to earn points and qualify for more benefits such as bigger loans.
6. They do not have a registered physical address information and display non-existent telephone numbers, websites and addresses.

Figure 2: Loan defaulters from key credit types (%)

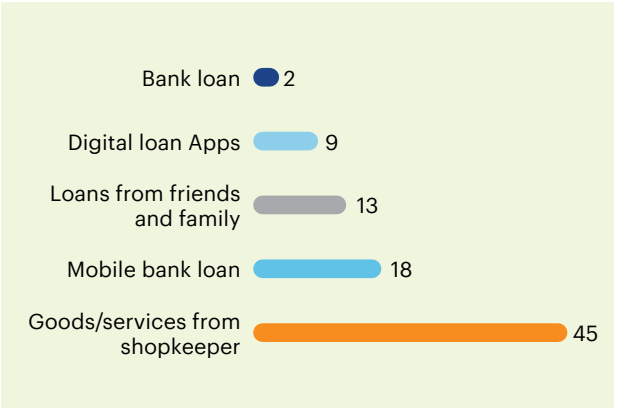
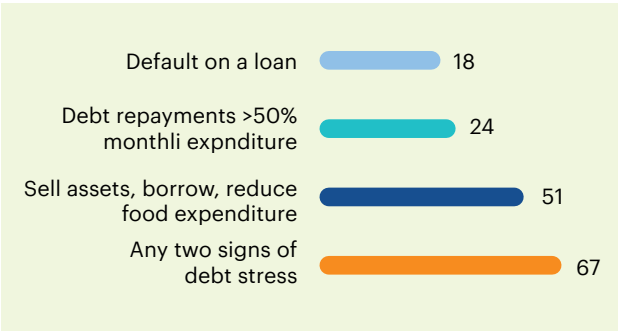


Figure 3 : Levels of debt stress (%)



Source: 2019 FinAccess data.

From an access perspective, digital credit has

5. See CBK press release: "Public notice: fraudulent financial services, products and applications." https://www.centralbank.go.ke/uploads/press_releases/130503108_Public%20Notice%20-%20Fraudulent%20Financial%20Services%20Products%20and%20Applications.pdf
6. A Data Protection Bill that establishes a legal framework for the protection of a person's privacy in instances where personal information is collected, stored, used or processed by another person has been developed, but is yet to be enacted into law.
7. Data derived from the 2019 FinAccess survey
8. Data from 2019 FinAccess also revealed that 50% of digital loan borrowers cite forgetting to pay as the main reason for defaulting on the loan, demonstrating how easy it is to end up with a negative listing.
9. Chege, Patrick, and Kaffenberger, Michelle. (2016). Digital credit in Kenya: time for celebration or concern?. Consultative Group to Assist the Poor (CGAP). https://www.cgap.org/blog/digital-credit-kenya-time-celebration-or-concern

doubtlessly impacted financial inclusion in Kenya. It has provided individuals with tools to manage their day-to-day needs and build livelihoods in ways that were not conceivable a decade ago. However, expanding access is just the first step towards realising the potential of credit to create long-term sustainable value for both borrowers and lenders. The intangibility of finance where trust is paramount means that providers must accept a duty of care to avoid harming their customers. This is sometimes underpinned by carefully designed and enforced regulation[10]. In Kenya, there are emerging concerns that the absence of such market-wide oversight has undermined some of the gains made by digital credit. Inevitably, there have been growing calls for the regulation of the digital credit sector[11].

This report presents the findings of a study aimed at understanding the conduct and practices of digital credit providers in Kenya. Research and analysis can play a role in generating a clear case for policy action, providing ex post evidence for success or the need for change in a regulatory area. The former is crucial to ensure that regulation does not stifle innovation while the latter can be a powerful force in changing the incentives of various players.

10 Ferrand, D. 2019. 'Towards a financial system which works for Kenya'' Blog Post, 11 February. https://fsdkenya.org/blog/towards-a-financial-system-which-works-for-kenya/ outlines an argument on why access alone is not enough to support greater economic and social empowerment.

11. See for instance: Kenya's central bank governor calls for regulation of fintech lenders

Picture / rawpixel.com

Chapter 2

Methodology

An audit study approach was used for this study. Audit studies offer a simple yet powerful methodological tool to examine issues that are often difficult to answer with observational data.

For this study, a team of nine research assistants with varied borrowing profiles was assembled to test real- world digital lending scenarios. Of the nine, two had never borrowed before, either from a digital lender or from any other financial institution. These were the 'inexperienced' borrowers. The remaining seven had varied borrowing experiences. Six had borrowed from both digital lenders and traditional lenders. Of the six, three had fully repaid their loans, while the other three had varied default histories (on both digital loans and loans issued by commercial banks). The remaining research assistant had never taken a digital loan, but had previously borrowed and repaid loans issued by banks and Saccos.

> Most sign-up failures were due to unstable apps that kept crashing.

In total, there were four profiles based on borrowing history ('experienced' and 'inexperienced') and repayment history ('defaulter' and 'non-defaulter'). While this profile sample does not represent the entire universe of borrower profiles that exist in the market, it enabled a nuanced insight into how borrowing and repayment histories impact access to digital credit to be derived.

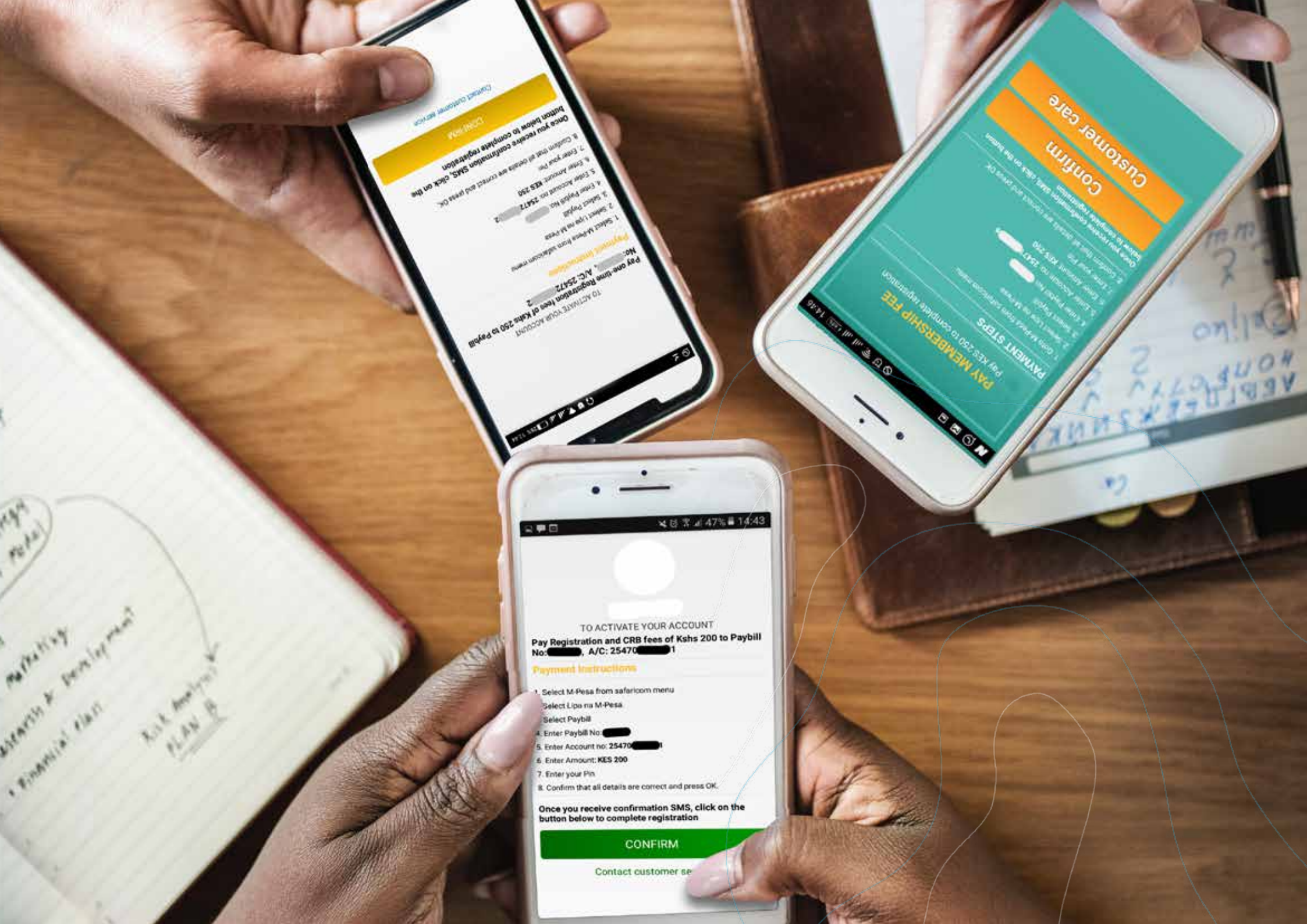
Part of the digital credit market is served by unregulated lenders. Even for the regulated lenders, publicly available data on the sector is hard to come by. To overcome data paucity, the research team trawled the two main mobile app stores (Google Play and App Store) and derived a long list of published mobile applications (apps) listed as providing digital credit in Kenya[12]. In deciding which apps to include in the list, the definition of digital credit as loans that are derived and repaid digitally—typically over a mobile phone, and are characteristically instant, automated and remote—was used[13]. As such, apps that were listed as providing products such as mobile airtime on credit, pay-as-you-go energy services and farm inputs on credit were filtered out. To this long list, digital credit products embedded in the SIM toolkits of Mobile Network Operators (MNOs) operating in Kenya were added. In total, the long-list comprised 110 digital credit products as of September 2018.

The research team attempted to sign up to all the 110 products in the long-list. However, only 64 sign-ups were successful. Most sign-up failures were due to unstable apps that kept crashing. In some cases, attempts to sign up were unsuccessful when the research team failed to meet certain criteria. For instance, some digital credit products offered by Saccos require one to first be a member of the Sacco before registration. Some banks offering digital credit have embedded the product in their mobile banking application, which is available only to the bank's customers. Some banks further require customers to visit their physical branches to validate or complete the registration process.

Thirty nine digital lenders issued a credit limit immediately after registration, majority below KShs 2,500. The highest credit limit assigned was KShs 16,000 from a bank-based lender but to a research assistant who held a transaction account at the bank. The research assistants then attempted to borrow from all the lenders who issued a credit limit after registration. A total of 40 borrowing attempts were successful, carried out over two borrowing and repayment cycles. The loans taken in the first cycle were all repaid within five days. One week elapsed between the first and the second loan. The research assistants checked their loan limits before taking out the second loan that was repaid after the maximum allowable loan term which varied per lender.

The data recorded during the registration (sign-up) phase, the transactional data from the two borrowing cycles, and desk reviews of the lenders' terms and conditions provided the data upon which this report is based.

12. In this report, both app-based and STK-based products are collectively referred to as 'digital credit products' while the providers are referred to 'digital lenders.'
13. Chen, Greg, and Rafe Mazer. (2016). "Instant, automated, remote: The key attributes of digital credit." CGAP. http://www.cgap.org/blog/instant-automatedremote-key-attributes-digital-credit


TO ACTIVATE YOUR ACCOUNT
Pay Registration and CRB fees of Kshs 200 to Paybill
Payment Instructions
1. Select M-Pesa from safaricom menu
2. Select Lipa na M-Pesa
3. Select Paybill
4. Enter Paybill No:
5. Enter Account no:
6. Enter Amount: KES 200
7. Enter your Pin
8. Confirm that all details are correct and press OK.
Once you receive confirmation SMS, click on the button below to complete registration
CONFIRM
Contact customer se
PAY MEMBERSHIP FEE
PAYMENT STEPS
Confirm
Customer care

Chapter 3

Market review: supply-side

A once concentrated market is now a deluge

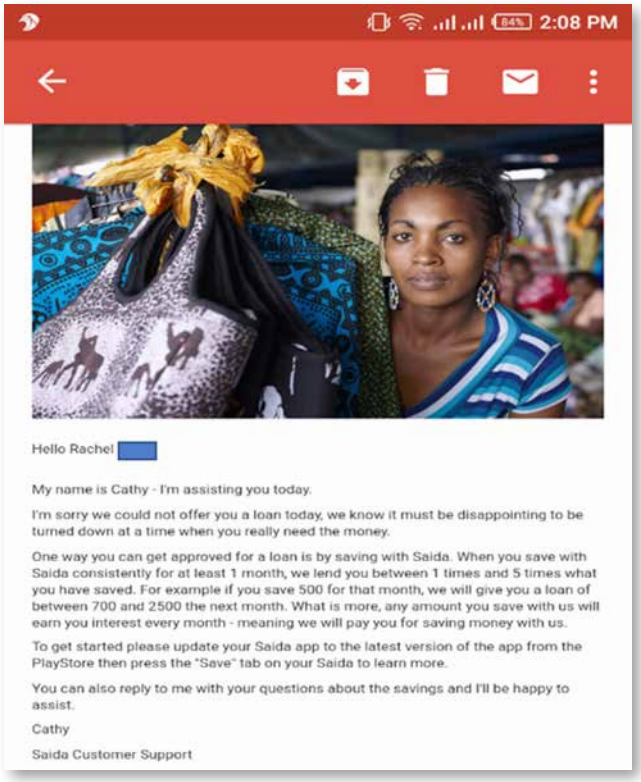
The digital credit landscape has rapidly changed since the launch of the first product, M-Shwari, in 2012. Two years passed before the next product, Mkopo Rahisi, later rebranded as Tala, was launched in 2014. This was followed a year later by two products, KCB M-Pesa and Branch in 2015.

Since then, hundreds of new products, mostly mobile apps developed by fintech companies, have emerged. In September 2018, the two main app stores had approximately 110 mobile apps provided by 74 unique developers listed as offering digital credit. As at April 2019, 65 of these apps had been pulled down from the app stores, while 47 new ones developed by 43 unique developers had emerged. There was an unprecedented rise in the number of apps published in 2018, from 14 in 2017 to 49 in 2018.

Most of these apps have less than 10,000 downloads from the two main App Stores. Two lenders, Tala and Branch, had more than one million downloads each as of March 2019. Two other apps had between 500,000 to one million downloads. There are relatively unknown lenders with download numbers as high as those of well-known mainstream lenders. However, the download numbers are not necessarily a reflection of the borrower base. Demand-side research has revealed that Branch, Eazzy loan, M-Coop Cash and Tala are the most popular app-based digital lending products in the market[14].

These numbers demonstrate how easy it is to enter, and indeed, exit the market. Low entry and exit barriers are essential to promoting efficiency, competition and innovation in markets. However, there are instances where having some entry and exit barriers are desirable, such as to vet the integrity of firms entering the market, or to deter firms with 'hit and run' strategies. The unprecedented entry of digital lenders reflects the sheer appetite for credit in Kenya. Kenya currently has a price cap on the interest rates charged on loans issued by commercial banks. A preliminary analysis of the impact of the cap show that there has been an impact on intermediation, with a number of borrowers shunned by banks[15]. There is undoubtedly a need to be served, or perhaps an underserved market to be exploited, which might have led to the growth in digital lending. Even for banks offering digital credit, a March 2018 court ruling that the interest rate caps did not apply to M-Shwari has enabled banks to expand digital credit offerings that exceed the cap threshold[16].

And not everyone is playing by the book

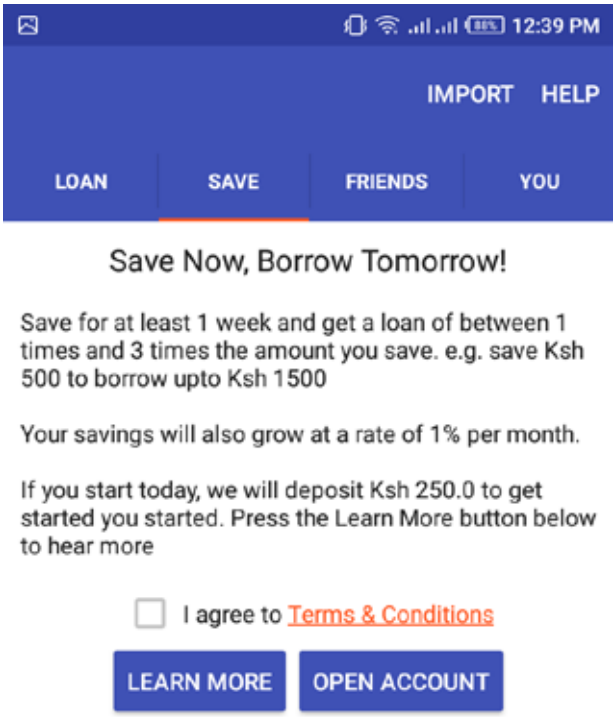


14. Kaffenberger, Michelle and Edoardo Totolo. 2018. 'A Digital Credit Revolution: Insights from Borrowers in Kenya and Tanzania''. Working Paper. Washington D.C. CGAP.
15. Central Bank of Kenya. (2018). The impact of interest rate capping on the Kenyan economy. https://www.centralbank.go.ke/wp-content/uploads/2018/03/Summary-of-the-study-on-Interest-rate-Caps_February-2018.pdf
16. Standard newspaper: Blow for borrowers as court retains M-Shwari facilitation charges. https://www.standardmedia.co.ke/business/article/2001274023/blow-for-borrowers-as-court-retains-m-shwari-charges.

Indeed, not all the lenders that have published digital credit apps are genuinely engaged in the business. While some are engaging in questionable and fraudulent practices, others are outrightly breaching existing laws.

The most egregious of these are lenders that are neither non-banks or non-DTSs but are mobilising deposits from the public. Current legislation places restrictions on institutions that can engage in deposit taking. For instance, banking business includes the accepting of public money as deposit repayable on demand or at the expiry of a fixed period[17]. However, one lender that is neither licensed as a bank, nor a microfinance institution or a DTS requires potential borrowers to first save by depositing money, through a PayBill number, with the promise of a 12% return, before becoming eligible for a loan.

Likewise, there are lenders who require the payment of a fee before potential borrowers are eligible for a loan. Sixteen lenders required the payment of a fee ranging

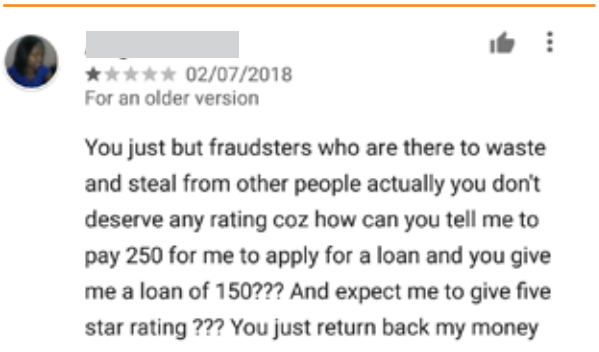


from KShs 200 to KShs 400 during the registration process. The purpose of the fee varies across lenders. Some lenders indicated that the fee is for a credit reference check yet there was no evidence of any enquiries on the borrowers' credit report once the fee was paid. Others indicated that it was a registration fee or a membership fee. Other lenders did not indicate the purpose of the fee. In total, the borrowers paid the registration fee to six lenders with varied outcomes. All the six lenders disbursed a loan once the fee was paid, but in some instances, the registration fees were higher than the loan amounts.

Table 1: Registration fees vs loan disbursed

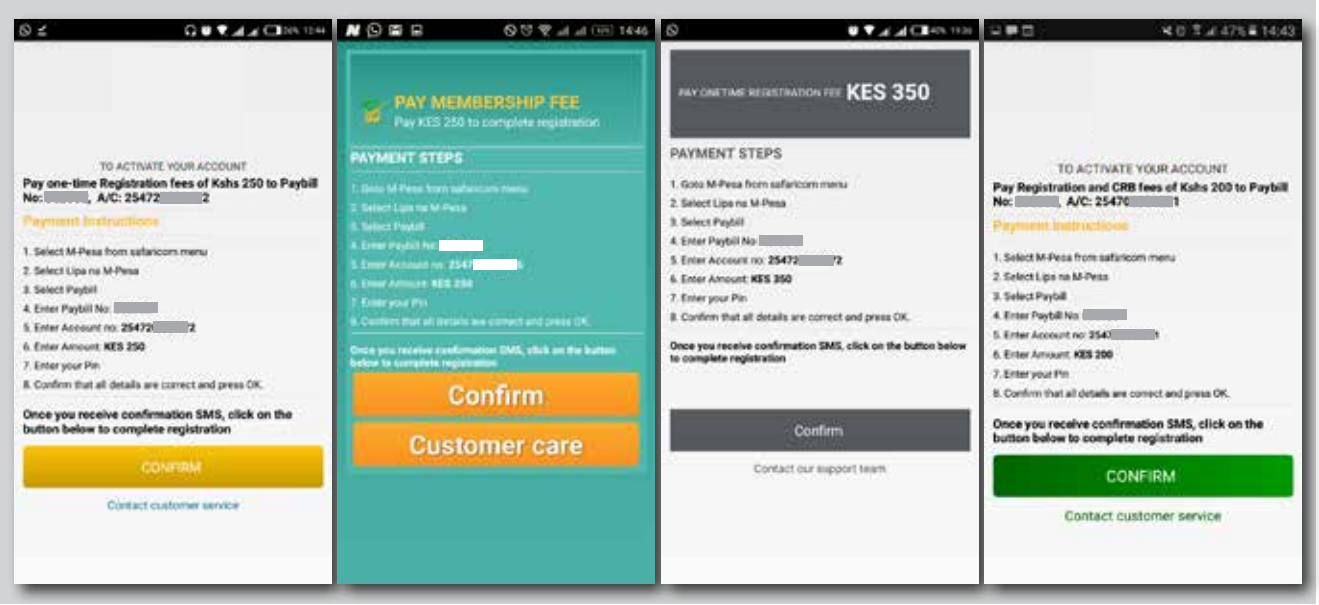
Lender	Fee (KShs)	Purpose	Loan amount (KShs)
Utunzi	**200**	Registration and CRB check	**700**
Kano	**350**	Membership	**700**
Dolax	**250**	Registration	**150**
Craft	**250**	Registration	**300**
Upazi	**250**	Registration	**150**
Usawa	**400**	Registration	**700**

The public notice issued by the financial services regulators cites the requirement of payment of a registration fee as one of the features of fraudulent financial services. The notice further warns the public to confirm the authenticity of providers requiring such payments, suggesting that they are collecting the fee but not disbursing any loans. User comments from the App Stores confirm as much.



Other apps encourage borrowers to write positive reviews with the promise of either higher loan limits or cash rewards. Some apps have names that mimic well-known lenders. Examples include 'CoopM-Pesa Credits', 'Tala Loans Kenya', 'Tala Pewa Loans', 'Tala Kash', 'Tala-Mkopo Instant', 'Fuliza Mpesa Loans', 'Fuliza Sasa', 'Mkopo Branch Rahisi' and many more. Some apps are

17. Section 3 of the Banking Act Cap 488: http://www.kenyalaw.org/lex/actview.xql?actid=CAP.%20488



even published as offering digital credit but are in actual sense mere fronts for in-app advertisements. These cases point to a 'free for all' market where even the most unscrupulous 'lenders' can thrive. Surprisingly, even the most nondescript apps, some bearing the hallmarks of a scam, seem to have attracted some potential borrowers. The underlying question is: what would draw borrowers to these types of lenders? Unsurprisingly, the user comments on these apps are mostly complaints from frustrated borrowers who have lost money in one way or the other.

Fintechs dominate the market

Nonetheless, there are lenders who are genuinely engaging in the business of delivering instant, automated and remote digital loans. Out of the 110 lenders in the initial long-list, this study estimates that approximately 60 are genuinely engaged in lending. Non-deposit taking fintech companies dominate this list. Beyond well-known bank lenders like M-Shwari by the Commercial Bank of Africa (CBA), KCB M-Pesa by the Kenya Commercial Bank (KCB) and Eazzy Loan by Equity Bank, other banks have followed suit and launched their own products. NIC Bank and Family Bank both offer mobile loans through their mobile banking apps. Finserve, a fintech company fully owned by Equity Bank, offers loans through its mKey application. Barclays Bank's offering is through its virtual account, Timiza.

Picture / nappy – pexels

Chapter 4

Consumer data

The use of data is wide-ranging and hard for consumers to manage

4.1 App permissions

The rapid expansion of digital credit in Kenya has been driven in part by the increasingly sophisticated uses of digitally-derived data. Such data include telecommunications data, applications data, financial transactions data, and social media data.

In the absence of a regulatory framework or industry standards on data ownership and the right to privacy, the use of such data might portend some risks to the consumer. Most consumers often do not know what data is being used, or how their data is being shared, and neither can they easily control how the data is used[18]. Usually, the business model of the digital lender dictates which data can be accessed, used and shared. Where the model comprises a partnership with an MNO or a regulated lender, financial data such as the borrower's mobile money transactions, will most likely determine the lender's credit decisions. A fintech app-based lender without access to potential borrowers' financial data may require permissions for the app to scrape data from the borrower's phone, including reading messages with details of financial transactions.

Financial data is likely to provide better insights into a borrower's true financial position compared to alternative data[19]. Providing credit requires lenders to perform an assessment of one's history with money[20]. However, not all the lenders have access to potential borrowers' financial data. Differential access to data can impede competition, disadvantaging other players and placing high entry barriers to smaller innovators.

Most of the lenders in this study required basic identification and bio data during the registration process. The borrower's phone number, name, email address, ID or passport number are the most requested information during sign-up. Some lenders also require potential borrowers to provide income data such as employment status and monthly income, while others require borrowers to have a social media account.

Box 2: Excerpt from Timiza's terms and conditions

You hereby agree and authorise Safaricom to share with the Bank personal information held by Safaricom pursuant to the agreement between you and Safaricom for the provision of Safaricom products and services and M-Pesa Services, including your phone number, name, date of birth, ID or Passport Number, and such other information that will enable the Bank to identify you and comply with the regulatory "Know Your Customer" requirements (together the "Personal Information").You also hereby agree and authorise the Bank to request Safaricom for information relating to your use of the M-Pesa Service, M-Pesa System and Safaricom Services as the Bank shall require for purposes of providing you the Services ("M-Pesa Information"). You hereby consent to the disclosure of the Personal Information and the M-Pesa Information by Safaricom to the Bank and to the aforesaid use of the Personal Information and the M-Pesa Information by the Bank.

18. AFI consumer empowerment and market conduct working group, November 2017, "Digitally derived credit: Consumer protection issues and policy responses to new models of digital lending" AFI.
19. Insights from a Kenyan digital lender revealed that relying on credit scores provided by Safaricom, a mobile network operator with a mobile money product, increased the lenders loan ticket size by up to 250% when compared to using the lender's own data. https://fsdkenya.org/blog/data-sharing-models-the-potential-for-financial-innovation-and-the-risks-that-must-be-managed/
20. For an overview of the use of alternative data for financial access, see Elena Mesropyan on the good and bad practices: https://gomedici.com/alternative-data-financial-access-good-bad-ugly/

A CGAP survey of 26 data centric financial service providers reveal that providers regard their data as a valuable competitive asset. Accessing transactional, phone-use and demographic data held by third parties especially MNOs remain a frustration to small businesses

There's variation in the number and type of data requested by bank and fintech lenders. Both require basic KYC data such as name, phone number, ID number, but the fintech lenders require additional data such as income range, employment status and guarantor details.

All the apps further request access to the phone's data. The registration process was done after Google updated its developer policy requiring all apps to request user permission prior to accessing their phone data[21]. Permissions to read SMSs, call logs, phone contacts and GPS location were the most requested. For fintech lenders, access to the photo gallery and to read the phone's identity were also requested. Some apps declined to complete the registration process when permission to read messages was not granted. There's little variation in the permission requested between banks and fintech lenders. The only striking difference is the number of fintech lenders who require permission to display in-app advertisements.

Figure 4: Data requested by fintech lenders and banks

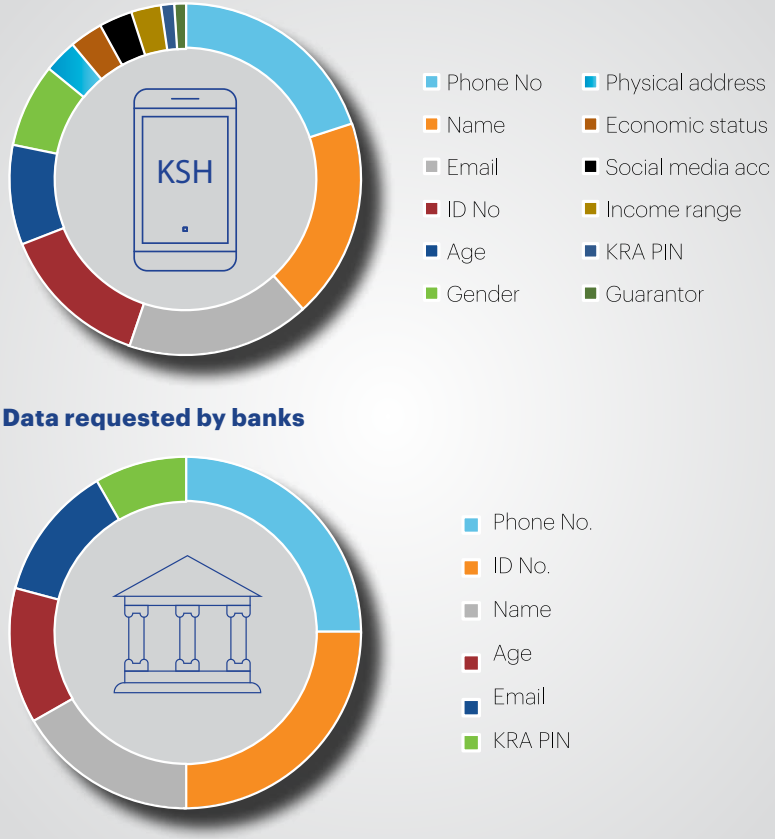


Table 2: App permissions requested

Permissions requested	Fintech lenders	Bank lenders
Read messages	✓	✓
Read phone contacts	✓	
Read call logs	✓	✓
Read GPS location	✓	✓
Display adverts	✓	
Access photo gallery	✓	✓
Read phone identity	✓	✓
Access emails	✓	

21. See https://play.google.com/about/privacy-security-deception/permissions/

4.2 Data privacy, access and consumer rights

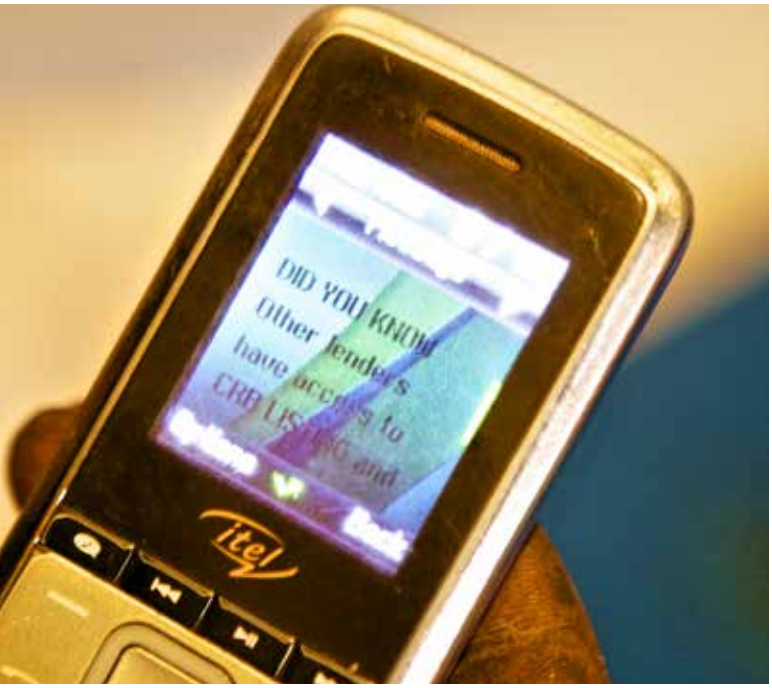
Table 3: Summary of data privacy provisions

Lender	Privacy policy	Privacy clause in Terms & Conditions (T&C)	Data usage	Receive data from third parties	Share data with third parties	Consent before sharing	Consumer right to use & access own data
Branch	✓	✓	Lending decisions	✓	✓	Only for marketing purposes	✓
Tala	✓	✓	Lending decisions	✓	✓	Lender has discretion to share data	Stores data even after app is deleted
Timiza		✓	Lending decisions	✓	✓	✓	
mKey	✓	✓	Data use at discretion of lender	✓	✓	✓	✓*
HF Whizz		✓	Lending decisions	✓	✓	Accepting T&C gives consent to disclose	
M-Shwari		✓	Lending decisions	✓	✓	Accepting T&C gives consent to disclose	
KCB M-Pesa		✓	Lending decisions	✓	✓	Accepting T&C gives consent disclose	
Eazzy loan		✓	Lending decisions		✓	Accepting T&C gives consent disclose	
O Kash	✓	✓	Lending decisions		✓	Accepting T&C gives consent disclose	
Craft, Upazi, Usawa, Dolax, Kano and Utunzi	✓	✓	Lending decisions	✓	✓	✓**	✓
Okolea	✓		Lending decisions	✓	✓	✓	
PesaPap***							
PesaZone	✓	✓	Lending decisions		✓	Accepting T&C gives consent disclose	Not liable for any loss due to data held
Kopa Cash		✓	Lending decisions	✓	✓	Accepting T&C gives consent disclose	
Stawika	✓		Lending decisions	✓	✓	Accepting T&C gives consent disclose	Customer has right to rectify inaccurate data/records
Ubapesa	✓		Lending decisions	✓	✓	Accepting T&C gives consent disclose	
Get Saida		✓	Lending decisions		✓	Accepting T&C gives consent disclose	

* mKey's consent before sharing customer's data and customers' right to access and use own data only applies to users in the European region under the GDPR framework.

** Craft's privacy policy states that they do not share customers data with third parties before seeking consent unless where necessary for recovering loans, where such consent might not be sought.

*** Family Bank does not have a privacy policy specific to PesaPap but rather a general one covering the bank's entire operations.



Various pieces of legislation, including the Constitution, have clauses that refer to the privacy and confidentiality of consumer information, and stipulate how information should be handled. Prior to the enactment of the Data Protection Act in November 2019, the collection, usage, sharing and disclosure of consumer data in digital financial services was guided by the providers' data privacy policy. However, consumers are often required to consent to the lender's privacy policy even when they do not fully understand how their data will be used and/or disclosed22. This study reviewed the data privacy policies of 23 lenders. This was not a comprehensive review but rather a cursory appraisal of whether the lender's policies conformed to minimum best practice.

The privacy policies were reviewed against the check-lists below:

1. Whether the lender's terms and conditions contain clauses on the usage and sharing of customers' personal information, or whether the lender has a policy on data privacy and protection, separate from the terms and conditions;
2. Whether the privacy policy limits the usage of data to legitimate business purposes, such as lending decisions, or gives the lender discretion on the usage of data;
3. If the lender shares consumers' personal data with third parties and whether consent is sought before the data is shared, as well as whether the lender receives data on the customers from third parties; and
4. Whether the consumer has any rights in their access to and usage of data held by the lender.

Fourteen of the lenders reviewed have a data privacy policy separate from the general terms and conditions. Surprisingly, six of these lenders have a similar privacy policy, word for word. Common use of data listed include evaluating credit applications (scoring), carrying out KYC checks, for analytical purposes and for marketing purposes. One lender, mKey, has a clause that gives it the sole discretion in the use of customers data. All the lenders reviewed share their customers' data with third parties. CRBs top the list of third parties that receive borrowers' data, while mobile money operators top the list of third parties that allow lenders to access borrowers' information. Most lenders use the borrowers' identity data that has already been collected by MNOs for KYC checks. However, other lenders have entered into data sharing arrangements with MNOs for commercial purposes besides KYC checks.

Accepting the lenders' general terms and conditions is the market practice for obtaining consent to share customer data. There are however some exceptions. For instance, Branch requires prior consent to share customer data if the sharing is intended for marketing purposes. Another lender, mKey, requires prior consent for sharing data but only for its European Union (EU) based users in line with EU General Data Protection Regulation (GDPR) requirements. Very few lenders give their customers the right to access and use their own data. Tala stores and uses the data collected even after the customer has deleted the app. Again, there are exceptions like Stawika, which gives the customer the right to rectify any inaccurate or incorrect data.

22. See Gayatri Murthy and David Medine (CGAP, 2018) on why data protection in digital financial services should go beyond consent: https://www.cgap.org/blog/data-protection-and-financial-inclusion-why-consent-not-enough

Box 3: Examples of data privacy clauses

mKey provisions giving their European region customers' rights over their data

Under the General Data Protection Regulation or other applicable local laws, you have the right to access, rectify, port, and erase your information, as well as the right to restrict and object to certain processing of your information. This includes the right to object to our processing of your information for direct marketing and the right to object to our processing of your information where we are performing a task in the public interest or pursuing our legitimate interests or those of a third party.

(Source: *https://www.finserve.africa/finserve-privacy-policy*).

Tala's clauses on customers' rights over their own data

I authorize Tala to verify and investigate the above statements/information as may be required, from the references provided and other reasonable sources. For this purpose, I hereby waive my rights on the confidentiality of client information and expressly consent to the processing of any personal information and records relating to me that might be obtained from third parties. I further agree that this application and all supporting documents and any other information obtained relative to this application shall be used by and communicated to Tala and shall remain its property whether or not my credit score is determined, or the loan is granted.

(Source: https://tala.co.ke/privacy-policy-ke/)

GetSaida on waiver of rights

For this purpose, I hereby waive my rights on the confidentiality of client information and expressly consent to the processing of any personal information and records relating to me that might be obtained from third parties, including government agencies, my employer, credit bureaus, business associates and other entities you may deem proper and sufficient in the conduct of my business, sensitive or otherwise, for the purpose of determining my eligibility for a loan which I am applying for.

(Source: *http://www.getsaida.com/privacy.html.*

PesaZone on protection of data and release from liability in case of any breach

We will seek to protect your data and funds available in your account, however, this is not something we are able to guarantee. You consent to the storage, transmission of data and communications through the Internet and you acknowledge that the Internet is not necessarily a secure communications and delivery system, and you understand the confidentiality and other risks associated with it.

You agree to be bound by any communication validated by ourselves or affiliates providing the service to which such communication relates. We accept no liability if communications sent via the platform are intercepted by third parties or incorrectly delivered or not delivered.

(Source: *https://www.pesazone.com/site/privacypolicy*)

Branch: consent to share information with third parties for marketing purposes

Should we wish to use your information for marketing purposes, we will inform you prior to such use. You shall be entitled to prevent such usage by informing us, within 10 days of being informed of the proposed use, that you do not wish to disclose such information. You can also exercise the right at any time by contacting us at support@branch.co.ke

(Source: *https://branch.co.ke/pp*)

Branch: release from liability in case of losses arising from personal information held and shared

You hereby agree and authorise BIL to obtain and procure your Personal Information and Relevant Information from your respective Mobile Money Provider and you further agree and consent to the disclosure and provision of such Personal Information by the Mobile Money Provider and further to indemnify and hold BIL and the Mobile Money Provider harmless with respect to any claims, losses, liabilities and expenses (including legal fees and expenses) that may arise as a result of the disclosure and reliance on such Personal Information and/or Relevant Information.
(Source: *https://branch.co.ke/tou*)

General clauses on accepting privacy policy that gives provider consent to share data. This is the practice with most lenders

The Account holder agrees that the Bank may disclose details relating to the Eazzy Loan to any third Party (including credit agencies) if in the Bank's opinion such disclosure is necessary for the purpose of evaluating any application made to the Bank or such third Party or maintaining the Operative Account with the Bank or other purpose as the Bank shall deem appropriate.

(Source: *https://www.equitel.com/eazzy-loan-terms-and-conditions.pdf*)

4.3 Credit reporting and information sharing

Credit reporting is a system which enables lenders to share information with credit reference bureaus on how borrowers repay their loans. It allows lenders to distinguish between borrowers with and without default histories, and to subsequently decide whether a potential borrower will repay a new loan. For the system to work well, a regulatory framework that ensures cross-market participation should be in place. However, this is not always the case as the rules for reporting borrowers' credit histories to the CRBs are often disparate across lenders.

In Kenya, banks are required by law to submit both borrowers' positive and negative information to the three CRBs. This should be regardless of the loan duration. Ideally, a loan borrowed and repaid within one day should be positively listed, just like a loan in arrears by one day past the cut-off date for non-performing loans set in law should be negatively listed.

Deposit Taking Saccos (DTS) licensed under the Sacco Societies Act are required to submit negative information and can also report positive information but the law does

Table 4: Summary of loans reported to the 3 CRBs

Lender	Number loans issued	Credit reports submitted	TransUnion	Creditinfo	Metropol
Tala	4	0			
Dolax	1	0			
Stawika	2	0			
Upazi	1	0			
Branch	2	5	✓	✓	✓✓
Okolea	2	2		✓	✓
Timiza	3	8	✓✓✓	✓✓	✓✓✓
Utunzi	2	0			
Usawa	1	0			
Craft	2	0			
Kano	2	0			
KCB M-Pesa	1	0			
PesaPap	2	2	✓✓		
PesaZone	2	0			
Stawika	1	0			
M-Shwari	2	4	✓✓	✓	✓
NIC Mobile loan	2	6	✓✓	✓✓	✓✓
Ubapesa	2	1	✓		
mKey	2	2		✓	✓
GetSaida	2	0			
Kopa Cash	2	0			
MCo-op Cash	1	0			

not insist on it. Non-bank digital lenders are not legally mandated to share borrowers' credit histories with the CRBs. However, they can voluntarily submit borrowers' positive and/or negative information to any of the three CRBs.

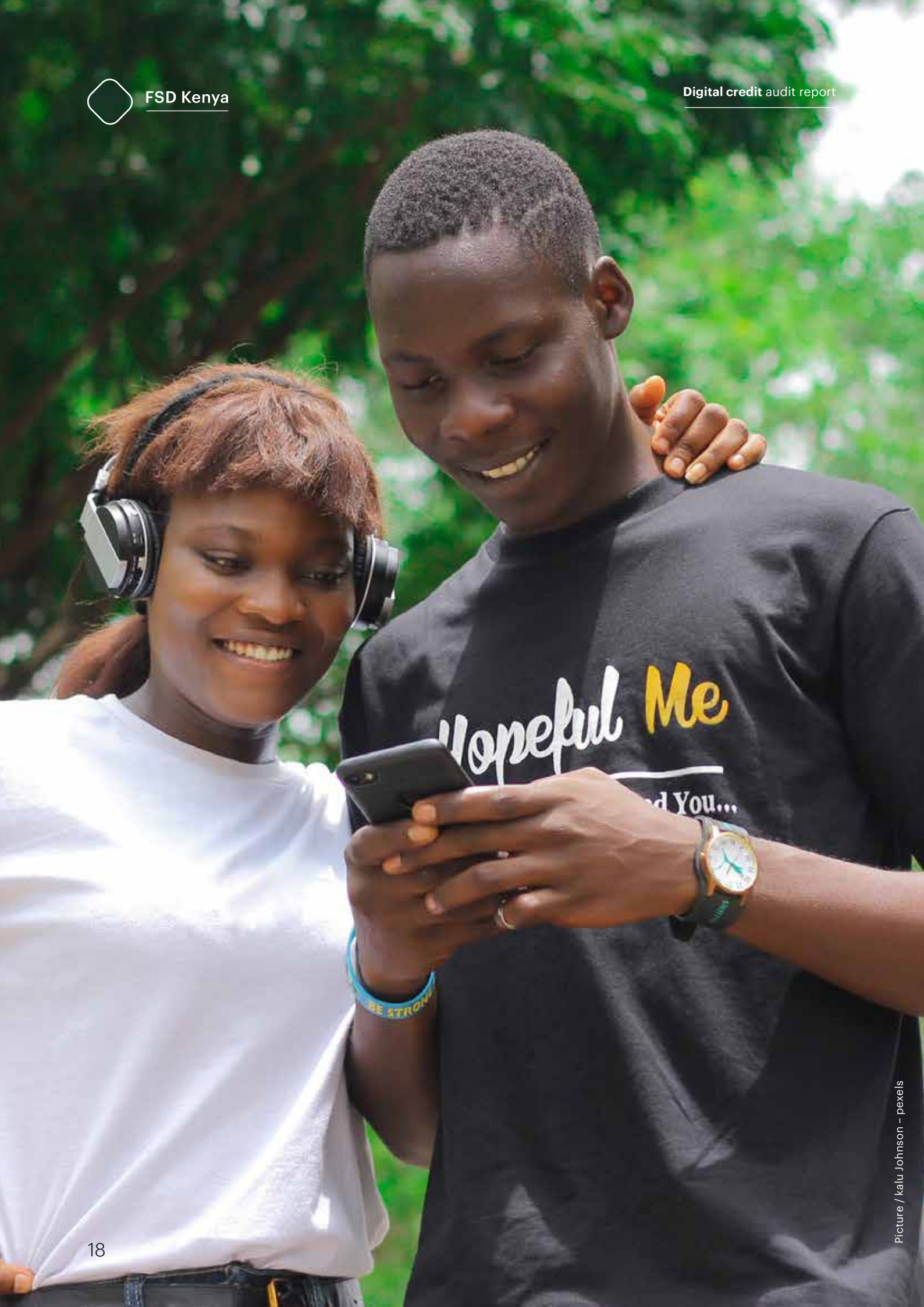
As such, a digital loan issued by a bank should appear in all the three credit reports issued by the three CRBs either as a positive or a negative record. On the other hand, a digital loan issued by a non-bank might not show on any of the credit reports issued by the three CRBs. If the non-bank lender voluntarily submits credit information, the loan might appear in one of the CRB reports but not all. A borrower from multiple non-bank lenders will require three reports from the three CRBs to provide a comprehensive credit history. These discrepancies in reporting requirements mean that borrowers are unable to fully leverage their credit histories to access better or bigger loan opportunities beyond those of the lenders already offering them credit.

4.4 Compliance with reporting requirements

Loans issued in the first borrowing cycle were deliberately repaid within five days, and the second cycle loans repaid at the absolute final due date. Of the bank lenders, only NIC Bank submitted the borrowers' loan information over the two borrowing cycles to each of the three CRBs as required by law. Failure to report by the rest of the banks was mostly for the first loans that were repaid within a shorter duration. However, KCB M-Pesa and MCo-op Cash failed to report the single loans they issued while PesaPap only submitted to one CRB. Of the non-bank lenders, only Branch was consistent in voluntarily submitting information to all the three CRBs, only failing to submit one loan repayment outcome to one CRB.

It is clear then that many digital lenders are not submitting positive borrowing history, and borrowers of digital credit are not given the chance to benefit from their positive history. At the same time, several non-paying borrowers have been listed, greatly skewing official data to make digital credit borrowers seem worse-off in aggregate than they actually are. This has helped contribute to extreme policy proposals such as removing small value digital loans from the credit bureaus entirely. Some of the issues could be addressed via grater enforcement of credit reporting obligations for banks and expansion of mandatory positive reporting for non-bank lenders[23].

23. https://www.cgap.org/research/publication/competition-mobile-financial-services-lessons-kenya-tanzania



Picture / kalu Johnson – pexels

Chapter 5

Pricing

Digital credit prices remain high

5.1 Types of fees charges

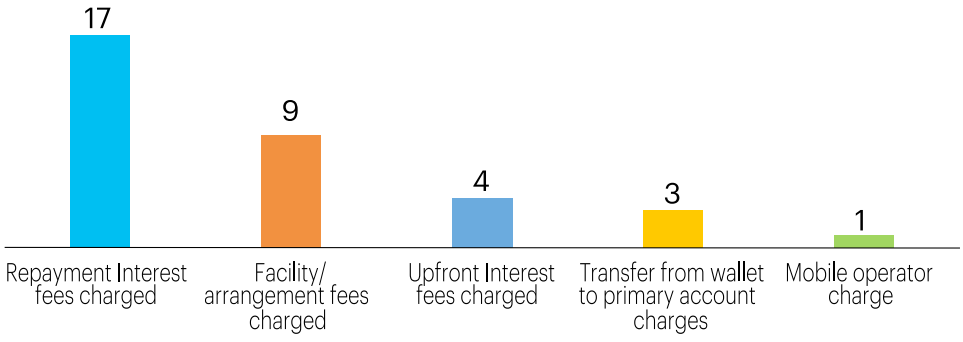
The ability to leverage new data sources and digital channels has been hailed as a significant innovation in advancing credit in ways that were not feasible with conventional lending. One of the prospective benefits that digital credit was expected to deliver was to drive down the cost of lending, especially to people with short-term needs. Granted, lending small amounts remotely to people often with limited digital footprints and credit histories carries significant credit risks. Digital credit held the promise of driving down some of the costs other than risk, that are related to lending, such as disbursement and collection costs. However, the cost of digital loans has remained comparatively high seven years after the first product was launched.

In some instances, the high costs are reflective of the lender's business model. Some of the lenders offer digital loans as part of a virtual account/electronic wallet offering that does not have the option of cashing out from the wallet. Instead, borrowers are forced to first transfer the loans from the virtual account to their mobile money wallet, incurring a fee, and then cash-out from the mobile money account, incurring a second fee. Another lender charges a 1% credit life insurance premium on the loan amount as part of the lender's facility fee. All these charges are reflected in the total cost of credit.

Box 3: Eazzy loan terms and conditions

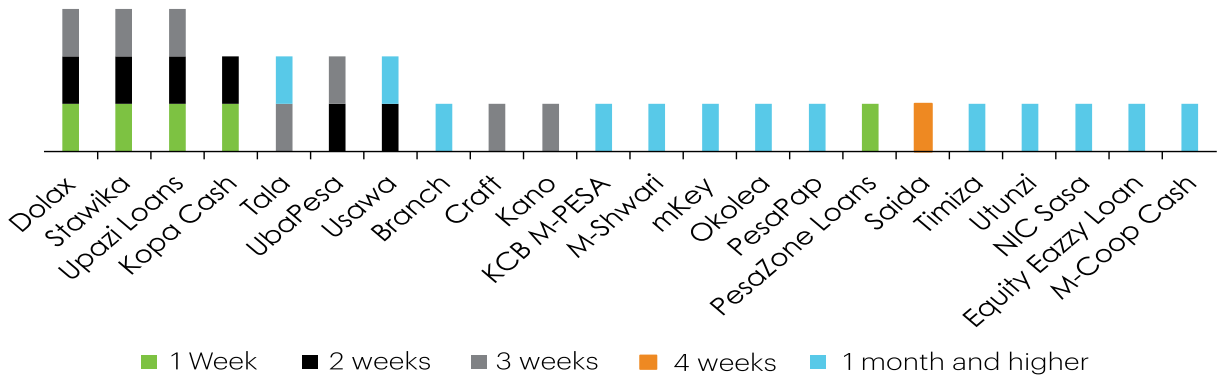
The Account Holder shall be required to take out a credit life insurance cover to cover death and or disability at the rate of 1% of the loan amount. 15.2 The Bank will arrange for such credit life insurance at no extra charge. However, if the Account Holder wishes to obtain a different cover other than that arranged for by the Bank, such cover shall be from a panel of underwriters in the Bank's panel which is available on our website http://ke.equitybankgroup.com/

Figure 5: Types of fees charged



24. See https://www.cgap.org/blog/digital-credit-kenya-time-celebration-or-concern

Figure 6: Repayment duration options



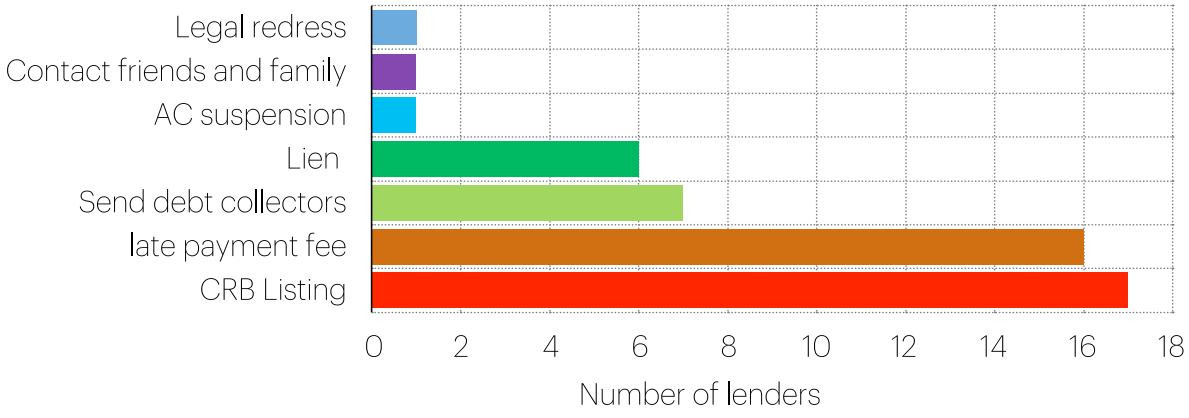
5.2 Repayment durations

Digital loans are short term, typically with a repayment period of less than one month. Borrowers who repay their loans earlier are still required to pay the full amount, effectively pushing up their annualised percentage interest rates. Only one lender in the study, M-Shwari, offers their borrowers a rebate for early loan repayments. All the bank lenders in this study offer one-month loans, with the non-bank lenders offering multiple repayment durations, some as short as one week. Borrowers who roll over their loans are still required to pay interest on the outstanding amount, with some lenders charging an additional late repayment penalty. Listing borrowers with CRBs and charging late repayment fees are the most common course of action taken by lenders for failure to repay the loan within the agreed period.

5.3 Total cost of credit

The total cost of credit is the sum of all interest payments, fees and charges on the loan contract. It is generally the difference between the amount that is given as the principal amount and the total amount that is paid back by the borrower. It is useful in terms of making the consumer aware of exactly how much more he will ultimately pay as a result of taking the credit facility In jurisdictions where there is no standardized disclosure regime, the TCCs of different credit providers are not easily comparable as there is no defined list or criteria for inclusion of costs in the TCC calculation. In these cases, the TCC is primarily useful for disclosing to the consumer how much the credit facility will actually cost. Where there is a standardized disclosure regime, TCCs across credit providers are more readily comparable as

Figure 7: Implications for late repayments



25. See Michelle Kaffenberger and Patrick Chege (CGAP, 2016) on using APR to compare the costs of digital credit products in Kenya, https://www.cgap.org/blog/digital-credit-kenya-time-celebration-or-concern
26. Naheed, H., Ketley, R., & Oyier, T. (2009). Definition of a standard measure for consumer interest rates in Kenya: a scoping study. Nairobi, Kenya: FSD Kenya. https://s3-eu-central-1.amazonaws.com/fsd-circle/wp-content/uploads/2015/08/30095756/09-06-03_Definition_of_Std_Interest_Measures.pdf

they broadly follow similar criteria for calculation. In many cases the TCC is linked to the calculation of the APR but there are limitations in annualising short-term loans. In this study, the cost of transferring the loan proceeds from a virtual account/e-wallet to the borrower's mobile money account was factored into the cost of the loan. This approach is premised on the argument that the virtual account offers very minimal functionality to the borrower, who still has to transfer the loan proceeds to a mobile money account to cash out.

Figure 8: Total cost of credit for fintech lenders

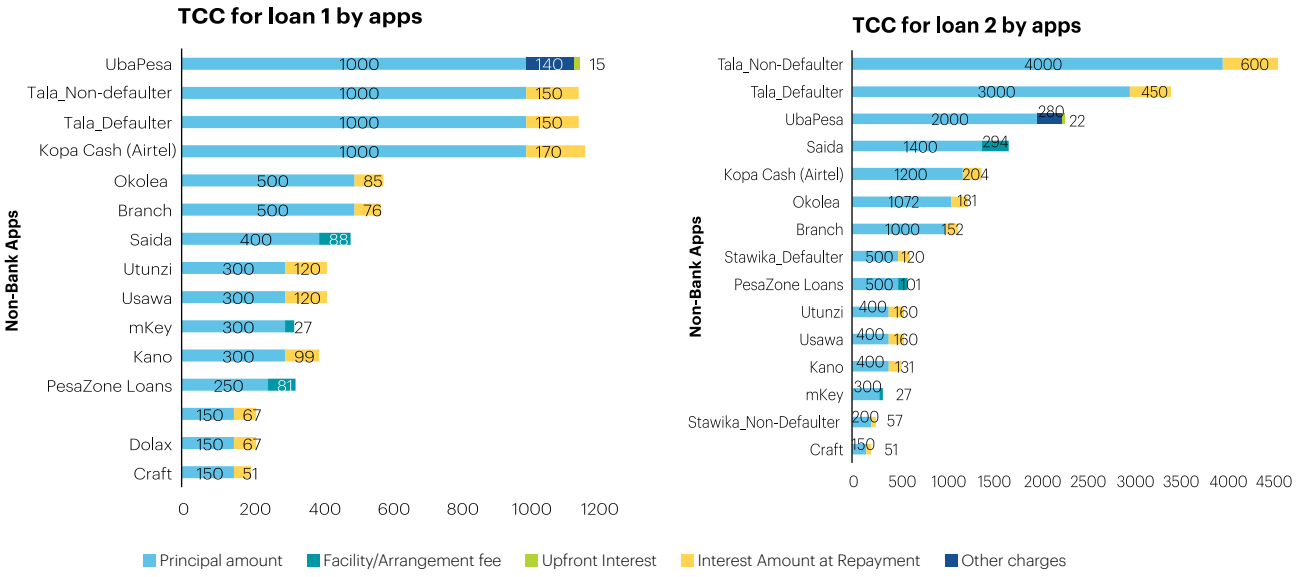
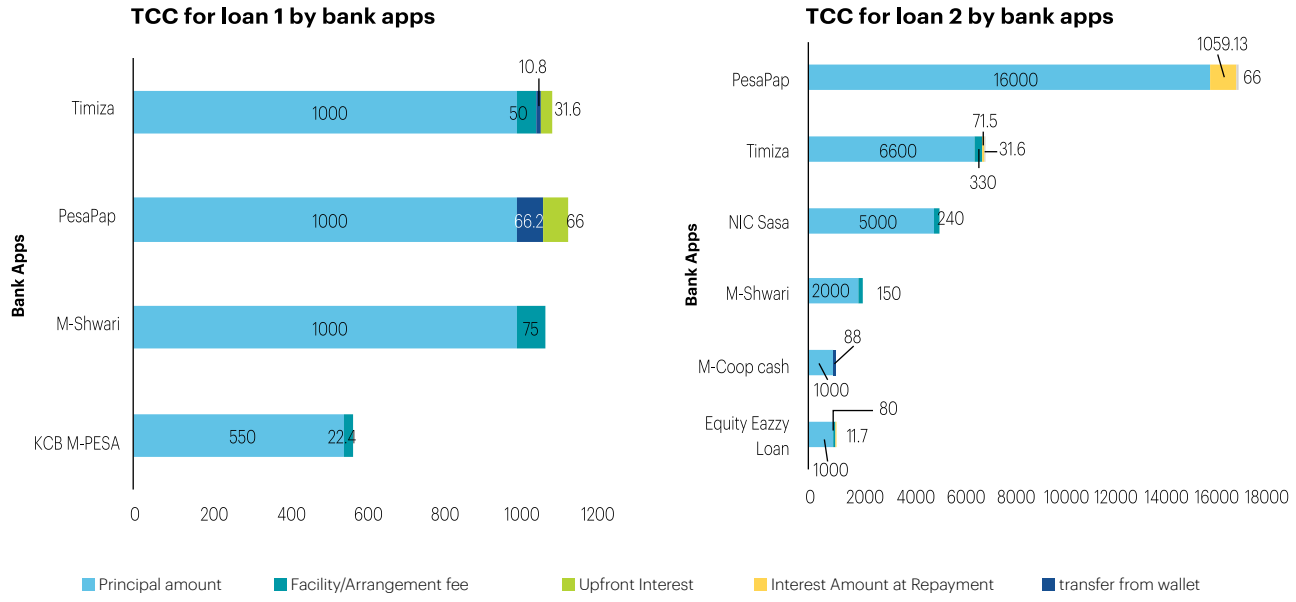


Figure 9: Total cost of credit for bank lenders



Not surprisingly, the highest APR was a loan with a repayment duration of one week, followed by loans with a three-week repayment. The bank lenders have lower APRs relative to the non-bank lenders, with KCB M-Pesa offering the lowest APR at 49%. The implication of the cost of transfers between a virtual wallet to a mobile money account on the APR is profound for lenders that charge a fixed fee. Timiza charges KShs 24.6 to transfer amounts below KShs 1,000 and KShs 31.6 for amounts up to KShs 70,000. As such, the transfer fee forms a higher proportion for smaller loan amounts, hence a higher APR.

Table5: Total cost of credit calculations for select products

Lender	Principal	Facility fee	Interest charged upfront	Interest charged on repayment	Cost of wallet transfer	Total fees	TCC	Calculated Nominal rate (%)	Repayment duration
PesaZone	250	81				81	331	32%	1w
Dolax	150			67		67	217	45%	3w
Kano	300			99		99	399	33%	3w
Upazi Loans	150			67		67	217	45%	1m
Usawa	300			120		120	420	40%	1m
Utunzi	300			120		120	420	40%	1m
Kopa Cash (Airtel)	1000			170		170	1170	17%	2w
Craft	150			51		51	201	34%	1m
Stawika	200			57		57	257	29%	1m
Stawika	500			120		120	620	24%	1m
Saida	400	88				88	488	22%	4w
UbaPesa	1000		140		15	155	1155	16%	20d
UbaPesa	2000		280		22	302	2302	15%	20d
Okolea	500			85		85	585	17%	1m
Branch	500			76		76	576	15%	1m
Tala	1000			150		150	1150	15%	1m
PesaPap	1000			66	66	132	1132	13%	1m
M-Coop cash	1000		88		36	124	1124	12%	1m
Timiza	1000	50		10.83	31.6	92.43	1092	9.24%	1m
Equity Eazzy Loan	1000	80		11.7		92	1092	9%	1m
mKey	300	27				27	327	9%	1m
M-Shwari	1000	75				75	1075	8%	30d
PesaPap	16000			1059	66	1125	17125	7%	1m
Timiza	6600	330		71.5	31.6	433	7033	7%	1 m
NIC Mobile loan	5000	240				240		5%	1m
KCB M-PESA	550	22				22	572	4	1 m

Chapter 6

Conclusion

Digital credit has undoubtedly impacted financial inclusion and the ways by which credit is accessed in Kenya. What started off as a market served by one lender, M-Shwari in 2012, is now a crowded market of more than sixty lenders. The demand is certainly there: over six million Kenyans have borrowed at least one digital loan to meet their day-to-day needs or to finance small enterprises.

Beyond these daily use-cases, digital credit is increasingly used to finance non-routine needs such as paying for school fees and healthcare. Indeed, digital credit continues to generate interest because of its promise to impact on livelihoods and small enterprises in ways that 'traditional' credit issued by banks has not been able to. However, while there are many bright spots, the evidence suggests that simply expanding the reach of digital credit does not necessarily lead to outcomes that underpin greater economic inclusion. Pricing continues to be a concern. Price charged on digital loans remains sticky downwards, even where market infrastructure that supports lending decisions exist. To an extent, this reflects inefficiencies and uneven access to such infrastructure. Notably, credit information sharing represents a foundational element of an efficient and open credit market yet participation and compliance is disparate across lenders.

When credit histories are either unavailable or incomplete, lenders resort to construct borrowers' financial position by exploiting their digital footprints. The absence of an overarching credit legislation means that anyone can publish a mobile application and start lending, making borrowing relatively easy. And when there are people who find it easy to borrow, it means that they are likely to easily fall into debt stress when checks and balances are not in place.

Inevitably, there have been growing calls to regulate the sector. Consumers have a collective interest in many elements of regulation and there are several ways by

"When credit histories are either unavailable or incomplete, lenders resort to construct borrowers' financial position by exploiting their digital footprints

Picture / bigstock.com

> However, it is vital that the design and implementation of such regulation does not inhibit the development of new value-adding financial solutions.

which regulation can impact on consumers and on the development of the sector. Regulation is frequently misrepresented as simply being about restricting what market actors can do while it can actually support effective market function. For digital credit, a starting point would be regulation that not only reduce the risk of harm to consumers but also shape the incentives for lenders to develop products that are in the long-term interest of their clients. However, it is vital that the design and implementation of such regulation does not inhibit the development of new value-adding financial solutions. It is also about ensuring that the approach continues to create opportunities and incentives for innovation that enhances competition and shape costs, prices and thus affordability. Furthermore, enforcement and compliance mechanisms are critical to ensuring that the intent of any regulation is achieved. Taking the example of credit information sharing, this report highlights inconsistencies in compliance even by lenders legally obligated to submit credit information to the CRBs.

Both the industry and regulators are beginning to respond. The Central Bank of Kenya (CBK) has on various occasions pronounced that it is exploring ways of protecting consumers from fraudulent and exploitative lenders. The CBK has also published draft credit reference bureau regulations that provide an elaborate and well-intentioned provisions to address some of the existing weaknesses in the current framework. For instance, there are proposed provisions that protect borrowers in the case of loan defaults, requiring lenders to issue a 30-day notice prior to forwarding the defaulters' details to the CRBs. On the other hand, a member association for digital lenders (Digital Lenders Association of Kenya) was recently established with the main objective of setting ethical and professional standards in the sector. While DLAK's current membership is not yet representative of the entire sector, a champion for reform to drive change and concurrent support across the sector is needed.

Beyond regulation, there are other pathways that can lead to a financial system, including digital lending, that supports greater economic and social inclusion. Some of these are explored in a recent blog published by FSD Kenya[27]. in picking elements relevant to digital credit, building an open infrastructure, the responsible use of digital data and addressing market failures using long-term solutions carry immense potential in accomplishing real financial inclusion.

27. Ferrand, David (2019). "Towards and financial system that works for Kenya. FSD Kenya. https://fsdkenya.org/blog/towards-a-financial-system-which-works-for-kenya/

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