# Competition and consumer protection in the Kenyan banking sector

# Phase II

Redacted Version

## Competition Authority of Kenya

submitted by


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# 0. Executive Summary and Recommendations

## 0.1 Introduction

### 0.1.1 Origin of this market inquiry

This report is the final product of a market inquiry (we will refer to it as the "Inquiry") into demand-side competition and consumer protection in the banking sector of Kenya carried out by the Competition Authority of Kenya (CAK). The Inquiry was announced by publication of the terms of reference by the CAK in the Official Gazette of Notice no. 678 on 5 February 2016. The economics firm Acacia Economics and the law firm Macmillan Keck Attorneys & Solicitors were engaged to advise and assist the CAK in conducting the Inquiry and have produced this report. An earlier Phase I market inquiry was completed in 2014 by Genesis Analytics. Phase I focused on barriers to competition in the sector from a supply-side perspective.

### 0.1.2 Nature of this Inquiry

The CAK's authority to conduct a market inquiry is derived from the Competition Act. The CAK is mandated to carry out inquiries into matters relating to competition and protection of consumers, study the effects of government policies and legislation and regulatory authorities on competition and consumer welfare, and investigate impediments to competition. A market inquiry under the Competition Act is not an "investigation" by the CAK.

### 0.1.3 Approach to this Inquiry

This Inquiry focused on the demand side. As such, the primary questions probed by the Inquiry concerned the ability and tendency of consumers to impose competitive discipline on banking services, and various consumer protection dimensions of banking services in Kenya. The Inquiry was thus not an exhaustive review of the banking sector.

A key element of the Inquiry's work related to price transparency. This included exploring and documenting the evidence of deficiencies in disclosure and sales practices by provider segments, including deficiencies in presentation of product information to consumers.

In particular, the Inquiry was interested in whether a lack of consumer engagement and barriers to searching and switching undermined the incentives of banks to compete on the main parameters of competition, in particular price, quality of service and products, and innovation.

In addition, the Inquiry assessed the level and current practices around consumer control over transactional data, as well as how such data is sold and assessed by third parties (e.g., use of mobile credit data to score and award credit offers without consumer consent). It also assessed the level of equal compliance with credit bureau reporting by digital credit providers and whether they report both positive and negative borrower data as required by the law, and whether there exists disparate treatment that gives them anti-competitive advantage and inhibits consumers' ability to take advantage of their own data for financial access.

### 0.1.4 Sources of information

The Inquiry gathered information from several sources, including a review of existing literature, submissions from and interviews with banks, unlicensed lenders, regulators and other participants in the Kenyan market, market research into Kenyan consumer perceptions, market research to test remedies in the Kenyan context, and international experience.

### 0.1.5 Priority market segments

After considering the personal, SME and corporate segments and literature relating to them, and after consulting with the CAK, the Inquiry decided to focus on the personal banking segment and, as a result, small business owners who use personal banking products in order to access credit.

### 0.1.6 Role of the Inquiry in the context of price regulation

After this Inquiry began, the Banking (Amendment) Act, 2016 was enacted, capping interest rates at 4% above the Central Bank Rate (CBR) and putting a floor on interest rates on deposits of 70% of the CBR.

As a result, Kenyan banks brought down their lending interest rates more or less uniformly. Competition on interest rates has disappeared, banks have limited credit options for riskier borrowers and anecdotally, banks that we interviewed stated that switching of loan providers and loan buyouts are becoming less frequent.

The Inquiry took the approach that the regulation of rates is likely to be temporary, as indicated in various public statements of policymakers, although it remains unclear how long these will remain in effect. The Inquiry thus pursued its line of inquiry and sought to address competition issues on the basis that the interest rate cap would in due course be lifted and that the Inquiry would contribute to enabling competitive pressure to grow in areas today controlled by regulation. Indeed, to the extent that measures recommended by the Inquiry might be expected to increase competition, then the adoption of these measures might support the removal or lightening of the rate regulation.

It is particularly important to recall the limitations of a demand-side inquiry such as this. The remedies discussed and recommended are not intended and should not be expected to resolve all of the undesirable market outcomes in the financial services sector in Kenya, including historically high interest-rate spreads.

For example, prior studies have identified difficulties with collateral and the high costs of enforcing contracts in Kenya as reasons for greater lending risks, and therefore higher lending interest rates. Further reasons include country risk and relatively high levels of government borrowing, which provide alternative assets for lenders in Kenya to invest in. The limited development of financial markets and services, including in respect of alternative financing mechanisms, also result in higher interest rate spreads in Kenya. These problems can only be resolved through policy and regulatory reforms that are outside of the scope of this Inquiry.

### 0.1.7 Outline of this report

After an introduction in Section 1, this report begins in Section 2 with an overview of the legal and regulatory context. Section 3 provides background and context on the banking sector. Section 4 provides background on how consumers perceive and engage with banks and alternative financial service providers. Section 5 examines gaps in transparency that produce information asymmetries between consumers and banks, and other demand side barriers to competition in the Kenya market in traditional bank products. Section 6 turns to digital products, reviewing first the providers' disclosure practices when it comes to pricing and other terms and conditions. It reviews consumer control over and access to transactional data, as well as how such data is sold and assessed by third parties, as well as access to data about consumers through credit bureaus given providers' varying reporting obligations and practices. Section 7 discusses remedies and includes the Inquiry's recommendations. Section 8 discusses other

measures the Inquiry considered as potential remedies but ultimately did not recommend at this time.

## 0.2 Legal & regulatory context

### 0.2.1 Multiple regulatory domains

Regulation of Kenya's financial services sector is divided among multiple regulators. Among others, the CBK is established under the Constitution of Kenya, 2010 and the Central Bank of Kenya Act.

### 0.2.2 Consumer protection in the banking sector

The CBK has issued the Prudential Guidelines, 2013 which apply to banks and other institutions licensed under the Banking Act. These Prudential Guidelines include the Guideline on Consumer Protection (the Guideline) which governs the treatment of consumers by banks. These include provisions on fairness and transparency of disclosure, including requirements to disclose terms and conditions of financial products.

The Competition Act establishes the CAK and defines its mandate. It includes consumer protection measures, including requiring disclosure of charges and fees, including specifically in banking services. The CAK is currently carrying out a process with digital financial service providers to ensure compliance with these requirements.

The Kenyan Bankers Association (KBA) has developed an "Annual Percentage Rate" (APR) pricing mechanism framework. The APR promotes pricing transparency by taking into account the interest rate components, bank charges and fees and third-party costs to provide loan applicants with an APR that can be compared across banks. All commercial banks in Kenya are bound to disclose APR for loans as part of their required disclosure of total cost of credit.

### 0.2.3 Sharing and accessibility of transactional data

There is no comprehensive legislation or regulation that addresses the protection or privacy of consumers across sectors in Kenya. A Data Protection Bill has remained in the drafting process for several years and it is unclear whether or when this might be enacted.

In the telecommunications sector, the Kenya Information and Communications (Consumer Protection) Regulations, 2010 section 3(1)(d) grants all customers of telecommunications licensees the right to "personal privacy and protection against unauthorized use of personal information." Section 15 regulates the use and sharing of customer information.

Mobile money services are regulated as payment service providers by the CBK and are subject to the confidentiality provisions of the National Payment System Regulations, 2014.

### 0.2.4 Credit information sharing

The Credit Reference Bureau Regulations, 2013 require that all banks and other institutions licensed under the Banking Act report both positive and negative credit information on consumers to Kenya's three credit reference bureaus.

Creditors that are not subject to this reporting requirement, which would include non-banks that provide digital credit services, have no obligation to submit any credit reference information to the bureaus. However, some non-bank digital credit services do voluntarily submit negative and even negative and positive information.

## 0.3 Competition concerns and interventions identified

### 0.3.1 Sector growth and signs of competition

The Kenyan banking sector has grown substantially and evolved remarkably over the last decade. Prior to the interest rate cap, there appears to have been some competition between banks on interest rates for specific loan product types and customer segments, in particular check-off loans and formal employed persons. In today's market, tariffs vary and substantial savings can be made if consumers were to choose carefully between banks. However, these savings cannot be realised unless consumers are aware of, and understand, the gains to be made, and then act accordingly. The Kenyan banking sector is characterised by high levels of innovation, which is evidence of rivalry among the main banks. There is also evidence of significant customer movement in the market which suggests that there is a flow of new customers and therefore scope for banks that compete to attract customers to increase their market shares.

### 0.3.2 Signs of competition problems

In the years leading up to the Inquiry, concerns were raised regarding high interest rate spreads (the difference between interest rates offered on bank deposits and on bank loans). A range of causes have been identified, including high overhead costs faced by banks, high cost of collateral, country risk, alternative investment opportunities for banks due to high government borrowing, and lack of effective competition. A range of innovations in the sector could have been expected to lead to a decline in costs for banks and therefore the interest rate spread. These include:

- an increase in the number of bank accounts;
- declining non-performing loans;
- the introduction of mobile and agency-based banking;
- improvements in the payments system; and
- the introduction of credit reference bureaus.

Yet, expected cost reductions have not been passed through to consumers in the form of lower pricing, suggesting lack of competitive pressure on pricing.

One competition issue potentially impacting the Kenyan banking sector concerns barriers smaller banks face when competing with the small number of larger banks. Large banks are able to mobilise large deposits at lower interest rates than smaller banks. Market segments are also relatively highly concentrated. Demand side causes of weak pricing competition have also been identified and are examined in this Inquiry.

### 0.3.3 Demand-side initiatives

Several recommendations have previously been made, including in relation to use of the Kenya Banks' Reference Rate (KBRR) when presenting interest rates to consumers, disclosure of the total cost of credit (TCC), regulations to require credit information sharing through credit reference bureaus, and enhancing consumer protection and education.

## 0.4 How consumers engage

### 0.4.1 How consumers choose

The Inquiry's qualitative interviews showed that low- and middle-income consumers tend to rely on recommendations from friends and family. High-income consumers are more likely to use online resources, print materials and advice of professional advisors. Consumers tend to distrust information about financial products that they receive from other bank staff. They tend to trust digital information supplied over the mobile platform.

Several factors hinder choice and switching by consumers. Low financial literacy in Kenya means that consumers are often unable to fully understand products and pricing with view to comparing them, and may also be unable to make a correct choice. Also, consumers may feel overwhelmed and confused by the amount and complexity of loans and savings products. Some consumers maintain familiar accounts and services despite fluctuations in price due to familiarity with the product, links to MNOs, or MNOs, (for digital products) and fears that other providers would have hidden costs and not meet their needs. Some employers have pre-arranged banking schemes with only one or a few banks and consumers often based their selection of bank on the relationships that exist between their employers and banks in order to receive salary payments sooner or obtain access to credit.

### 0.4.2 How consumers engage with pricing

For consumers, interest rates are often secondary to other factors such as bank stability. Many borrow money for non-routine purchases, such as in emergencies, so interest rates are often secondary to access to credit. It appears that there is a lack of engagement with charges due to the consumer's focus on access to credit, as well as the complexity of fees and charges, consumers' lack of understanding of them, and general distrust of banks. This would suggest that, far from concluding that there is no need to intervene in pricing, it may be all the more important to intervene to improve transparency of charges and reduce information asymmetries between consumers and banks.

### 0.4.3 How consumers engage with non-price factors

Consumers select banks on a variety of non-price related factors:

- perceived stability and status, i.e., reputation;
- accessibility; and
- quality of service.

## 0.5 Transparency, information asymmetries and switching in traditional banking

The customer's ability to successfully identify and select an alternative product as well as their ability to actually implement a switch is pivotal to the exercise of competitive pressure on the banks from the demand side.

In each of these cases, we find that there are significant weaknesses in the banks' disclosure practices in dealing with customers, and that in some cases (particularly relating to disclosure of the TCC and assessing the needs of customers), the weaknesses appear in part to stem from noncompliance with regulation.

This lack of transparency, particularly in pricing, reinforces the information asymmetry arising particularly where consumers have low financial literacy, and reduces the ability of consumers

to shop around, whether when initially selecting a bank and product or when they might consider switching. A key barrier to exerting competitive pressure on banks is the difficulty consumers face in making comparisons between banks. Banks do not sufficiently assess needs and guide customers, and do not provide disclosure of charges and fees sufficiently clearly or early enough. The deficiencies in today's practices help to explain the lack of consumer engagement with pricing and the distrust of banks.

### 0.5.1 Information about which products to consider

Because customers have a difficult time making meaningful comparisons among products, they are particularly reliant on bank staff to guide them through the selection process. However, banks tend not to carry out effective needs assessments, or effectively explain customers' options as required by regulation.

### 0.5.2 Costs of borrowing

Customers rely on bank staff to disclose the features, costs and penalties of these products. Accordingly, clear and complete disclosure of product features by bank staff, including their costs, is essential for customers to make informed decisions when selecting these products.

Prior studies of bank lending suggest that bank disclosure relating to loans is inadequate. The [CONFIDENTIAL] showed that over 40% of shoppers were not informed of the loan amount, duration of loan, total cost of capital and additional fees and in particular, interest rates, the repayment amount and repayment period were not sufficiently explained. The results of the mystery shopping exercise conducted by this Inquiry raise questions about whether there may be significant failures to comply with mandatory disclosure requirements.

The CBK's Prudential Guideline on Consumer Protection requires banks to disclose to borrowers the total cost of credit (TCC), which is defined as "the total amount payable for credit, including all fees and other charges from the lender, after deducting the original loan amount." TCC disclosure often suffers from a deficiency in form. The KBA has created a template for disclosure of TCC that incorporates all of the elements of the definitions found in the Guideline.

Many banks have adapted the template as their standard form of TCC disclosure to consumers. The template does not have a field that shows the sum of all interest, costs and charges, i.e., the actual cost of borrowing. The TCC form is thus inadequate in disclosing costs to consumers to enable them to understand, assess and compare products. Furthermore, the monthly payment amount is extremely important to many consumers who have difficulty understanding rates and overall borrowing costs. The TCC template omits this. In addition, the KBA APR is absent from this template, requiring banks to make a separate disclosure.

Just as importantly as the content or omission of content of disclosures is their timing. Disclosures of costs are often not made until the end of a lengthy application process when the loan applicant receives confirmation that the loan will be authorised. As a result, customers may be unable to overcome inertia and compare the loan with competing products at other banks.

### 0.5.3 Costs of savings and transaction accounts

Many customers are unaware of the costs and fees associated with their savings and transaction accounts. Large numbers of customers appear not to be receiving basic disclosures on fees and charges applicable to the accounts, in violation of mandated disclosure requirements.

### 0.5.4 Initiatives to increase transparency through price comparisons

The KBA has launched a costofcredit website that calculates the cost of credit for each bank, and compares costs with other banks. The Inquiry understands that the KBA intends to develop a mobile phone app version.

The Inquiry reviewed the KBA cost of credit calculator, and found it to be a helpful contribution to the market. It enables comparison of the monthly loan payment with five "top alternatives" from other banks, thereby reducing search costs. The cost of credit calculator for a given bank shows the monthly repayment amount and the sum total cost of credit, unlike the TCC standard form, which only shows the component parts of the cost of credit. Thus, two important data pieces for the customer are shown, although only the monthly repayment amount (not the TCC) is compared with other banks.

There are areas for potential improvement. The customer must search each bank one-by-one rather than simply searching for the best deal. The "top 5 alternatives" comparison mitigates this problem to some extent. The top 5 banks are not simultaneously compared with the initial bank searched: the customer must click to request the top 5 alternatives in the browser to obtain the comparison.

More importantly, the top 5 alternatives search function appears to compare banks only on the basis of the monthly repayment amount, and not the TCC. As a result, a bank with a lower TCC is not differentiated from other banks when their monthly repayment amounts were the same. Thus, the comparison facility does not differentiate to show the overall cheapest loan. This is arguably misleading and a significant problem in the design, and should be corrected.

Other work was well advanced by Kenyan firm Think Business with the support of Financial Sector Deepening Kenya to develop a PCW for financial services. It has gathered pricing information from all Kenyan banks on their tariffs for retail and SME services and created a calculator enabling a consumer to compare the costs of a variety of services. In addition, South Africa based CompareGuru (previously branded Click n Compare) is reportedly establishing a service in Kenya.

If a substantial promotional investment is made in building up consumer awareness of the KBA costofcredit calculator and, when launched, the Think Business PCW, these have the potential to reduce search costs, eliminating the barrier arising from the customer having to apply and wait for approval before disclosure of the total cost of credit, and the effort to shop around for alternatives. The additional step the consumer must take to apply for and obtain the loan remains a limitation of PCWs. However, PCWs may evolve into websites that enable consumers to sign up for the chosen product, and the Inquiry considers that this and the improved market transparency are beneficial to the market.

### 0.5.5 Switching

In Kenya, there are various forms of account switching. For example, for savings or transaction accounts there may be the following types of switching:

- full switching with account closure;
- partial switch with dormancy (becomes a full switch); and
- partial switch with multibanking.

In the case of a loan, there are two chief types of switching:

- loan buyout; and
- choosing a new bank for the next loan.

Multibanking is prevalent. Customers rarely formally close accounts even when they have no intention of ever using them again. Rather, they tend to withdraw all of their funds and leave a zero balance. Customers find the process to formally close an account difficult, time-consuming and costly, if not impossible. Banks also appear to actively discourage formal account closure. Customers feel "hassled" when they initiate the account closure process.

Loan buyouts were fairly common in the market before the interest rate cap. There have since been reductions and the Inquiry found few banks pursuing this market today.

Switching accounts that are linked to an employer is subject to additional administrative barriers. The employer may not permit the switch, being unwilling to deposit salary payments into the new bank. The switch may also require burdensome paperwork between the employee, employer and the two banks to ensure that salary deposits are made into the new account.

The prevalence of multibanking and lack of difficulty of leaving an old account open until the bank closes it suggests that barriers to switching do not lie in a need to close an old account in order to switch to a new bank. However, the Inquiry identified several barriers to switching in the markets for traditional loans, and savings and transaction accounts.

The ability to switch depends on the ability to identify a product that is preferable to an existing product (or one that the consumer has used previously, in the case of a loan that has been repaid). Here, the relevant concerns have previously been set out in relation to:

- how consumers make choices, including barriers to their information gathering, high distrust of banks, low financial literacy, challenging complexity of products, a tendency not to change, as well as the role of the employer influencing choice;
- weak assessments by banks of consumers' needs and communication of product options to consumers; and
- weaknesses in the disclosure of pricing of loans and savings and transaction accounts, including inadequate disclosure to enable understanding and comparison of pricing.

In short, the limitations on the consumer's ability to shop around that are detailed in the sections mentioned above are also barriers to the consumer's ability to switch.

A switching barrier when obtaining a loan from a traditional bank is the requirement that the customer have an ongoing prior relationship with the bank. This must often be a transaction account with that bank with a transaction history over several months demonstrating the ability to repay the loan through arranging salary or other income payments into that new account. With some banks, this can be greatly reduced by producing bank account statements from a prior bank, although this appears to be infrequent. Some banks also waive the prior relationship requirement if the borrower's employer agrees to pay a portion of the borrower's salary to the bank in repayment of the loan.

## 0.6 Transparency, information asymmetries and customer data in digital savings, loans and mobile money

### 0.6.1 Introduction

Compared to mobile money, mobile savings and credit in Kenya are fairly new but are evolving and growing fast. M-Shwari was introduced in 2012 and has grown to over 9 million accounts, while KCB M-Pesa was introduced in 2015. There are a range of other mobile offers including several app-based models. Co-operative Bank has released MCo-op Cash as a mobile wallet that offers savings and loans, and Branch provides small loans using information stored on an individual's smartphone, such as SMS, social media and M-Pesa usage.

M-Shwari and other digital products are enabling people to access or save money, leading to increased financial sophistication. There is widespread perception that M-Shwari is cheap – despite its high effective interest rates.[1] This discrepancy between perceived and actual costs may reflect the fact that borrowers may not fully understand interest rates.

### 0.6.2 Disclosures in digital savings and loans

The Inquiry identified key issues in the lack of transparency and compliance with disclosure requirements in relation to charges and other terms and conditions. None of the leading digital savings service providers provided any disclosure within the STK or USSD applications on fees or charges associated with the savings account. Some provide additional disclosure at the branch, but not on the phone. Others involve linking through more than one web page and reviewing pdf documents with terms and conditions.

Consumers value the convenience and speed of application for and disbursement of digital loans. They often use these loans for immediate and urgent demands. However, the speed of this process makes it difficult for them to evaluate and compare products in a deliberative manner. This is further complicated by a lack of transparency of loan costs and features. Digital lenders provide minimal information about the service. Only two of seven services reviewed disclosed the costs of the loan before the transaction was executed. Only one disclosed the mandatory TCC.

With respect to bank digital lenders, these deficiencies appear not to be in compliance with the CBK's Prudential Guideline on Consumer Protection. Bank and non-bank digital lenders appear not to be in compliance with the Competition Act's disclosure requirements.

The lack of disclosure of costs by other providers prior to execution of a transaction is a barrier to the ability of customers to compare the rates between services. This is all the more so when recalling how consumers get their information and engage with pricing information and in particular the relatively low level of consumer financial literacy in Kenya.

Consumers generally are not aware of the prices that are charged for digital credit. They are not receiving information at a time when the information might inform their choices, i.e., before taking up the product. This means that they are in a far weaker position to shop around for the best deal than if they received this information. This weakens the prospects for price-based competition in such services.

[1] See for example, Cook, T and McKay, C (2015). How M-Shwari Works: The Story so Far. Access to Finance Forum No. 10, April 2015. CGAP. Available at http://www.cgap.org/sites/default/files/Forum-How-M-Shwari-Works-Apr-2015.pdf

The CAK has been working with loan providers to bring their disclosures into compliance with the Competition Act. This includes requiring that disclosure of charges and fees must be made on STK, USSD and app channels.

### 0.6.3 Disclosures in mobile money

Mobile money providers in Kenya have typically not disclosed their charges in a user-friendly way. For example, in order for an M-Pesa customer to know how much a payment for goods and services will cost, the consumer must dial *234# and follow the prompts. Just as with mobile savings and loans, while charges for transfers are disclosed on Safaricom and Airtel's website for their mobile money services, accessing a website and searching for the charges from a smartphone, even where the consumers have a smartphone (and many do not), is not user-friendly.

Consumers are not aware of the prices they pay for various kinds of mobile money transactions, including for money transfers, withdrawals, payments for goods & services, bills and balance enquiries. This means that consumers are not in a position to shop around based on price, which likely presents a barrier to switching between providers.

Just as with digital savings and loans, the CAK has been requiring mobile money providers to ensure that consumers are made aware of transaction charges before they undertake the transaction.

### 0.6.4 Customer transactional data

Digital credit enables lenders to leverage a variety of consumers' digital data without having to rely on formal credit histories. Digital credit providers use proprietary software algorithms to collect, sift through and apply appropriate weighting to this data in order to evaluate loan applications without any human review.

The nature and sources of the data that serve as inputs into these algorithms vary across credit products.

- For *mobile credit products provided by banks* that are linked or closely associated with existing traditional bank accounts, this data consists largely of prior banking transactions.
- For *Android app-based products provided by non-banks*, customers grant permission to allow the credit provider to access M-Pesa, SMS, call history, social media and other data on a user's smartphone.
- Finally, *products linked to mobile money accounts of MNOs* primarily use mobile money transactional data, as well as airtime and call activity.

Due to the rapid rise and large scale of borrowing in the third of these, and because Safaricom's M-Pesa in particular is by far the most widely used mobile money service in Kenya, the Inquiry focused on the use of M-Pesa and other Safaricom data by digital credit providers and the ability of Safaricom subscriber to access this data.

Safaricom collects information on its customers' usage of its services, including GSM services (including airtime purchases) and M-Pesa transactions. It currently shares aggregated customer transactional data related to these services with three partners:

- KCB (in conjunction with KCB M-Pesa);
- CBA (in conjunction with M-Shwari); and

- M-KOPA Solar.

Airtime purchases and M-Pesa activity were the most critical inputs to credit evaluation.

In the case of KCB M-Pesa and M-Shwari, Safaricom's customers must "consent" to having their transactional data shared with these partners when they accept the terms and conditions prior to account activation for these two services. Customers are required to confirm via STK that they have read and accepted the Terms and Conditions of the respective service. These Terms and Conditions are not actually delivered to customers, whether via STK or otherwise. Rather, customers are provided Internet links that would only be accessible to customers with smartphones.

Even if consumers are able to access this document, the use of a pdf document for viewing is particularly customer-unfriendly and visually difficult to follow. Furthermore, disclosure of transactional data sharing is buried in a long, legal disclosure document written in complex legalese. It is not remotely realistic to expect customers to navigate to this document, display it on the small screens of their mobile devices, and find and comprehend the provisions on data sharing.

Accordingly, the current disclosure appears not to meet the requirements of the Kenya Information and Communications (Consumer Protection) Regulations, 2010. The Inquiry understands these to impose an affirmative obligation on MNOs to provide conspicuous notice to customers that transactional data may be sold to third parties and obtain prior customer consent before selling or sharing it with third parties. Nor does this disclosure appear to meet the requirements of National Payment System Regulations, 2014 to obtain written authorisation from a customer before sharing customer information. A more effective means of providing such notice and obtaining customer consent would be, for example, to include a description of such sharing in plain English directly in the STK template which a customer could accept.

Customers are able to access their M-Pesa transaction histories. A customer can visit a retail centre and obtain a printout of M-Pesa transaction history for approximately Ksh 20 per printed page. A customer can also request 6 months of transaction statements through the STK menu or the Safaricom website. The process appears to be easy and is used for obtaining credit from at least one digital lender, GetBucks. Overall, the Inquiry finds that customers are able to access their M-Pesa and Safaricom transaction data without unreasonable effort.

In addition, the Inquiry did not find that Safaricom's control of Safaricom and M-Pesa transactional information of its customers and current partnership arrangements with CBA and KCB is inhibiting competition in the market for digital lending.

### 0.6.5 Credit reporting

Digital lending products are offered both by banks (and other regulated financial institutions) and by unregulated non-banks. Bank lenders are required to comply with the Credit Reference Bureau Regulations, 2013 and report both positive and negative credit information on consumers to Kenya's three credit reference bureaus. Unregulated non-banks have no such reporting obligation.

During our initial field visit in March 2016, we were informed by CIS Kenya that KCB and Equity Bank had been reporting both positive and negative credit information with respect to loans from their KCB M-Pesa and Eazzy Loans services, respectively, while CBA had only been reporting negative information with respect to M-Shwari loans. CBA's reluctance to share positive information was due in part to a concern over what it considered to be potential "free

riding" by other digital lenders. During the Inquiry's stakeholder interviews in January-February 2017 and subsequently, we confirmed that CBA had begun reporting both positive and negative credit information on a monthly basis. However, the current methodology it has employed still omits reporting on any loans that are not open on the reporting date each month but were successfully repaid. This does not appear to be aligned with the requirements of the Credit Reference Bureau Regulations, 2013.

The current monthly reporting system was not designed to deal with the short terms and high turnover of digital credit. The Inquiry understands that the CBK is moving toward requiring daily reporting for digital loans, although this was not confirmed directly by the CBK.

The Inquiry considered whether the disparity in reporting obligations between banks and non-banks creates a significant advantage for bank lenders that harms competition. The Inquiry did not find there to be a significant advantage with respect to the banks' reporting burden or the lack of availability of credit histories from those non-bank lenders that do not voluntarily report.

The Inquiry considered the effects of the difference in reporting obligations between banks and non-banks on competition in digital lending and consumers' ability to use their credit histories for financial access.

There was concern that compliance with reporting obligations involves costs borne by banks that are not borne by non-banks. However, it is not clear that the costs borne by the banks are substantial enough to create a significant disadvantage vis-à-vis the non-banks. In contrast, Kenya's non-bank digital lenders are all entrepreneurial start-ups. Introducing mandatory reporting may disproportionately affect these entities, whether in terms of costs or the technical and administrative effort to incorporate reporting into their business.

The Inquiry did not conduct an accounting of reporting costs and cannot reach a sure conclusion on the comparative impact of costs on banks and non-banks. However, no party submitted to the Inquiry any quantitative, qualitative or even anecdotal evidence that current costs of credit reporting imposed on bank digital lenders are creating an anti-competitive advantage of any substance for the non-bank digital lenders in the market.

A second concern is that non-banks are able to "free-ride" on the positive reporting data of bank digital lenders. However, the Inquiry found that neither bank nor non-bank digital lenders are currently relying significantly on borrowers' credit histories in making lending decisions. Also, non-bank mobile lenders do not currently rely significantly on credit bureau data in their credit evaluations. Altogether, the Inquiry did not receive evidence that the disparity in reporting obligations currently affords non-bank digital lenders an unfair competitive advantage in the market for digital lending. Concerns about competitive advantage appear at this time to be more a matter of principle than based on an actual or threatened substantial adverse economic impact on the bank digital lenders.

A third concern is that a lack of credit-reporting by non-banks prevents consumers from easily switching between digital lenders, since they are unable to take their credit history with them. Digital credit providers typically approve borrowers for only very small amounts initially and gradually raise the available credit limit over time as borrowers evidence a history of successful repayment. Because these repayment histories are not shared across lenders, a lack of credit reporting serves as a disincentive to switch providers, as borrowers would have to again start out borrowing small amounts from the new provider. However, as described above, digital credit providers are largely not utilizing credit histories of their borrowers in credit assessments

anyway, and the value of this information will only materialize if and when they begin to do so.

For similar reasons, the Inquiry also did not find compelling evidence that the lack of reporting by non-bank digital lenders is currently hampering growth in financial access or resulting in over-indebtedness. The Inquiry is also concerned that adding reporting obligations at this time could become a barrier to entry and growth in a young innovative market that could itself hinder new access to financial services, and so potentially even be counterproductive.

Altogether, in the absence of compelling evidence that requiring reporting by non-banks would have a significant positive impact on financial access, the Inquiry does not recommend changing the legislation to introduce a new reporting obligation to this still-young segment of the market.

Positive reporting by digital lenders (as currently required of banks and as done voluntarily by some non-banks) is in its infancy. It is possible that as the problems with the monthly timing of reporting, the built-in lag time and other deficiencies are addressed and as this pool of data becomes richer, it will become more useful to digital lenders. Additionally, as the loan amounts in digital lending increase and terms are extended, credit histories for digital lending may become more relevant to credit assessments in traditional lending. The Inquiry considers that a review of the disparity of reporting obligations within two years would be appropriate.

## 0.7 Remedies

### 0.7.1 Approaching remedies

The Inquiry considered seven remedies. It recommends pursuing the first four:

- improving price transparency,
- encouraging price comparison tools,
- improving access to customer information, and
- centralised KYC.

The Inquiry does not recommend at this time mandating the last three remedies discussed:

- publishing quality of service indicators,
- account number portability, and
- a switching facility.

The remedies consist of different layers of intervention:

- The first layer is to reinforce the pricing disclosure regime by ***better enforcement of existing regulation*** to ensure the transparency that is already provided is reinforced.
- The second layer involves measures to increase ***consumer engagement***, particularly with pricing. These build on existing regulation and advocate additional measures intended to sensitise consumers to the possibility of obtaining products at better prices from alternative providers, in short to encourage shopping around.
- The third layer is to ***reduce barriers to switching*** so that consumers not only become aware of the possibility of acquiring better priced products from alternative providers but face fewer barriers in acting on it, thereby crossing the threshold and making the switch.

Underlying these layers and the individual remedies discussed is the Inquiry's primary concern, which is to empower consumers of banking products to pursue their needs from the banking sector more effectively. A common thread in the research carried out was that consumers are disempowered through weakened countervailing bargaining power when dealing with banks due to a stark information asymmetry. The perception of hidden charges and distrust of banks, and lack of proactive engagement to find lower priced products, all point to a market in which the demand side accepts what is presented to it (albeit sometimes with resentment).

The remedies recommended can be expected to increase competitive pressure on prices, increase innovation and improve products and services. If the interventions are introduced, they should lead to greater competition, both among existing providers and even potentially new entrants as Kenya's banking sector opens up to new licensees in due course.

The remedies have been devised with the benefit of insights from "behavioural economics," including the design and testing of interventions in a few cases where this was possible to assess their likely effectiveness.

The Inquiry worked with the Busara Centre for Behavioural Economics (Busara) to design a range of focused interviews, mystery shopping exercise, experiments and analysis of existing data to collect evidence. This allowed the Inquiry to determine the critical steps in the customer journey, and to understand the psychological barriers that may be responsible for the failure to switch. This enabled the Inquiry to suggest and recommend appropriate policy interventions, and insofar as was possible, evaluate their impact.

- Experiment 1 was a field-based experiment designed to assess the effect of different messages on switching behaviours in the digital credit market. The scale of the experiment was too small to reach robust conclusions. However, the results did not yield strong evidence to suggest that regular mass SMS messaging will prompt consumers to actively search for cheaper credit providers or switch primary digital lenders.
- Experiment 2 was a lab-based experiment designed to assess the effect of several interventions on searching behaviour. The results suggest that the focus of interventions should be on simplifying and standardizing information, and ensuring early disclosure of terms.
- Experiment 3 was a lab-based experiment designed to test whether displaying cost information in a consistent way made it easier for people to compare prices across alternative providers and choose the cheapest option. The results suggest that further policy on standardization of how cost information is displayed could benefit the consumer in making optimum loan choices.

### 0.7.2 Improving pricing transparency

As a starting point, vigorous enforcement of existing regulatory requirements for traditional banking products would ensure that consumers are receiving mandated disclosures and needs assessments.

**Recommendation 1.** The Inquiry recommends more vigorous enforcement of disclosure obligations under the Prudential Guideline of Consumer Protection by the CBK. In lending, enforcement of total cost of credit (TCC) disclosure by banks should be made a priority and the CBK should work with the KBA to ensure that banks are provided with templates that comport with the mandated disclosure requirements.

In the case of loans, the Inquiry finds that current disclosure requirements around costs of borrowing are insufficient. Even when banks are in technical compliance with the Guideline and the KBA's APR disclosure requirements, the content and timing of the disclosures are often not adequate to foster useful comparisons between bank products.

**Recommendation 2.** The Inquiry recommends that section 3.4.5 of the Prudential Guideline on Consumer Protection (the Guideline) be amended to require total cost of credit (TCC) disclosure to include disclosure of annual percentage rate (APR) (as is currently required by the Kenya Bankers' Association) and periodic repayment amounts. The Inquiry further recommends that section 3.4.5 of the Guideline be amended to require disclosure of TCC to the customer prior to submission of an application for a loan.

In addition, the Inquiry recommends a corresponding amendment of section 31A of the Banking Act to require that banks must, "before accepting an application for a loan from a borrower, disclose all the charges and other costs and periodic repayment amounts relating to the proposed loan in a format to be prescribed by the CBK except where it is unfeasible to do so."

The Guideline currently requires disclosures to be given to consumers "choosing" a product or service and (after having chosen) before the consumer buys the product or service. The Inquiry considers it appropriate to specify further that such information should be in writing, specify particular pricing information that should be included and provide a provide a standardized template for such information that enable easy comparisons across products.

The Inquiry thus considers that any customers inquiring about a loan should be given a simple written statement setting out basic costs, charges and features of the loan, including,

- TCC (as enhanced by our recommendations above);
- description of how interest rates are calculated, including whether they are fixed or variable;
- repayment schedule, indicating principal repayments and interest charged;
- any late payment or prepayment fees or fees for inquiries; and
- any other charges that the customer may incur during the course of the lending relationship.

Customers inquiring about transaction or savings account should be given a simple written statement of the basic charges, including:

- account opening charges;
- periodic service charges;
- charges for balance inquiries, and statement requests and other inquiries;
- deposit and withdrawal charges;
- charges for payment services (including top-ups of air-time and mobile money accounts, funds transfers, and bill and merchant payments);
- minimum balance requirements;
- charges and interest rates for arranged and unarranged overdrafts; and
- any other material charges.

Additional information that should be disclosed to the consumer in the case of savings accounts:

- minimum period associated with a savings product;
- the date on which a preferential interest rate will terminate; and
- any other material terms.

In all cases the format of the written statements should be standardized and easy to follow to allow customers to easily make comparisons among products. The formats of the statements should be tested with users to ensure they are understandable and useful and before they are implemented across the sector.

**Recommendation 3.** The Inquiry recommends that section 3.4.5 of the Prudential Guideline on Consumer Protection be amended to require banks to provide customers with a simple, standardized, written statement setting out basic costs, charges and features of bank products.

The Inquiry considers that there would be significant benefit to customers receiving an electronic message summarising key information about a product for which they are interested in applying. This could occur during a visit to a branch to inquire about the product, or shortly after leaving the branch. This could be used for a wide variety of products, including loans, and savings and transaction accounts.

Electronic messaging could also alert consumers that they have incurred or are about to incur a charge, which would increase their sensitivity to pricing. In the case of savings accounts, electronic alerts could also be used to inform a customer when the balance dips below (or is close to dipping below) the level required to obtain a particular interest rate, or if the period applicable to a given preferential interest rate expires.

Furthermore, such messages could include supplementary Internet links or short codes that could provide consumers with additional educational content on understanding bank product costs and charges. The Kenya Bankers Association could be encouraged to develop such content and make it available to all banks and consumers.

This Inquiry did not carry out extensive testing to enable it to recommend a specific form or language for such messages. However, all such messages should always be clear, not misleading, and consistent with the underlying contractual terms. And, where a financial decision is involved, such as to increase the balance to avoid or reduce overdraft charges in a transaction account or to benefit from a higher savings account interest rate, the message should be sent with sufficient time for the consumer to act up on it and benefit accordingly.

**Recommendation 4.** The Inquiry recommends that the Prudential Guideline on Consumer Protection (the Guideline) be amended to require banks to provide messages delivered to a customer's mobile phone summarising key information about a product for which they are interested in applying. Electronic messaging could also alert consumers that they have incurred or are about to incur a charge, which would increase their sensitivity to pricing.

The Inquiry considers that a 12-month period from the implementation of this requirement for electronic alerts should suffice. Where particular circumstances make it impossible or unreasonable for a bank to introduce an alert service within this period, an extension could be sought. The Inquiry further recommends that Banks should be required to periodically report to the CBK on the implementation of their messaging systems.

The Inquiry recommends that the CAK and/or CBK carry out pilot experiments into the effectiveness of a variety of such message formulations with a view to understanding their relative effectiveness.

The consumer research carried out by the Inquiry and by others suggests that bank customers are not aware of the degree to which they could save if they were to look to alternative providers. The Inquiry considers it important to alert customers not only to the cost of the product in

question, but to the fact that prices vary in the market and that better deals may be found through shopping around.

**Recommendation 5.** The Inquiry recommends ensuring that consumers are alerted not only to the cost of the product in question, but to the fact that prices vary in the market and that better deals may be found through shopping around. The Inquiry recommends that in the case of loans banks be required by the CBK to receive electronic messages at appropriate times to remind them that banks charge different prices, and to encourage them to shop around.

The Inquiry also recommends that the CAK collaborate with the CBK to evaluate *ex post* the impact of such a message among consumers, including their tendency to shop around as a result of receiving it at the time when they are inquiring about the availability of a bank product. The Inquiry also recommends that the CAK carry out further research into the potential use of electronic alerts for broader purposes, such as for the pricing of transaction and savings accounts.

The Inquiry found that there appears to be significant non-compliance with disclosure requirements in digital lending and savings over mobile platforms.

**Recommendation 6.** The Inquiry recommends that the CAK continue its work of requiring digital financial services providers to comply with the pricing disclosure requirements of the Competition Act. The Inquiry further recommends that the CBK devote resources to vigorously enforce the disclosure requirements of Prudential Guideline on Consumer Protection, which should be taken into account during the product approval process, and which the Inquiry considers to be crucial for the development of a competitive market in digital financial services.

The Inquiry considers that consumers would be better able to compare products and so shop around if there was greater harmonisation of charges. The Inquiry considers that in the case of digital credit provided by banks, the disclosures described above with respect to traditional credit – of the TCC, APR and periodic repayment amount – will achieve the desired harmonisation. These particular forms of price disclosures would not apply to non-bank lenders as they are not subject to the Guideline, and the Inquiry is not proposing amending the Guideline in this respect. However, non-banks would remain subject to the requirements of the Competition Act.

Consumer behaviour research in Kenya has found that explicitly offering the consumer the choice to view the terms and conditions during the customer journey before proceeding to borrow increases the likelihood that the consumer will read the terms and conditions, and that this leads to lower default rates.

**Recommendation 7.** The Inquiry recommends that digital financial service providers be required to remind customers to review the terms and conditions applicable their product within the digital channel and to provide basic summaries of the terms and conditions within the channel. The Inquiry believes that the CAK is best placed to lead efforts to require such disclosure as its mandate extend to non-bank providers and such requirement is consistent with the Competition Act. The Inquiry further recommends ongoing coordination between the CAK and the CBK on disclosure requirements applicable to digital financial services.

### 0.7.3 Price comparison websites and similar services

The process of gathering the information and holding it all in one place (physically, digitally or mentally) to carry out a comparison among different banks' products remains laborious and a challenge for consumers. Tools that would reduce such difficulties and so help consumers shop

around include price comparison websites (PCWs) and SMS or USSD search tools that make pricing information more easily comparable and salient. There is evidence from other countries that consumers that review products ranked by price make better price-based decisions.

PCWs could be developed and provided in a variety of ways. In addition to their potential benefits, PCWs present various risks, including incorrect information, bias due to commercial relationships with ranked providers, adverse effects on competition due to omissions or framing of product disclosures. An ideal PCW might embed certain principles:

- A PCW should be generally open and competitively neutral as to the different types of participating institution whose products it lists.
- A PCW should rank products in a competitively neutral manner, i.e., showing financial products based on objective criteria pursuant to search functions based on key features of the product.
- At no time should any ranking or prominence given to any financial product or provider in a comparison be affected by the commercial interests of the PCW.
- Relatedly, there should be clear differentiation between advertising on the PCW and ranking of products in order to prevent customers becoming confused between what is an objective ranking result and what is promotional.
- The PCW should disclose the number and names of participating banks and other institutions so that consumers are aware of the limits of the comparison facility.

At this time, there appear to be no plans to regulate the planned PCWs in Kenya. PCWs could be provided freely or subject to a licensing or other requirement, or under an accreditation scheme. Some countries have required them to be accredited, while others not.

While price transparency can improve competition for the reasons described above, it can also harm competition, whether through facilitating coordination or excluding innovation, also as described above. For these reasons, the CAK should keep a close eye on the manner in which PCWs are designed and operated. Where they run a risk of resulting in horizontal constraints on trade, in particular through risk of pricing coordination, it may even be appropriate for PCWs coming onto the market to ask the CAK for clearance under its Exemption Guidelines for Horizontal Practices, 2012.

Under any scenario, such regulatory intervention should be done delicately in order not to discourage investment in PCWs. Indeed, if carried out with consultation over a reasonable period of time, regulation may even establish a helpful publicly-known framework for operation, lending a legitimising force that may contribute to confidence of the PCW itself and trust among participating institutions and consumers.

A strong regulatory intervention to boost PCWs could be to require banks by regulation to publish prices of certain products on a PCW site before offering them to the public online, or to require financial service providers to provide a link on their websites to one or more PCWs.

The Inquiry considered all these options and considers that a cautious approach is appropriate at this time.

**Recommendation 8.** The Inquiry recommends that policy makers encourage a small number of commercial PCWs to develop, and ideally two or three to impose competitive pressure on one another. In particular, there would be benefits from applying some public guidance as to their governance and operation, which could initially take the form of a ‘best practices’ paper of the CAK or CBK after holding a workshop and carrying out a study involving the banks, the

KBA and aspiring PCWs. This would seek to establish key design and operating principles for PCWs, but without being overly prescriptive. These principles would relate to (1) competitive neutrality, (2) openness to different types of financial provider, (3) protection of content from the PCW's commercial interests, (4) differentiation between advertising and ranking, and (5) disclosure of participating institutions.

We also recommend that any PCW brought to market be tested with consumers in order to verify its effectiveness and lack of distortions from the manner in which information is presented.

We do not recommend at this time introducing a licensing, clearance or accreditation scheme at this time, or requiring banks to participate. These options should be considered after the operation of PCWs has been reviewed over a period of 2 years or if problems emerge earlier.

The Inquiry also recommends that the CAK and the CBK engage with those organisations that are already preparing PCWs and multilateral agencies to examine how USSD and other customer interfaces might be added to PCW initiatives, including examining the types of products that could be compared with simplicity, and potential business models.

#### 0.7.4 Use of, access to and reporting of customer information

Consumers face a switching barrier where approaching a new bank for a service (typically a loan) that requires them to provide transaction data from their existing and potentially prior banks. The Inquiry considers that some steps could be taken to simplify, accelerate and extend the process.

**Recommendation 9.** The Inquiry recommends that the CBK and the CAK review this option if it is shown that customers continue to show reluctance to switch and such reluctance is primarily due to the administrative effort of doing so. Any such consideration of switching facility must take into account the potentially large costs of its establishment and operation and proportionality to the market failure it would be intended to remedy.

The Inquiry found that the current mechanisms used by Safaricom to obtain consent to share Safaricom and M-Pesa transactional data with CBA and KCB (its partners in the M-Shwari and KCB M-Pesa products, respectively) are insufficient.

**Recommendation 10.** The Inquiry recommends that mobile money platforms be required to include a simple, plain English consent to use of customer transaction data for credit evaluation (and any other purposes for which such data is used). It also recommends including a short description of such sharing in the STK screen for customers to read prior to indicating consent. The Inquiry also recommends that the Communications Authority of Kenya and the CBK review the practice of MNOs in using such data with a view to assessing compliance with the privacy provisions of the Kenya Information and Communications (Consumer Protection) Regulations, 2010 and the confidentiality provisions of the National Payment System Regulations, 2014, respectively.

We discussed above the Inquiry's findings with respect to the disparity in reporting obligations for bank versus non-bank lenders.

**Recommendation 11.** The Inquiry recommends that the CBK review the reporting regime employed for M-Shwari loans and require compliance with the Credit Reference Bureau Regulations, 2013.

In order to ensure that reporting on digital loans is appropriately tailored to the short-term nature of these loans, the Inquiry supports any efforts to require daily reporting.

The Inquiry does not recommend adding a new reporting obligation for non-bank digital lenders at this time. However, the Inquiry does recommend that this issue be monitored and revisited as the market develops, review it within two years.

### 0.7.5 Centralised or coordinated KYC

Differences in KYC standards among Kenyan banks result in duplicative KYC procedures that are both inefficient and a barrier to switching. The additional costs of banks are passed through (albeit indirectly) as costs to consumers in charges and interest. It also provides a disincentive to consumers who have to go through the inconvenience and effort to provide KYC information to a new bank to which they wish to switch. This is a complex topic that requires further study.

**Recommendation 12.** The Inquiry recommends that the CBK confer with the CAK, the KBA, existing KYC providers and other appropriate bodies to consider the potential benefits of facilitating centralised or coordinated KYC, the design options for such a system, the costs of establishing and maintain the system, the incentives of banks to participate, and international examples. As consumers did not claim that the KYC process was a direct barrier to switching, it may be more prudent to commence with a voluntary approach than imposing it by regulation, although regulation could be used to establish a KYC provider status that might attract trust necessary to encourage substantial participation.

## 0.8 Other measures considered

### 0.8.1 Publishing quality of service indicators

Price is only one of several potential facets of competition in a well-functioning market. Others include product innovation and quality and variety of service. One possible means of increasing competitive pressure on banks in the area of quality of service would be to increase customer sensitivity to this competitive factor by providing consumers with more information. Customer satisfaction indicators could include proxy statistics on comparative levels of customer satisfaction, such as likelihood to recommend a bank or call centre performance.

However, there does not appear to be a lack of customer engagement with quality of service as a competitive factor. Indeed, customers already appear to be very sensitive to it and to act on it including to switch. Thus, it is not clear that the benefits from introducing new mandatory customer satisfaction surveys and comparisons are likely to outweigh the additional cost and effort involved.

Although it does not recommend imposing quality of service ranking disclosure requirements, the Inquiry does recommend taking further steps to test whether providing consumers with comparative information on quality of service is likely to affect outcomes. Increasing the information load to consumers may create overload, or may distract from other areas which may be more important. Further study in the Kenyan market is needed to determine whether consumers will absorb information on quality of service that is provided under a regulated mechanism as opposed to information received from friends and family, the comparative reliability of such information, and whether consumers are likely to act on it

### 0.8.2 Account number portability

The Inquiry considered introducing a powerful measure to enable switching by through account number portability (ANP). ANP would take switching further by allowing consumers to retain their bank account numbers and bank identification number. It is not necessary to inform third parties about a new account number, and should greatly reduce switching costs.

However, ANP is costly and has not been taken up in other countries. Also, because Kenyan consumers prefer and rely heavily on partial switching rather than full switching, it is not clear that ANP would have the desired impact in Kenya anyway.

The Inquiry does not recommend pursuing ANP at this time. We would recommend it only if it is shown that customers continue to show reluctance to switch, that such reluctance is primarily due to the administrative effort of doing so, that the potentially large costs of its establishment and operation are proportionate to the market failure it would be intended to remedy, and that there is evidence of its success elsewhere.

### 0.8.3 Switching facilities

The Inquiry considered the possibility that a lighter intervention, such as establishing a switching facility or service, could support the switching process and increase the tendency of customers to switch. This could involve a system that facilitates the transfer of transaction accounts, or of loans through loan buyouts.

However, a switching service is typically most useful in the case of full switching rather than partial switching. The extensive multibanking practice in Kenya suggests that there is a high tolerance for leaving an account with an old bank open after switching to a new bank. Banks will in any case treat the account as dormant after a period of inactivity, and are not entitled to charge the customer for the account during that period. There is, then, already a default process for closing accounts that does not impose excessive costs on customers. In addition, a switching service is most effective really where there is a culture of using extensive direct debits and standing orders, which there is not yet in Kenya.

The Inquiry does not recommend imposing a switching facility at this time. This remedy might be revisited at a later time after the market has matured and only after a careful weighing of the anticipated benefits of the remedy against the burden of introducing it.

# Competition and consumer protection in the Kenyan banking sector

## Phase II

## Competition Authority of Kenya

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# 1. Introduction

## 1.1 Origin of this market inquiry

This report is the final product of a market inquiry (we will refer to it as the "Inquiry") into demand-side competition and consumer protection in the banking sector of Kenya carried out by the Competition Authority of Kenya (CAK). The Inquiry was announced by publication of the terms of reference by the CAK in the Official Gazette of Notice no. 678 on 5 February 2016. The economics firm Acacia Economics and the law firm Macmillan Keck Attorneys & Solicitors were engaged to advise and assist the CAK in conducting the Inquiry and have produced this report.

An earlier Phase I market inquiry was completed in 2014 by Genesis Analytics. Phase I focused on barriers to competition in the sector from a supply-side perspective. Phase I examined the structure of the banking industry to determine whether there were indicators of market concentration and pricing levels out of line with those seen in comparator markets or excessive profitability. It found that profitability of the banks and interest rate spreads in Kenya are comparable to those in other relevant countries. It also found that with the exception of certain savings market segments, the banking sector was not overly concentrated (i.e., supplied by relatively few firms).

Various segments of the market did not form part of the Phase I inquiry, including digital savings and credit, which were then still in their infancy. The Phase I report suggested further research on interoperability among the banks to improve the ability for small banks to compete, increasing capital requirements among the banks to encourage consolidation so as to allow smaller banks to compete more effectively, and improving consumers' ability to switch between accounts.

On this last point, stakeholders remained concerned that demand-side factors may be impacting the effectiveness of market function. Drawing on the results of Phase I, two areas were highlighted as potentially significant: barriers to switching banks and the transparency of pricing to consumers. These are closely related, as lack of transparency in pricing may reduce

consumer engagement with pricing as a facet of competition, weakening the consumer's inclination to switch and ability to compare alternative offers. This Phase II Inquiry focused on these concerns, as well the activities of recently emerging digital credit and savings providers and the use and disclosure of consumer transactional data.

## 1.2 Nature of this Inquiry

The CAK's authority to conduct a market inquiry is derived from the Competition Act.[2] The CAK is mandated to carry out inquiries into matters relating to competition and protection of consumers, study the effects of government policies and legislation and regulatory authorities on competition and consumer welfare, and investigate impediments to competition.[3]

A market inquiry under the Competition Act is not an "investigation" by the CAK, which is a distinct process under Competition Act. Investigations are specifically directed at conduct that may constitute contraventions relating to restrictive trade practices or abuse of dominance, and involve greater information gathering powers than in a market inquiry.[4]

Rather, a market inquiry will result in a report in which the CAK may "[i]n appropriate cases […] identify sectors where factors relating to unwarranted concentrations of economic power subsist and give advice regarding measures which may ameliorate such situations."[5] Thus, although a market inquiry will not make binding determinations about infringement of a prohibition under the Competition Act, or enact specific remedies, it may identify potential infringements of a prohibition under the Competition Act and other potential constraints on competition, recommend that an investigation be undertaken, and explore potential remedies for consideration.

The Inquiry is, then, the first in a potential series of steps that might include an investigation by CAK to identify violations of the Competition Act and apply remedies under that Act. This

[2] For purposes of this report, we refer to the Competition Act, No. 12 of 2010, Revised Edition 2012, published by the National Council for Law Reporting with the Authority of the Attorney General, plus the amendments to the Competition Act contained in the Finance Act, 2014, as published in the *Kenya Gazette Supplement No. 141 (Acts No. 16)*, 19 September 2014.

[3] Section 9(1) of the Competition Act enumerates the CAK's functions and includes the following abilities which are essential carrying out a thorough market inquiry: […] (g) carry out inquiries, studies and research into matters relating to competition and the protection of the interests of consumers; (h) study government policies, procedures and programmes, legislation and proposals for legislation so as to assess their effects on competition and consumer welfare and publicise the results of such studies; (i) investigate impediments to competition, including entry into and exit from markets, in the economy as a whole or in particular sectors and publicise the results of such investigations; (j) investigate policies, procedures and programmes of regulatory authorities so as to assess their effects on competition and consumer welfare and publicise the results of such studies; […] (m) liaise with regulatory bodies and other public bodies in all matters relating to competition and consumer welfare; (n) advise the government on matters relating to competition and consumer welfare.

Section 18(4) similarly states: At the request of a regulatory body, or at its own instance, [the CAK] may conduct an inquiry into any matter affecting competition or consumer welfare and provide a report within a reasonable period.

[4] See section 31(1) of the Competition Act. Also, in an investigation, the CAK may compel production of information, documents, records and testimony, conduct searches, seize information and take evidence of witnesses (sections 31(4), 32-33). Under section 36 of the Competition Act, after concluding an investigation where the CAK determines that an undertaking has infringed a prohibition under the Competition Act, the CAK may restrain the undertaking from engaging in that conduct, take action against the undertaking to reverse the infringement, impose penalties or grant other appropriate relief. Section 37 of the Competition Act allows the CAK to grant interim relief to prevent serious, irreparable damage from potential infringement or on public interest grounds.

[5] More fully, section 18(3) of the Competition Act provides: "In appropriate cases, after conclusion of an inquiry or a sectoral study, [the CAK] shall in its report to the Minister identify sectors where factors relating to unwarranted concentrations of economic power subsist and give advice regarding measures which may ameliorate such situations."

study might also be a source for other regulatory authorities with important roles in the mobile financial services sector, including in particular the Central Bank of Kenya (CBK).

## 1.3 Approach to this Inquiry

This Inquiry focused on the demand side. As such, the primary questions probed by the Inquiry concerned the ability and tendency of customers to impose competitive discipline on banking services, and various consumer protection dimensions of banking services in Kenya. The Inquiry was thus not an exhaustive review of the banking sector, for instance surveying the range of products, pricing and innovation and other indications of the presence or limitations of competition. Nevertheless, this report does review some of these elements to provide context for the findings.

In accordance with the terms of reference, the Inquiry sought to identify demand-side features of the Kenyan banking market that prevent, restrict or distort competition in the provision of banking services in Kenya. If any were found, we sought to determine whether any intervention by the CAK or other regulatory bodies would be appropriate in order to remedy, mitigate or prevent such harm to competition or adverse effect on customers.

In particular, the Inquiry was interested in whether a lack of consumer engagement and barriers to searching and switching undermined the incentives of banks to compete on the main parameters of competition, in particular price, quality of service and products, and innovation.

The Inquiry sought to understand and document the end-to-end banking consumer journey and identify triggers that prompt the decision of customers to switch, as well as barriers that prevent switching. In doing so, the study explored barriers to customers searching for alternative products and switching providers, including lack of awareness of alternatives, the ability to access and assess relevant information and then eventually act on this information to switch. We considered, in particular, costs of switching, account closure practices and any behavioural biases that may lead to customer inertia to switch.

The Inquiry sought to determine how the barriers identified impact market development and customer choice, and to uncover the extent to which the barriers identified relate to competition in the banking sector and the extent to which they could be addressed by regulatory action by the CAK and other government agencies. This included exploring alternate consumer focused measures beyond the CAK's regulatory scope that could address the identified switching barriers, including strengthening consumer awareness, as well as an assessment of their potential impact.

A key element of the Inquiry's work related to price transparency. This included exploring and documenting the evidence of deficiencies in disclosure and sales practices by provider segments, including deficiencies in presentation of product information to consumers. It identified how both transparency and suitability can be improved to address these issues, including regulatory action by the CAK or other government agencies. The work related not only to traditional banking, but also assessed the adequacy of disclosing costs to consumers when transacting on digital channels.

While the above factors relate to competition, they also comprise consumer protection concerns, which are also under the mandate of the CAK. This report thus discusses such issues also from the perspective of consumer protection.

In addition, the Inquiry assessed the level and current practices around consumer control over transactional data, as well as how such data is sold and assessed by third parties (e.g., use of mobile credit data to score and award credit offers without consumer consent). It also assessed the level of equal compliance with credit bureau reporting by digital credit providers and whether they report both positive and negative borrower data as required by the law, and whether there exists disparate treatment that gives them anti-competitive advantage and inhibits consumers' ability to take advantage of their own data for financial access. Lastly, it assessed any restrictions on consumers' use of their own digital transactional data and provision of the same to third parties for commercial use.

As a demand-side study, the Inquiry was not focused on supply-side competition issues, such as the level of concentration or the presence of dominance, or whether high levels of concentration are adversely affecting customers, or what barriers to entry and expansion constrain the ability of banks to enter or expand (except as these might relate to switching barriers).

Being focused on the consumer experience (particularly banks' disclosure practices and use of consumer data) rather than on the degree of competition, the Inquiry did not require a detailed market definition exercise (e.g., using a hypothetical monopoly test) to be carried out, such as is typically used in dominance-related assessments and interventions, and in a merger context. Although the Inquiry did review various market segments in both traditional and digital banking, it did not consider it necessary to reach separate, formal market definitions for competition analysis purposes as it was not assessing market concentration, which was the purpose of the Phase I Inquiry. Nevertheless, we did have occasion to consider the level of concentration (see Section 3.2.4), revisiting some of the conclusions from Phase I.

As explained further in Section 7.1, the remedies recommended by the Inquiry have been devised with the benefit of broad insights from the field of behavioural economics, as well as the findings from three behavioural experiments carried out under the auspices of the Inquiry in order to test the efficacy of potential interventions.

## 1.4 Sources of information

The Inquiry gathered information from several sources, including a review of existing literature, submissions from and interviews with banks, unlicensed lenders, regulators and other participants in the Kenyan market, market research into Kenyan consumer perceptions, market research to test remedies in the Kenyan context, and international experience. This information was used to inform the key hypotheses that were tested in the experimental component of the Inquiry's work, and from which additional data was generated.

### 1.4.1 Literature review

We carried out a thorough review of literature in order to organise and consolidate relevant work already done, as well as relevant laws and regulations applicable to banking services, digital lending, competition and consumer protection. Various large surveys of financial access have been undertaken in Kenya and provide a range of quantitative data. These include:

- the FinAccess surveys in 2006, 2009, 2013 and 2016,[6] which provide a significant amount of information on what kinds of financial services consumers take up, and how such behaviour has evolved over time;
- the Financial Diaries Survey undertaken in 2013[7] which follows in depth the financial experiences of 298 households over the period of a year; and
- the Financial Inclusion Insights Programme,[8] which is focused on digital financial inclusion and conducts both tracker surveys and "Consumer Experience Monitoring" projects.

In addition, several teams have undertaken their own surveys and focus groups to better understand market issues. These include several studies commissioned by FSD as well as studies by academic researchers. [CONFIDENTIAL][9]

Collectively, there is therefore a wealth of data and prior analysis on the sector.

### 1.4.2 Input from market participants and other stakeholders

The Inquiry prepared written information requests for 14 banks, 3 non-bank digital lenders and (in relation to digital financial services) one telecommunications operator. We received substantive responses from 5 banks, 1 non-bank digital lenders and the telecommunications operator. The information included policies and procedures on opening and closing accounts, tariffs, disclosures of pricing, and various other information. Annex 2 (Input from market participants and stakeholders) sets out the entities that received information requests and those who responded.

The Inquiry also carried out 29 in-person interviews with banks, other financial service providers, credit reference bureaus, mobile money providers and regulatory authorities (including the CBK, the CAK, and the Sacco Societies Regulatory Authority) and other stakeholders (12 interviews during the initial field visit, 17 during the second), and 6 remote interviews via Skype, amounting to a total of 35 interviews (listed in Annex 2 (Input from market participants and stakeholders)). The Inquiry also consulted with Financial Sector Deepening Kenya (FSD), the Consultative Group to Assist the Poor (CGAP) and the Busara Centre for Behavioural Economics throughout the Inquiry. Relevant information received is integrated into the description of the Kenyan banking sector and competition and consumer issues throughout this report.

### 1.4.3 Research into consumer perceptions and the customer journey

The Inquiry included primary research into consumer perceptions and the customer journey, through qualitative interviews (focus group discussions and in-depth interviews of individual consumers) a mystery shopping exercise and a customer observation exercise. These were carried out by the Busara Centre for Behavioural Economics (Busara), a local research organization focused on the evaluation and implementation of behavioural interventions in developing country contexts. The findings on consumer perceptions are included in Sections 5 and 6. The customer journeys are mapped and detailed in Annex 1 (Customer journeys).

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[6] FinAccess National Surveys, available at http://fsdkenya.org/dataset/finaccess-household-2016/.

[7] Kenya Financial Diaries Research programme, data and reports available at http://fsdkenya.org/financial-diaries/.

[8] Financial Inclusion Insights, http://finclusion.org/.

[9] [CONFIDENTIAL]

### 1.4.4 Experimental research to test interventions

Again with the assistance of Busara, the Inquiry designed and carried out behavioural experiments to better understand consumer behaviour, including interrogating the effect of various switching barriers on consumer switching behaviour, and assessing consumer responses to potential policy interventions such as price transparency and early disclosure rules that could improve competition. These are described in Section 7.1.

### 1.4.5 International experience

The Inquiry also drew upon international experience in banking and financial regulation, including market inquiries. In recent years, a number of countries have carried out competition market inquiries, including South Africa,[10] the UK (including substantial reviews of the Competition and Markets Authority of the retail banking[11] and payday lending[12] sectors), Australia,[13] Denmark,[14] the Netherlands[15] and Sweden.[16] The UK's Financial Conduct Authority has been particularly active in considering competition problems and consumer-oriented remedies relying on behavioural economics, including pricing disclosures and use of price comparison websites (PCWs).

This Inquiry has drawn on these countries' experiences while retaining the perspective of Kenya as a lower income country with a comparatively thriving financial sector. It has also drawn on numerous studies in other countries of how information about financial services is made available to consumers, and the impact on their ability to make informed decisions that meet their needs.[17]

Notably, many countries are struggling with the same concerns, in particular lack of consumer engagement with pricing as a facet of competition. Remedies applied in other countries have been considered in this report, with some being adapted to the Kenya context and others found inappropriate, as discussed in Section 7.

## 1.5 Priority market segments

On a broad level, the three main banking consumer segments are personal, SME and corporate customers, although these broad delineations are not rigid as personal loans are often used for SME finance. Further differentiations can be made on consumer characteristics, for example, personal can be divided by income bands and SME can be divided by size (turnover, number of employees, etc.). As such there are a range of different segments that can be assessed.

[10] Report to the Competition Commissioner by the Enquiry Panel: The Banking Enquiry.

[11] Competition and Markets Authority (2016): Retail banking market investigation.

[12] Competition and Markets Authority (2015): Payday lending market investigation.

[13] Australian Financial System Inquiry (2014).

[14] Konkurrence- og Forbrugerstyrelsen, (2013) Competition in the Danish Banking Market.

[15] The Netherlands Authority for Consumers & Markets (2014): Barriers to entry into the Dutch retail banking sector.

[16] Konkurrensverket, Swedish Competition Authority (2013): Competition on the financial services market: deposits, mortgages and funds.

[17] E.g., Xavier Giné, X. and Mazer, R. (2016): Financial (Dis-)Information: Evidence from a Multi-Country Audit Study, World Bank Group Policy Research Working Paper 7750.

In the Phase I inquiry, within each of the three main customer segments (personal, SME and corporate), four products were considered: demand deposits, savings deposits (and other interest-bearing instruments), secured lending and unsecured lending. The bulk of the literature thus far is focused on personal banking, with less research on the SME and corporate sectors.

Few studies specifically assess SME use of financial services from the demand side.[18] There are a range of other studies that assess SME finance from the supply side.[19] FSD has also reviewed extensively supply-side factors related to SMEs in Kenya, finding gaps in long-term bank finance, equity finance, bond finance, OTC market finance and finance from government SME finance schemes. Informal and short-term bank finance were the most prevalent means of finance.[20]

The Inquiry considered focusing on those segments and areas in which there is very little primary demand-side research, such as corporate banking. However, this segment has not been identified as facing significant competition problems.

We considered and consulted with the CAK on potential focal areas for the study and decided to focus on the personal segment and, as a result, small SMEs who typically use personal banking products. The literature on the personal segment provides considerable background information on the personal sector and highlights a range of problems and anomalies in consumer behaviour. These problems largely remain unresolved and policy responses to some of them could potentially be tested through behavioural interventions. While a study of SME and corporate banking may be warranted at some point, our survey of the literature combined with interviews with stakeholders in Kenya and focus groups suggested that personal consumers have identifiable difficulties that should be addressed.

For example, the literature shows that consumers have low levels of financial literacy[21] and a lack of understanding of interest rates, bank pricing and policies. It shows that consumers do not trust or use banks optimally, and highlights the existence of multiple accounts and account dormancy. This suggests that there is value in designing interventions to better guide usage of

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[18] Totolo (2015) presents the results of a FinAccess Business, a project that assessed both the supply and demand side of SME finance. A survey of 1,047 banks in Nairobi was undertaken. He notes that the SME product portfolio offered by banks is unsophisticated and tends to use "credit instruments that are expensive, unsuited for their needs and expose them to various types of risks." There is high use of overdraft financing and very little use of other options such as trade finance. Furthermore, SMEs have limited awareness of available financing options. In addition, the survey also shows that access/cost of finance is a main obstacle for business: 32.6% of respondents identify this as an obstacle for business. Totolo, E. (2015). The supply and demand for SME finance in Kenya. Nairobi, Kenya: FSD Kenya.

[19] Calice *et al* (2012) interviewed and surveyed banks in East Africa (four in Kenya). They found that while SMEs were a strategic focus for banks, they were often constrained by a lack of collateral and information as well as informality and family-owned structures. Calice, P, Chando, V and Sekioua, S. (2012) Bank financing to small and medium enterprises in East Africa: Findings of a Survey in Kenya, Uganda, Tanzania and Zambia. African Development Bank, Working PaperNo 146, March 2012.

[20] Mela, M, Patel, A, Turner, S and Wells, S (2015) Review of growth enterprise market segment (GEMS) and increasing access to Kenya's capital market by small and medium enterprises (SMEs). FSD.

[21] For example, in the FII 2014/15, in response to a question on the amount of money they would have if they invested Ksh 100 at 2% over 5 years, only 58.1% stated that it would be more than Ksh 100 with the rest answering wrongly or refusing to answer. Similarly, only 47.8% of respondents answered correctly that a loan of Ksh 100 attracting interest of 2% would require a total repayment of more than Ksh 100 in a year. The number of incorrect responses and non-responses increased in a more complex variation, which took into account inflation. Also, the FinAccess 2015 Survey asks two questions related to financial literacy. The first asks a simple division question. "You are in a group and win a promotion or competition for KSh 100,000. With 5 of you in the group, how much do each of you get?" 42% of respondents did not get the correct answer, with 20% of respondents providing an incorrect answer and the remainder stating that they did not know the correct answer. The second question relating to interest rates had a poorer response. In response to the question "You take a loan of KSh 10,000 with an interest rate of 10% a year. How much interest would you have to pay at the end of the year?" over 60% of respondents did not give the correct answer with 32% providing an incorrect answer and 29% not responding.

the banking system within the personal sector. As a result, the existing literature was primarily used to identify the concerns targeted from a behavioural standpoint and used as a platform from which to design behavioural interventions.

## 1.6 Role of the Inquiry in the context of price regulation

As is described in more detail in Section 3, Kenya has seen numerous debates and studies related to the cost of credit, and initiatives to reform aspects of the banking industry in order to improve credit. These included enhancements in credit information sharing and movements towards a more unified disclosure of bank charges.

Despite these, impatience with the speed of change has led to the enactment of the Banking (Amendment) Act, 2016, capping interest rates at 4% above the Central Bank Rate (CBR) and putting a floor on interest rates on deposits of 70% of the CBR. This Inquiry was announced in the Official Gazette on 5 February 2016 and the rate regulation was introduced on 14 September 2016.

As a result, the nature of competition has changed during the course of the Inquiry. Kenyan banks brought down their lending interest rates more or less uniformly, eliminating the prospect for price- based competition in the interest rate. The cap covers only interest rates and not fees and charges. This led to some anomalous situations. For instance, M-Shwari characterises its charge for borrowing as a "facility fee" and not interest, and so avoided reducing its charge, maintaining it at 7.5% for a one-month loan.[22] At the same time, KCB M-Pesa, which had quoted an interest rate, reduced this interest rate to 1.16% for a one-month loan while maintaining a separate "negotiation fee" of 2.5%.[23]

The effects of the interest rate regulations are still being felt in the market and we are not in a position to draw conclusions on their impact. However, recent statistics do offer some indications. While the number of loan applications have increased year on year by 23.4%, the value of these applications has decreased. Loan approvals have increased by 35.6%, while their value decreased. Lending to micro, small and medium enterprises has fallen by 5.7%.

Thus, with interest rates migrating to the cap, competition on interest rates has disappeared, banks have limited credit options for riskier borrowers and anecdotally, banks that we interviewed stated that switching of loan providers and loan buyouts are becoming less frequent. In addition, since larger banks are also offering higher interest rates on deposits, smaller banks are less able to compete for consumers through offering favourable deposit terms.

However, rate regulation may also spur banks to increase efficiency of their operations as margins have been reduced. One bank noted that the rate regulation caused it to find ways to decrease paperwork in its loan application process, including the development of an online portal to receive applications.[24]

The effect of rate regulation on competition has direct implications for this Inquiry, which is intended to improve competition. As a result of these regulatory initiatives, the prospects for price competition in the banking sector were greatly hampered as banks reduced their lending

[22] M-Shwari Terms and Conditions, available here: http://cbagroup.com/m-shwari/terms-and-conditions/

[23] KCB website, https://ke.kcbbankgroup.com/home/loans/mobile/kcb-m-pesa

[24] [CONFIDENTIAL]

rates and increased their deposit rates according to regulation rather than competitive pressure, removing the meaningful likelihood of price differentiation.

Initially, while there might have been scope for competition in fees and charges, there was little prospect of competitive reductions in these as banks sought to use unregulated fees and charges to compensate for interest rate reductions. However, in a subsequent circular, the CBK affirmed the requirement that all bank products must be approved by the CBK, including any changes to approved products, such as increases in charges to address complaints of arbitrary charges added to banking products.[25]

The effect of rate regulation on lenders that are not subject to the interest rate cap, such as SACCOs and unregulated lenders, is unclear and was not a focus of the Inquiry. There are likely to be both positive and negative effects. On one hand, the cap may harm these lenders as they are forced to compete with artificially low rates imposed on the banks. However, as the rate cap may have largely eliminated the ability of banks to engage in risk-based pricing of loans, riskier borrowers may no longer be able to obtain loans from banks at the current rates, leaving lenders that are not subject to the cap as their only option for credit.

The Inquiry took the approach that the regulation of rates is likely to be temporary, as indicated in various public statements of policymakers, although it remains unclear how long these will remain in effect. The Inquiry thus pursued its line of inquiry and sought to address competition issues on the basis that the interest rate cap would in due course be lifted and that the Inquiry would contribute to enabling competitive pressure to grow in areas today controlled by regulation. Indeed, to the extent that measures recommended by the Inquiry might be expected to increase competition, then the adoption of these measures might support the removal or lightening of the rate regulation.

Even if the interest rate regulation remains in place, the Inquiry considers that the remedies recommended could still significantly promote competition within the sector by improving the ability of consumers to better understand pricing and product information. This should facilitate comparisons across banks, which in turn, should prompt consumers to become more demanding of their banks and lead banks to compete more vigorously for consumers.

Having said that, it is particularly important to recall the limitations of a demand-side inquiry such as this. The remedies discussed and recommended in Section 7 are not intended and should not be expected to resolve all of the undesirable market outcomes in the financial services sector in Kenya, including historically high interest-rate spreads.

For example, as discussed in more detail in Section 3.2.2, prior studies have identified difficulties with collateral and the high costs of enforcing contracts in Kenya as reasons for greater lending risks, and therefore higher lending interest rates. Further reasons include country risk and relatively high levels of government borrowing, which provide alternative assets for lenders in Kenya to invest in. The limited development of financial markets and services, including in respect of alternative financing mechanisms, also result in higher interest rate spreads in Kenya. These problems can only be resolved through policy and regulatory reforms that are outside of the scope of this Inquiry.

[25] Banking Circular No. 6 of 2016, 3 October 2016.

## 1.7 Outline of this report

The substance of this report begins in Section 2 with an overview of the legal and regulatory context, to which the later sections refer when considering whether problems result from lack of respect for existing regulation and whether remedies require adding additional regulation to the existing framework.

Section 3 provides background and context on the banking sector, including discussions of historically high lending rates and their likely causes, potential competition issues affecting the banking sector, and signs of active competition among banks.

Section 4 provides background on how consumers perceive and engage with banks and alternative financial service providers. This includes discussions of how consumers choose banks and interact with price and non-price factors.

Section 5 examines gaps in transparency that produce information asymmetries between consumers and banks, and other demand-side barriers to competition in the Kenya market in traditional bank products.

Section 6 turns to digital products, reviewing first the providers' disclosure practices when it comes to pricing and other terms and conditions. It reviews consumer control over and access to transactional data, as well as how such data is sold and assessed by third parties, as well as access to data about consumers through credit bureaus given providers' varying reporting obligations and practices.

The competition and consumer protection problems identified in Sections 5 and 6 are then addressed through a discussion of remedies in Section 7. While remedies relating to price transparency are largely recommended, some remedies tried or advocated in other markets such as switching facilities and account number portability are discussed but found to be inappropriate in Kenya at this time. Other remedies that do not amount to full switching facilities but that may aid in reducing switching barriers (such as access to customer transaction data and centralised or coordinated KYC) are adapted for that purpose. Section 8 discusses other measures the Inquiry considered as potential remedies but ultimately did not recommend at this time.

Table 1 below sets out each element of the terms of reference for the Inquiry, as published in the Official Gazette on 5 February 2016, and ties it to findings and recommendations included in this report.

**Table 1: ToR items addressed in this report**

| ToR Item | Findings and Recommendations |
|---|---|
| ***(1) Demand-side analysis*** | |
| (a) understand and document the end-to-end banking customer journey and identify triggers that prompt the decision of customers to switch providers | The end-to-end customer journeys for traditional loan, savings and transactions accounts and digital savings are documented in Annex 1 (Customer journeys), and analysed along with the triggers that prompt switching in Sections 5 and 6 of this report with respect to traditional and digital banking, respectively. A more general discussion of consumer behaviour, including prompts for switching, can be found in Section 4 of this report. |

| ToR Item | Findings and Recommendations |
|---|---|
| (b) explore and establish if there are any barriers to bank customers switching providers, including, but not limited to, lack of awareness of alternatives, the ability to access and assess relevant information and eventually act on this information to switch, costs of switching, account closure practices and any behavioural biases that may lead to consumer inertia to switch | Sections 5 and 6 of this report explore barriers to switching with respect to traditional and digital banking, respectively. |
| (c) determine how the barriers identified impact on market development and customer choice | Sections 5 and 6 of this report explore the effects of the barriers to switching on the market. Section 7.1.3 describes the experimental research we used to explore how the barriers identified affect how customers choose. |
| (d) uncover the extent to which the barriers, if any, identified above relate to competition in the banking sector and the extent to which they could be addressed by regulatory action by the Authority and other government agencies | Section 7.2 of this report discusses enforcement related to disclosure that can be taken by the CAK and CBK and amendments that additional regulatory action that can be taken. Section 7.4.1 of this report explores other regulatory action that could be taken by the authorities in relation to use of bank transaction histories. Section 7.5 of this report looks at a centralised KYC system and Sections 8.2 and 8.3 consider other interventions to ease switching such as account number portability and switching facilities. |
| (e) explore alternate consumer focused measures beyond the Authority's regulatory action that can address the switching barriers identified including strengthening consumer awareness and assess their potential impacts | Part of the barriers to switching identified relates to issues of transparency. Remedies related to transparency that are outside of regulatory action by the authorities include PCWs which are discussed in Section 7.3 of this report. |
| ***(2) Price transparency*** | |
| (a) explore and document the evidence on any deficiencies that exist in disclosure and sales practices by provider segments including deficiencies that are as a result of not presenting product information in the way that consumers want | Section 5.2 of this report assesses the disclosure of costs as well as the timing of these disclosures for traditional banks while Sections 6.2 and 6.3 focus on disclosures in digital savings and loans and mobile money, respectively. |
| (b) identify how both transparency and suitability can be improved to address these issues including regulatory action by the Authority and other government agencies | Sections 7.2 and 7.3 of this report identify remedies to improve transparency and suitability. Section 7.2 focuses on ways that providers can make improvements and Section 7.3 explores the use of third-party price comparison websites and similar services. |
| (c) assess the adequacy of disclosing P2P, bill pay and loan costs to consumers when transacting on digital channels | Section 6.2 of this report assesses the adequacy of disclosure in digital loan and savings products and Section 6.3 assesses the adequacy of disclosure in mobile money. Section 7.2.2 sets out remedies to improve disclosure across digital channels. |
| ***(3) Consumer protection*** | |
| (a) identify any outstanding consumer protection concerns that arise as a result of the analysis undertaken under the demand side and price transparency analysis in (1) and (2) above | Consumer protection concerns identified largely relate to disclosure and are discussed in Sections 5 and 6 of this report with remedies explored in Section 7.2. |
| (b) assess the level and current practices around consumer control over their transactional data and how this is sold or accessed by third parties such as the usage of mobile credit data to score and award credit offers without consumer consent | Section 6.4 of this report assesses current practices around consumer control over transactional data and Sections 7.4.1 and 7.4.2 discuss remedies related to use of transactional data. |

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| (c) assess the level of equal compliance with Credit Bureau reporting by digital credit providers and if they report both positive and negative borrower data as required by law and if there exists disparate treatments that gives them anti-competitive advantage and inhibits consumers' ability to take advantage of their own data for financial access | Section 6.5 of this report assesses practices around reporting of credit reference information and Section 7.4.3 discusses remedies related to such reporting. |
| (d) assess if there exists restrictions on consumers use of their own digital transactional data and provision of the same to third parties for commercial use | Section 6.4 of this report assesses restrictions on consumers use of their own digital transactional data and Section 7.4.2 discusses remedies related to use of transactional data. |

# 2. Legal & regulatory context

## 2.1 Multiple regulatory domains

Regulation of Kenya's financial services sector is divided among multiple regulators. The CBK is established under the Constitution of Kenya, 2010 and the Central Bank of Kenya Act.[26] The CBK has many functions, including formulation and implementation of monetary policy and regulation of payment systems. For purposes of this Inquiry, its most relevant functions are to regulate and license banks and credit reference bureaus under the Banking Act.[27] However, relatedly, it also regulates other financial institutions and mortgage finance companies under the Banking Act and microfinance banks under the Microfinance Act.[28]

Other regulators that operate within the financial services sector include the Sacco Societies Regulatory Authority (SASRA), which regulates and licenses deposit-taking sacco[29] societies, the Capital Markets Authority, which regulates capital markets products and intermediaries, the Insurance Regulatory Authority, which regulates the insurance industry, and the Retirement Benefits Authority, which regulates retirement benefits schemes. In addition, while not a sector regulator, the CAK's mandate to regulate competition extends across the financial services sector.

We understand that efforts were underway to consolidate these multiple sector regulators into two:

- a single Financial Services Authority which would regulate market conduct across the entire sector; and
- an expanded and reformed CBK which would serve as the sole prudential regulator with expanded powers that also apply across sector.

While a draft bill implementing these structural changes has reportedly been circulated to the attorney general as of January 2017, we understand that no final decisions have been announced.[30]

[26] For purposes of this report, we refer to the Central Bank of Kenya Act, Chapter 491, incorporating amendments up to 1 Oct 2015, printed and published by the CBK.

[27] For purposes of this report, we refer to the Banking Act, Chapter 488, incorporating amendments up to 15 September 2015, printed and published by the CBK.

[28] For purposes of this report, we refer to the Microfinance Act, 2006, incorporating amendments up to 1 January 2014, printed and published by the CBK.

[29] Savings and credit cooperative

[30] Meeting with National Treasury, 30 January 2017.

As this Inquiry is focused on the banking sector (a subset of the larger financial services sector) as it stands today and in the recent past, we will consider and address the role and functioning of the CBK in its current form. In addition to banking, this Inquiry will also examine digital lenders that are not banks. These non-bank institutions have no regulatory oversight yet are competing with traditional banks in the market for digital credit.

## 2.2 Consumer protection in the banking sector

### 2.2.1 The Banking Act, Prudential Guidelines and CBK action

***Consumer protection in the Prudential Guidelines***

The CBK has issued the Prudential Guidelines, 2013 which apply to banks and other institutions[31] licensed under the Banking Act. These Prudential Guidelines include the Guideline on Consumer Protection[32] (the Guideline) which governs the treatment of consumers by banks. The provisions of the Guideline are wide-ranging. For purposes of this report we have briefly summarized some of the most relevant and noteworthy provisions relating to fairness and transparency.

*Fairness*

The Guideline requires banks to act "fairly and reasonably in all its dealings with consumers."[33] This includes a prohibition on unfair or deceptive practices or using small print, complex language or voluminous documents to disguise, diminish, obscure or conceal material facts or warnings.[34] In the context of prudent lending, the Guideline also requires banks to assess a consumer's "general understanding and appreciation of the risks and total cost of the proposed credit agreement and his rights and obligations under the agreement."[35] Banks are required to explain products and services "clearly in simple and ordinary language" and inform the customer of all "charges, fees, penalties and any other financial liability."[36]

*Transparency*

The Guideline requires banks to adopt "standardized pre-contractual disclosure practices" to allow comparisons among similar products and services and to develop "specific disclosure mechanisms, including possible warnings," to provide information "commensurate with complex and risky products and services."[37] This includes providing consumers with summarized key information on the benefits, risks and terms of a product or service.[38] Banks must inform a consumer of and provide terms and conditions that highlight all fees, charges, penalties, interest rates and other liabilities or obligations.[39]

[31] Under the Banking Act, "institutions" means "a bank or financial institution or a mortgage finance company."

[32] Guideline on Consumer Protection-CBK/PG/22

[33] §3.2.1(a)

[34] §3.21(c)(i) & (iv)

[35] §3.21(d)(i)

[36] §3.23(a)

[37] §3.4.1(iii) & (iv)

[38] §3.4.3(i)(a)

[39] §3.4.4

In the case of interest-bearing deposits and interest rates on loans, banks are required to make specific disclosures prior to the consumer signing a contract. These are worth setting out in full. A bank must:[40]

(a) inform the consumer of the term of the fixed deposit or loan;

(b) inform the consumer of the charges, if any, for, and consequences of, prematurely terminating a fixed deposit or loan;

(c) inform the consumer of whether the interest is fixed or variable;

(d) give a consumer information on the applicable interest rates for the contracted period and the basis and frequency on which interest payments or deductions are to be made;

(e) explain the method used to calculate interest rates;

(f) disclose prominently the total amount of income the consumer shall receive on the fixed rate deposits of the consumer;

(g) provide a repayment schedule over the term of the loan indicating periodic principal repayments and interest charged; and

(h) disclose the total cost of credit.

Total cost of credit, which must be disclosed under (h) above, means the total amount payable for a loan, including all fees and other charges, after deducting the original loan amount.

***Introduction of regulated interest rates***

In July 2014, the CBK issued a circular[41] requiring that all banks and mortgage finance companies price their flexible rate loans using the Kenya Banks' Reference Rate (KBRR) as the base rate. The purpose of this requirement was to enhance transparency in pricing of credit and mortgages which would allow customers to more easily compare rates across products and banks.

The KBRR is set periodically by the CBK and takes into account the Central Bank Rate and the 2-month moving average of the 91-day Treasury bill rate. For banks, the interest rate charged to customers was required to be disclosed as 'KBRR + X' and the CBK indicated that it expected banks to keep their rates as close as possible to KBRR. These disclosure requirements and expectations were phased out with the recent introduction of the interest rate cap.

In 2016, the Banking Act was amended to introduce a cap on interest rates for loans and a floor for interest rates on savings accounts.[42] Specifically, section 33B of the Banking Act was amended to require that banks (and other financial institutions regulated by the Banking Act) set interest rates on credit facilities that do not exceed 4% over a base rate published by the CBK. In addition, the minimum interest granted on a deposit held in an interest-bearing account is required to be 70% of the same base rate. Contravention of these provisions are considered an offense and could result in fines of not less than Ksh 1 million or imprisonment of the bank's chief executive officer for a term not less than one year. The CBK clarified that the base rate

[40] §3.4.5

[41] Banking Circular No. 4 of 2014, Operationalisation of the Kenya Banks' Reference Rate.

[42] The Banking (Amendment) Act, No. 25 of 2016.

specified will be the Central Bank Rate and that the interest rate requirements apply on an annual basis.[43]

Some market participants responded to these interest rate requirements by adding charges to loan and savings accounts or by converting savings accounts to non-interest-bearing transaction accounts. The CBK subsequently issued a circular to address "complaints from bank customers stating that their banks have imposed arbitrary charges or unilaterally converted their savings accounts into transactional accounts, and thereby losing the benefits that were accruing from these savings accounts."[44] The CBK affirmed the requirement that all bank products must be approved by the CBK, including any changes to approved products, such as increases in charges.

***Legislative disclosure requirements***

The 2016 amendments to section 31A of Banking Act also required that banks "before granting a loan to a borrower disclose all the charges and terms relating to the loan."[45] While these disclosures were already required by the Prudential Guidelines, they were not set out in legislation. The CBK additionally required that all banks submit copies of their policies to ensure such full disclosure.[46]

### 2.2.2 The Competition Act and CAK compliance action

***The Competition Act***

Kenya's competition law framework is governed by the Competition Act. The Competition Act establishes the CAK and defines its mandate, sets out restrictive trade practices, and grants the CAK certain powers to conduct inquiries and investigations, among other things.

Part VI (sections 55-70) of the Competition Act specifically addresses consumer welfare. Most of these provisions would likely not apply to the provision of banking services. However, it is worth noting the following:

- Section 55(b)(i) considers an offence, any false or misleading representations "with respect to the price of goods or services."
- Section 56(1) & (2) considers an offense any unconscionable conduct against consumers taking into account whether the consumer was able to understand related documents.
- Section 56(3) specifically addresses the provision of banking services, prohibiting the imposition of charges and fees that are not brought the attention of a customer prior to their imposition or the provision of the services.
- Section 56(4) entitles a customer to be informed by any service provider of all charges and fees imposed for the provision of the service.
- Section 57 considers an offence any unconscionable conduct in business transactions.

***CAK action on price disclosure of digital financial services providers.***

Beginning in 2015, the CAK carried out an audit and investigations in to the disclosure and transparency practices of digital financial services providers in Kenya.[47] The investigations

[43] Banking Circular No. 4 of 2016, 13 September 2016.

[44] Banking Circular No. 6 of 2016, 3 October 2016.

[45] The Banking (Amendment) Act, No. 25 of 2016.

[46] Banking Circular No. 4 of 2016, 13 September 2016.

[47] Competition Authority of Kenya, *Digital Financial Services (DFS) in Kenya*.

drew on the results of a price sensitivity survey conducted in 2015 and the Price Awareness in DFS Baseline Survey conducted in 2016.[48] The CAK made the following findings:[49]

*i. Consumers who access loans via Sim card, USSD codes or mobile apps are not informed of the applicable transaction fees and charges, interest rates and roll over charges of the loan on the mobile interface before being asked to accept terms and conditions.*

*ii. Consumers who transact using mobile phone platforms are not informed of the charges or fees applicable prior to making such payments. This includes both charges levied by the Mobile Network Operator as well as the financial service provider for person-to- person payments, bill payments, merchant payments, and all mobile banking services.*

*iii. For most of these products, price information is conveyed only after the consumer enters into a binding loan agreement or has already completed a payment transaction.*

In May 2016, the CAK issued a letter titled [CONFIDENTIAL] to [CONFIDENTIAL][50] banks and financial services providers.[51] The letter referenced section 56(4) of the Competition Act which provides that, "A consumer shall be entitled to be informed by a service provider of all charges and fees, by whatever name called or described, intended to be imposed for the provision of a service." The CAK stated that it had determined that there were inadequacies in the timing of disclosure of pricing information of each of the providers that received the letters. It required that the disclosure in their platforms be modified so that all charges are fully disclosed prior to the consumer entering into a loan agreement or completing a payment transaction.[52] The letter also required the providers to submit samples of the new disclosures for approval by the CAK.[53]

We understand from discussions with the CAK and with providers that the providers who received the May 2016 letter have entered into a dialogue with the CAK to make the disclosure changes required. During the course of this Inquiry and continuing beyond, these providers have been in the process of revising their disclosures of charges as a result of this dialogue.

Some of the data collected in this Inquiry (e.g., screenshots of digital financial services, which were taken in December 2016 and used for the customer observation exercise and to determine compliance with legal and regulatory requirements) may have been superseded in the CAK's efforts to improve compliance. The CAK's actions on price disclosure in digital financial services are further discussed in Sections 2.2.2 and 7.2.2.

#### 2.2.3 The Consumer Protection Act

Kenya has enacted a Consumer Protection Act, No. 46 of 2012 (CPA), applicable across the Kenyan economy, which contains general prohibitions on false, misleading, deceptive or unconscionable representations.[54] The CPA contains provisions regulating "credit agreements,"

[48] Competition Authority of Kenya, *Digital Financial Services (DFS) in Kenya*.

[49] Competition Authority of Kenya, *Digital Financial Services (DFS) in Kenya*.

[50] [CONFIDENTIAL]

[51] Letter, dated 17 May 2016, from the CAK to mobile payment and mobile credit providers.

[52] Letter, dated 17 May 2016, from the CAK to mobile payment and mobile credit providers.

[53] Letter, dated 17 May 2016, from the CAK to mobile payment and mobile credit providers.

[54] §§12 & 13

regardless of whether the entity is a licensed bank, however it is not clear from the definitions whether these would apply to all loans or only to credit extended as part of a consumer transaction (e.g., a supplier credit agreement).[55] There is no regulator specified in the CPA as responsible for enforcement. Rather, consumers are able to commence proceedings on behalf of a class of persons.[56]

### 2.2.4 Kenya Bankers Association introduces APR disclosure

The Kenya Bankers Association (KBA) is an industry organization that considers itself to be "the umbrella body of the institutions licensed and regulated by CBK." It has a current membership of 47 financial institutions. [57]

Building on the requirement in the Prudential Guidelines that banks disclose total cost of credit to loan applicants, the KBA developed an "Annual Percentage Rate" (APR) pricing mechanism framework. The APR promotes pricing transparency by taking into account the interest rate components, bank charges and fees and third-party costs (i.e., insurance costs, legal fees, valuation fees and government levies) to provide loan applicants with an APR that can be compared across banks. As of July 2014, all commercial banks in Kenya were bound to disclose APR for loans as part of their required disclosure of total cost of credit. [58]

## 2.3 Sharing and accessibility of transactional data

This Inquiry includes an assessment of current practices around customer control over MNO and mobile money transactional data and the ability of customers to use their transactional data and to provide this data to third parties (see Section 6.4). It is our understanding that there is no comprehensive legislation or regulation that addresses the protection or privacy of consumers across sectors in Kenya. A Data Protection Bill has remained in the drafting process for several years and it is unclear whether or when this might be enacted.

Article 31 of the Kenya Constitution provides that "every person has the right to privacy, which includes the right not to have "information relating to their family or private affairs unnecessarily required or revealed" or "the privacy of their communications infringed." While there are some information privacy and security provisions in the CBK's Guideline on Consumer Protection,[59] these would not apply to the use, sharing and accessibility of mobile money and other transactional data by MNOs.

In the telecommunications sector, the Kenya Information and Communications (Consumer Protection) Regulations, 2010 section 3(1)(d) grants all customers of telecommunications licensees the right to "personal privacy and protection against unauthorized use of personal information."

Section 15(2) requires that telecommunications licensees establish mechanisms by which customers:

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[55] Part VII.

[56] §4

[57] http://www.kba.co.ke/overview/about-us

[58] http://www.kba.co.ke/research-center/research-note/285-banks-adopt-annual-percentage-rate-calculation-method-for-consumer-loans

[59] See, §§3.2.11 and 3.3.3.

(a) know that information is being collected about them through their use of various telecommunications services and systems; and

(b) receive conspicuous notice [. . .] that such information could be sold (or is intended to be sold) to other companies or entities.

Section 15(3) clarifies that "nothing in this regulation shall be construed to mean that a licensee may sell or offer for free, to a third party, any information collected by a licensee without the prior consent of the customer concerned."

We have interpreted section 15(2) as requiring MNOs to provide conspicuous notice to customers that transactional data may be sold to third parties. We have interpreted the privacy rights granted in section 3(1)(d) read in conjunction with section 15(3) as imposing an affirmative obligation on telecommunications licensees to obtain prior customer consent before selling or sharing transactional data with third parties. So far as the Inquiry is aware, these interpretations have not been judicially tested or subject to any particular administrative interpretation in Kenya.

Mobile money services are regulated as payment service providers by the CBK and are subject to the provisions of the National Payment System Act[60] and the National Payment System Regulations, 2014 (NPS Regulations).[61] Section 42(1) of the NPS Regulations requires that a payment service provider "keep the information in respect of services provided to any customer confidential in accordance with the [National Payment System] Act." Section 42(2) specifies that customer information may only be disclosed in the following circumstances:

*(a) to the customer concerned;*

*(b) to the [CBK];*

*(c) when authorised, in writing, by the customer concerned;*

*(d) as legislated by an Act of Parliament; or*

*(e) as ordered by a court of law.*

Section 42(3) provides that failure to comply with these requirements may result in a monetary penalty of no more than Ksh 1 million.

## 2.4 Credit information sharing

The Credit Reference Bureau Regulations, 2013 require that all banks and other institutions licensed under the Banking Act report both positive and negative credit information on consumers to Kenya's three credit reference bureaus.[62]

Creditors that are not subject to reporting requirement, which would include non-banks that provide digital credit services, have no obligation to submit any credit reference information to the bureaus. However, these "third parties" are permitted to submit positive and negative credit reference information to credit reference bureaus if they are approved by the CBK and obtain

[60] Laws of Kenya, No. 39 of 2011, Revsied Edition 2012 [2011] published by the National Council for Law Reporting with the Authority of the Attorney General.

[61] Kenya Gazette Supplement No. 119 (Legislative Supplement No. 43), 1 August 2014.

[62] §18

the consent of a customer.[63] Some non-bank digital credit services do voluntarily submit negative and even positive information.[64]

Banks can receive credit information from the bureaus without customer consent in certain circumstances, including when evaluating a customer's credit application or recovering a debt.[65] These institutions can also share credit information with the CBK and the customer, but need customer consent to share with other parties.[66]

The Regulations require banks and other entities that intend to submit negative information to the bureaus to give 30 days' prior notice to the customer, allowing the customer an opportunity to dispute the accuracy of the information.[67] Customers also have the right to access their credit reports from the bureaus and dispute the accuracy of information in a report.[68]

The Regulations have been subject to judicial challenge based on violation of the constitutional rights of consumers. However, the High Court of Kenya recently issued a judgment confirming that the Regulations do not violate the Constitution, including, among other provisions, the rights to privacy under Section 31 of the Constitution.[69]

# 3. Competition concerns and interventions identified

In this Section, we introduce the banking sector, reviewing signs of competition, concerns about high prices and signs of a lack of competition in key areas.

In Section 3.1, we discuss the growth of the sector and the indications that there is some level of competition active in the sector. These include price-based competition for customers in check-off loans and other loans to formal employees, differences in fees and charges among banks, rapid innovation and readiness of customers to change banks.

Notwithstanding these, interest margins have remained high, as we discuss in Section 3.2. Reasons cited for these include high overhead costs, cost of collateral, high country risk, high levels of Government borrowing and lack of effective competition. Signs of competition problems are evident in high interest rate spreads, where apparent cost reductions are not being passed through to consumers. Market segments are characterised by relatively high levels of market concentration, and barriers to small banks competing with larger banks.

In Section 3.3, we note various policy initiatives that have been taken to address these competition concerns on the demand side.

[63] §23

[64] Input from CGAP, 28 June 2017.

[65] §27(2)

[66] §26(1)

[67] §25

[68] §35

[69] *Barbra Georgina Khaemba v Cabinet Secretary, National Treasury and Attorney General*, Republic of Kenya, In the High Court of Kenya at Nairobi, Constitutional and Judicial Review Division, Petition No. 516 of 2014, Judgment dated 11 March 2016.

This Section sets the scene for the rest of the report which focuses on the details of the demand-side issues, including consumer engagement, information asymmetries and switching barriers in Sections 4, 5 and 6, and considers remedies in Section 7.

## 3.1 Sector growth and signs of competition

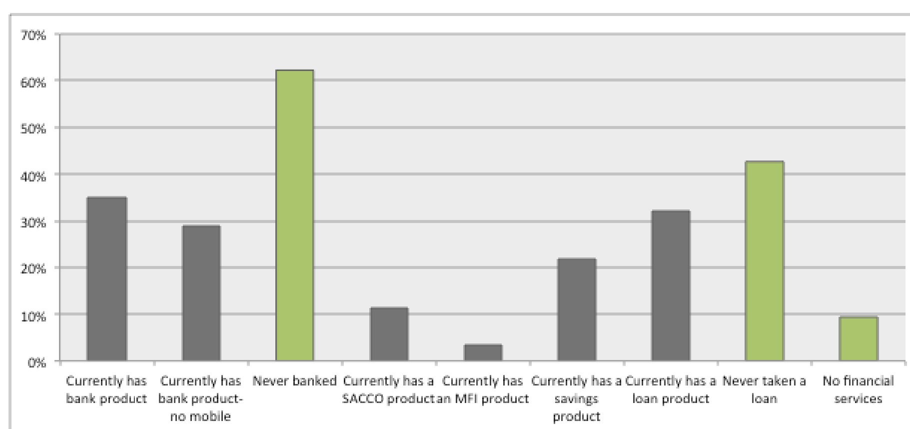
### 3.1.1 Sector growth

The Kenyan banking sector has grown substantially and evolved remarkably over the last decade. The number of bank deposit accounts more than tripled from 11.9 million in 2010 to 37.4 million in 2016 and the number of loan accounts quadrupled from 1.7 million to 7.16 million over the same period.[70] As a result of the growth in the number of bank accounts, the use of formal, prudentially regulated financial services grew from 15% of adults in Kenya in 2006 to 42.3% in 2015. Estimates of financial inclusion in general show dramatic growth over the last 10 years, from 26.7% in 2006 to 75.3% in 2015.[71]

Various factors contributed to this growth. It has in part been underpinned by an increased use of mobile financial services such as mobile money (used by 71.4% of adults in 2015), as well as the use of products such as M-Shwari and KCB M-Pesa, which have increased formal bank product usage. It has also been aided by the rollout of branch infrastructure across the country and the introduction and rapid growth in agency banking from March 2010. As of March 2016, agency banking is used by 17 banks through 40,224 agents, who have facilitated over 170.5 million cumulative transactions valued at Ksh 930.2 billion.[72]

While research highlights the rapid expansion in access to and usage of financial services (including mobile financial services) in Kenya over recent years, a large proportion of Kenyans remain unbanked and use informal institutions (shown in Figure 1). As such, the Kenyan market is not yet a mature banking market but one in which there is substantial room for growth and innovation, particularly as the unbanked are brought into the formal sector.

**Figure 1: Use of financial services by percentage of population**




*Source: FinAccess 2016*

[70] CBK, Developments in the Kenyan Banking Sector for the Quarter ended March 2016, available here.

[71] 2016 FinAccess Survey Report, available at http://fsdkenya.org/publication/FinAccess2016/

[72] CBK, Developments in the Kenyan Banking Sector for the Quarter ended March 2016, available here.

As we discuss next, there are signs that the market has a level of dynamism and that banks compete for new customers, and it would be misleading to characterise the Kenyan banking market as being non-competitive (as opposed to lacking competition in key areas, such as pricing).

These signs of competition include the popularity of traditional promotional attempts such as roadshows in which marketers engage in door-to-door promotions, or promotions at workplaces and public spaces, as well as innovation in new digital products (discussed further in Section 3.1.4). There is also evidence that some level of price-based competition existed prior to the regulation of interest rates and differences in fees and charges may even enable some level of price-based competition even today. To some degree, customer movement among providers may also indicate a level of competition in the Kenyan market.

### 3.1.2 Historical competition in lending interest rates

As noted earlier, prior to September 2016 when interest rate regulation was introduced there was a strong sense among regulators and borrowers that the interest rates on loans were too high. However, now that the interest rate has been capped, lending rates have clustered around the regulated maximum. According to banks interviewed, this has dampened the level of competition among banks in lending rates. For customers too, the impetus to shop around based on interest rates has disappeared.

Prior to the interest rate cap, though, there appears to have been some competition between banks on interest rates for specific loan product types and customer segments, in particular check-off loans and formal employed persons.

***Check-off loans***

Check-off loans are a convenient form of credit in which an employer arranges with a lending bank to directly and regularly pay a portion of the borrower's salary to the lending bank as repayment of the loan. Check-off arrangements are not typically made on an *ad hoc* basis. Rather, the employer enters into formal arrangements with one or a few banks to make these loans available to employees. In the absence of an extensive prior history with a bank, a check-off loan may be a borrower's only means of accessing credit.

The Inquiry found some anecdotal evidence that there was competition in the check-off loan market when employers utilized multiple check-off loan providers. In these cases, customers could select one of several check-off loan providers from a list of banks prepared by the employer, allowing for price-based competition among these banks. Furthermore, where employers tendered for check-off loan providers and shortlist a bank to contract with on the basis of price, this created competition "for the contract." This would occur in a context where large employers may have some level of countervailing power against the banks. However, in instances where the check-off loans are bundled within a larger corporate offering, this may not occur as selection of a provider may be based on other factors.

***The formally employed***

The Inquiry's interviews with banks suggested that there remains some competition for the business of formal, employed individuals and that prior to the introduction of the cap, buyouts of loans for these individuals were common. Banks stated that they formerly competed for these individuals on the basis of service as well as price. However, after the introduction of the interest rate cap, there has been diminished interest in loan buyouts as there are no price gains from switching.

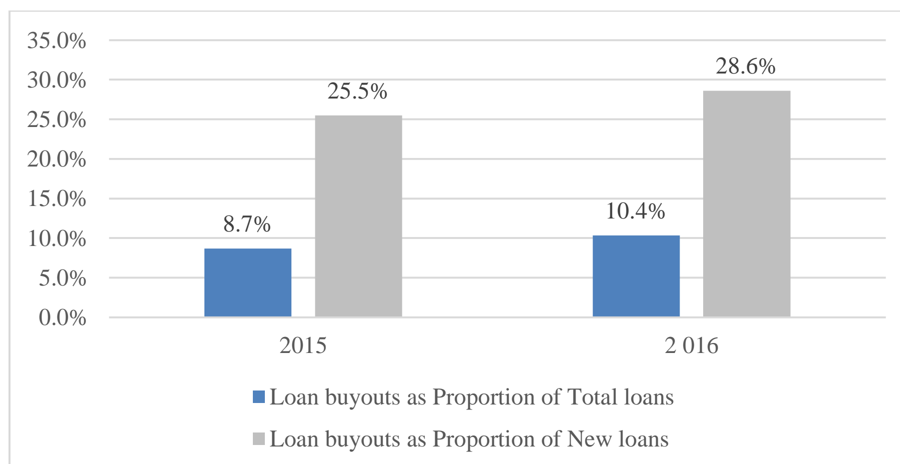
***Loan buyouts***

In a loan buyout, a customer having a loan with one bank approaches, or is approached by, a second bank to solicit an offer with better terms (e.g., a lower interest rate or longer repayment period). The second bank then buys out the loan from the first becoming the new lender to the borrower.

While we have limited data on the market for loan buyouts before the introduction of the interest rate cap, anecdotal information from interviews suggested that buyouts were common among the larger banks (with similar due diligence requirements).

[CONFIDENTIAL] all indicated that they either buy out loans from other banks or permit buyouts of existing loans by other banks and have procedures in place to facilitate them.[73] [CONFIDENTIAL] stated that prior to the introduction of the interest rate cap as much as [CONFIDENTIAL] of its loan facilities were buyouts. [74] Data from [CONFIDENTIAL] (prior to the cap) supports this, showing that loan buyouts historically made up over a quarter of all new loans.[75] While a proportion of this is likely to be due to employers changing corporate accounts, some are likely to be personal accountholders. However, [CONFIDENTIAL] indicated that the loan buyout market had been severely crippled by the imposition of the interest rate cap because pricing of loans had become essentially uniform. [76]. As is discussed in Section 5.5.4, the results of the Inquiry's mystery shopping exercise suggested that in the current market buyouts are difficult to negotiate in practice.

**Figure 2: [CONFIDENTIAL] loan buyouts**




*Source: [CONFIDENTIAL] submission, Acacia Economics calculations*

### 3.1.3 Potential competition in fees and charges

In today's market, substantial savings can be made if consumers were to choose carefully between banks. In a survey undertaken by ThinkBusiness,[77] tariffs across various banks are used to compute the average retail banking annual cost of a model customer (in formal employment and married with two school-age children). As is shown in (Figure 3) below, there

[73] [CONFIDENTIAL]

[74] [CONFIDENTIAL]

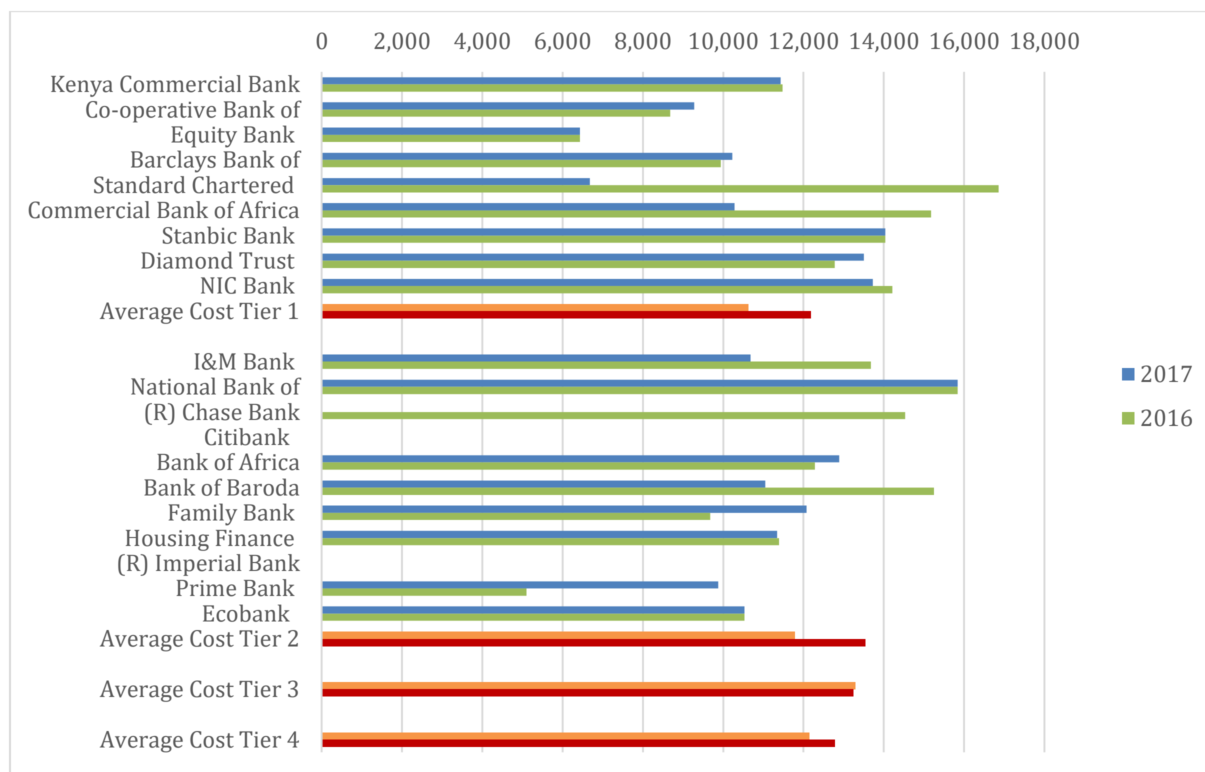
[75] [CONFIDENTIAL]

[76] [CONFIDENTIAL]

[77] ThinkBusiness, Banks Tariff Survey 2017- Banking from a customer's perspective.

is considerable dispersion in bank fees across banks. This dispersion varies across tiers and across banks with local and foreign ownership.

**Figure 3: Average Tariffs by bank (2017)**




*Source: ThinkBusiness*

The ten least expensive banks by transaction costs for a model retail customer are as shown in Table 2 below. In 2017, a model customer who switched from the most expensive bank (Bank of India) to the cheapest (Equity) would make a saving of Ksh 9,998 (which is more than a year's cost of banking at Equity). Even if the model customer switched between the highest and lowest tier 1 banks (Diamond Trust and Equity) they would make a saving of Ksh 7,075. The differences were even starker in 2016 when a saving of Ksh 12,190 could be made from switching from the highest to the lowest fee banks (Guardian Bank to Prime Bank) while a saving of Ksh 10 430 would be made from switching from the highest to lowest Tier 1 bank (Standard Chartered to Equity).

**Table 2: Retail bank charges for a model customer, ranked lowest to highest (2017)**

| | |
|---|---:|
| Equity Bank | 6,430 |
| Standard Chartered | 6,680 |
| Habib Bank Ltd | 8,000 |
| UBA Kenya Ltd | 8,200 |
| Co-operative Bank of Kenya | 9,280 |
| Prime Bank | 9,880 |
| ABC Bank | 10,020 |
| Barclays Bank of | 10,228 |
| Development Bank of Kenya | 10,250 |
| Commercial Bank of Africa | 10,280 |

*Source: ThinkBusiness*

While many of the top tier banks are included in the ten least expensive banks, the largest bank (KCB) is not among them. Furthermore, while Standard Chartered, Habib Bank and CBA were among the top ten most expensive in 2016, they have since dropped transaction costs significantly and now rank among the ten least expensive in 2017. This suggests some significant competition on transaction costs in the market.

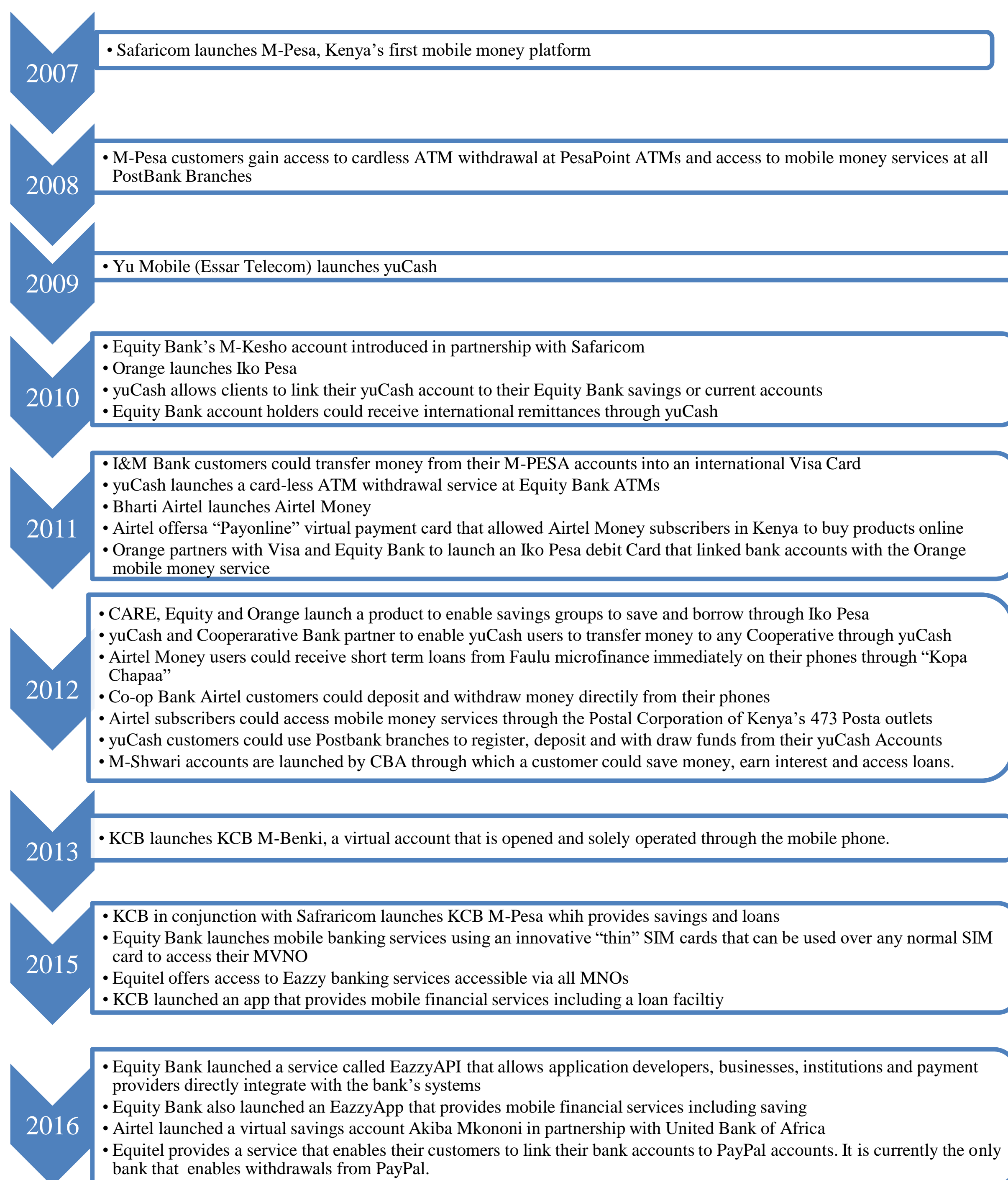
In addition, the average annual cost of retail as well as SME banking has dropped in the last year. For retail banks this follows a trend of rising annual costs and is consistent across tiers. This reduction in banking charges suggests that banks have not sought to increase tariffs in response to the interest rate cap.

This suggests that there are substantial savings to be made by consumers. However, these savings cannot be realised unless consumers are aware of, and understand, the gains to be made, and then act accordingly. Because the most cost-effective package changes across time, ease of switching between providers is key to consumers being able to maximise savings over time.

#### 3.1.4 Signs of competition through innovation

The Kenyan banking sector is characterised by high levels of innovation. Kenya has been a world leader in mobile money with the launch of M-Pesa in 2007. Subsequently, participants in the banking sector have been involved in experimenting with and launching a range of innovative products. The timeline of these innovations is shown in Figure 4 below.

**Figure 4: Timeline of innovation**




*Source: GSMA and authors' analysis*

The first wave of innovation from the banking sector came in the form of partnerships between mobile money providers and banks that allowed for the integration of products. For example, from 2010 Equity Bank engaged in several partnerships to enhance integration. Equity's M-Kesho account which was introduced as part of a partnership with Safaricom could be managed using M-Pesa. Users were able to link yuCash accounts to their Equity Bank accounts. This was

followed by other innovations, including cardless withdrawal at ATMs for Equity. By 2012 Co-operative Bank had partnered with Airtel and customers were able to deposit and withdraw money directly from their mobile phones.

Digital banking stepped up with the launch of M-Shwari by CBA and Safaricom in 2012. This enabled individuals with an M-Pesa account to open a CBA account that could be used for digital savings and loans. Previously unbanked consumers became able to access loans, as their mobile phone usage records were used to provide the bank with a risk rating. Since then there have been several innovations in the market for mobile banking. In March 2015, after experimentation with various earlier forms of the product (such as the M-Benki account in 2013) KCB, in conjunction with Safaricom, launched KCB M-Pesa which is a similar product to M-Shwari.

A few months later, in June 2015, Equity Bank launched mobile banking services for its customers called Equitel My Money using novel methods such as its thin SIM card and then MVNO arrangement with Airtel. Equitel also offers access to Eazzy, a mobile banking service that provides Equity account holders access via all MNOs. This includes access to their digital loan product EazzyLoans. During this Inquiry, [CONFIDENTIAL][78] However, their ability to innovate and experiment has been hampered by the interest rate cap which increased the cost of experimentation with risky lenders as higher interest rates cannot be used to compensate risk.

The majority of banks have also developed various apps and internet banking interfaces to provide greater consumer convenience. These have also included additional offerings such as the KCB app which provides maps to the nearest branches and ATMs and allows for currency conversions and news.

As such, there is evidence of rivalry among the main banks in the form of competition through innovation.

### 3.1.5 Readiness of customers to move

There is also evidence of significant customer movement in the market which suggests that there is a flow of new customers and therefore scope for banks that compete to attract customers to increase their market shares. Table 3 shows the levels of churn[79] and suggests that the market is one which has high levels of movement.

**Table 3: Churn levels by bank**

| | [CONFIDENTIAL] | [CONFIDENTIAL] | [CONFIDENTIAL] | [CONFIDENTIAL] | [CONFIDENTIAL] |
|---|---|---|---|---|---|
| 2015 | 49.2% | 24.6% | 52.4% | 37.3% | 45.8% |
| 2016 | 60.8% | 16.8% | 51.8% | 81.0% | 31.0% |
| 2015 | 56.5% | 32.5% | 45.2% | 30.8% | 36.8% |
| 2016 | 57.5% | 22.8% | 47.6% | 59.7% | 27.0% |
| 2015 | 69.8% | 32.6% | 167.8% | 43.7% | 24.9% |
| 2016 | 75.3% | 21.6% | 126.9% | 43.2% | 25.1% |

*Source: Submissions of banks included*

[78] [CONFIDENTIAL]

[79] Churn is measured as the sum of accounts opened, accounts closed and accounts classified dormant during the year as a percentage of total accounts at the end of the calendar year. The number of accounts opened and closed are an 'active' indication of customers switching into or out of particular products at a particular bank, while dormant accounts are a more 'passive' indicator of consumers choosing not to continue transacting with a particular bank account.

While churn levels are sometimes treated as evidence of switching, this interpretation is not reliable. High churn figures could result from people closing accounts without opening an account at a different bank due to lack of funds, death, seasonal work or losing their job, and due to new customers opening accounts. There may, then, be a significant amount of churn that is movement rather than switching. Nevertheless, the existence of movement signals a flexibility among the Kenyan consumer market to change provider, suggesting that inertia may not be the primary challenge.

## 3.2 Signs of competition problems

### 3.2.1 High interest rate spreads

Although the impact of increased access to financial services has been important and there have been signs of significant competition, the Kenyan authorities have remained concerned that aspects of the banking market are not functioning well. In the years leading up to the Inquiry, concerns were raised regarding high interest rate spreads (the difference between interest rates offered on bank deposits and on bank loans) and the perceived stability in the interest rate spread. This precipitated regulatory interventions in 2016 which imposed caps on loan interest rates and minimum interest rates for deposits (see Section 2.2.2).

The Phase I inquiry specifically looked at interest rates in comparison to other countries. While international comparisons of interest rate spreads are complicated by varying institutional factors, including the levels of financial sector development and risk profiles among countries, the Phase I inquiry selected a range of countries with similar levels of financial sector development, measured by the ratio of bank deposits to GDP (which was 42.5% in Kenya in 2011).[80] In that year, Kenya's spread was 9.4%, compared to an average of 7.1% among the 10 countries selected for that sample.

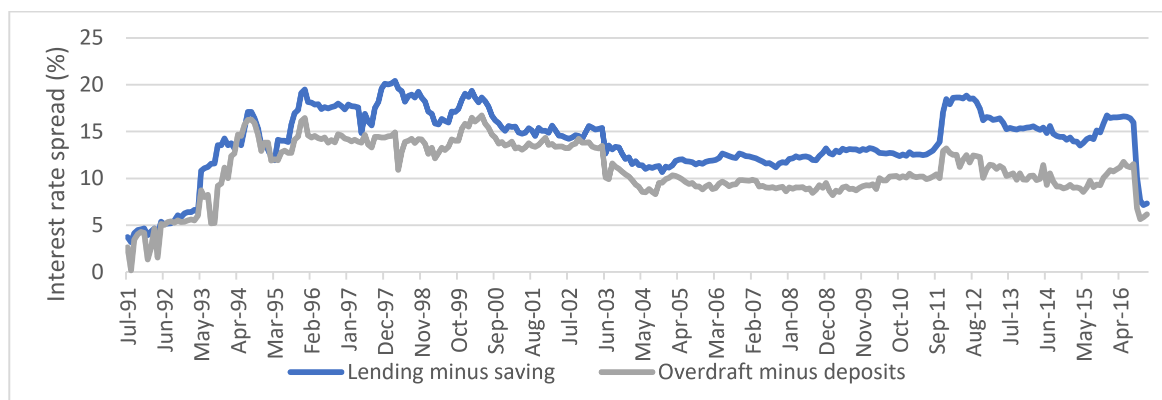
While this was not conclusive evidence that interest rate spreads in Kenya were high, Kenya's interest rate spreads were certainly higher than countries at comparable levels of economic and financial sector development. It can be noted however, that in 2015, the year prior to government intervention in the market (discussed in further detail below), Kenya's interest rate spread at 6.89% was already moving closer to the average for lower middle-income countries (6.83%) and was not far from the average for middle income countries (6.58%).[81]

In addition to concern from the regulators, there is also a perception among consumers that interest rates charged by banks on loans are high. For example, the Financial Inclusion Insights survey 2015/2016 reported that 11.6% of respondents reported that the main reason that do not borrow from a bank is that the interest rate is too high.

[80] See Genesis Analytics, 2014, 'Kenyan banking sector study – Phase I,' Section 6.1, "CAK Phase 1 report."

[81] World Bank Data, Interest Rate Spread – Lending minus deposit rate, available here

**Figure 5: Interest rate spreads in Kenya, 1991 - 2016**




*Source: Analysis of CBK data*

### 3.2.2 Causes of persisting high interest rate margins

A range of factors appear to have contributed to higher interest rates. The Government of Kenya, regulators and other stakeholders have been investigating these structural and regulatory issues for some time. For example, the CBK, together with the Kenya Bankers Association and FSD, released a report on the costs of collateral in Kenya in 2009 (the Cost of Collateral Report).[82] The National Treasury later released a report on the cost of credit, developed by the Cost of Credit Committee in May 2014 (the Cost of Credit Report).[83] These reports considered both 'structural' and 'competition' issues in the banking sector. A World Bank report also highlighted the high costs of financial intermediation, in addition to the lack of competition between banks, in explaining high interest rate spreads in Kenya.

Issues brought to the fore by these studies included the following:

- *High overhead costs faced by banks*: This includes high wage costs, high fixed costs spread over limited borrowers with a lack of infrastructure sharing, and high costs of commercial justice and cash-in-transit. However, they also noted that banks had high profit margins and returns relative to certain comparator countries.
- *Difficulty with collateral*: The legal environment around collateral is complicated, the costs of registering collateral such as stamp duty are high and the process is fragmented and difficult to navigate. This limits consumers' ability to access a lower rate through offering collateral.
- *Country risk:* Foreign shareholders of Kenyan banks require compensation for higher risks of operating in in Kenya, which at the time of the report was on the FATF dark grey list.
- *Alternative investment opportunities for banks:* Lending rates that are constrained to be at least as high as interest on government securities, which account for 21.5% of bank sector assets. Lower lending rates are noted to only be possible if Government borrowing declines.
- *Lack of effective competition:* The reports highlight a lack of effective competition.

[82] See FSD, CBK, KBA. (2009). 'Costs of collateral in Kenya: Opportunities for reform.' Available here.

[83] See Committee on Cost of Credit and Constraints in Mortgage Finance (2014), cited above.

This last point is the core of the Phase I inquiry and this Phase II Inquiry.

### 3.2.3 Failure to pass through efficiencies indicates potential competition issues

The stable interest rate spread over time was of particular concern from a competition perspective because several market features could have been expected to lead to a decline in costs for banks and therefore the interest rate spread:[84]

- *The number of bank accounts increased*, which should enable banks to offer services more efficiently, with significantly declining ratios of bank employee to deposit and loan accounts enabling greater efficiencies of scale.[85]
- *Declining non-performing loans* from 35% in 2000 to less than 6% in 2014, (though it has subsequently risen to a slightly higher 7.8% in March 2016 and up to 9.6% in April 2017)[86] might be expected to lower banks' costs, enabling reductions in interest rates based on risk.
- The introduction of *mobile and agency-based banking* could be expected to reduce the investment in extensive branch and ATM infrastructure.
- *Improvements in the payments system* such as the introduction of the Real Time Gross Settlement (RTGS) system in 2005 (use of which has grown significantly since) should reduce risks in the payment system and lower costs per transaction.
- The introduction of *credit reference bureaus* which provide centralised information on customers credit profiles could be expected to reduce risk faced by banks (though this is still in the early stages and as such is not seen as a good predictor of risk by some banks as yet).[87]

Yet interest rate margins remained stubbornly resistant to reductions from these costs.

Where costs are expected to decline, banks in a competitive market would be expected to pass these gains through to consumers in the form of lower pricing, yet this was not occurring. Accordingly, a number of potential competition issues have been identified to explain these stubborn margins.

### 3.2.4 Market concentration and bank size

One competition issue potentially impacting the Kenyan banking sector concerns barriers smaller banks face when competing with the small number of larger banks. Large banks are able to mobilise large deposits at lower interest rates than smaller banks. Smaller banks must pay a *risk premium* to depositors to attract them. Past bank failures have led depositors to accept lower interest rates from banks that appear to be more stable. This is likely to be exacerbated by the failure of banks such as Imperial and Chase in the past. It ultimately leads to a higher interest rate spread as deposits attract very low interest rates as long as the banks offering them are seen as stable.

[84] See, for example, the Committee on Cost of Credit and Constraints in Mortgage Finance. (2014). 'Background report on increasing private sector credit in Kenya.'

[85] See Committee on Cost of Credit and Constraints in Mortgage Finance (2014), cited above.

[86] See CBK, Developments in the Kenyan Banking Sector Quarter until March 2016. CBK, Monetary Policy Committee Press Releases, May 2017, available here.

[87] Source: Interviews with banks during the course of the Inquiry.

A second competition issue potentially impacting the Kenyan banking sector concerns the *impact of bank size on the market*, with bank size leading to market power. On the one hand, large banks have large branch networks, and lower average transaction volumes, and therefore have higher average costs to cover and therefore require a higher spread. However, despite the larger spreads, large banks are able to use scale effectively compared with their smaller competitors. The large banks' significant branch, agent and ATM networks are attractive to consumers. They are also able to provide large scale lending to corporate customers. Smaller banks are not able to match these capabilities.

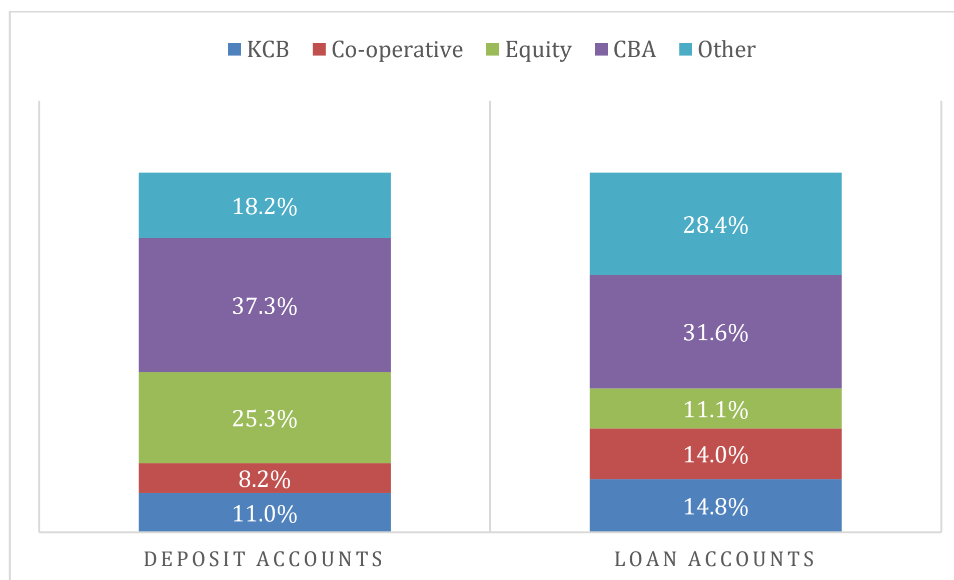
A third competition issue potentially impacting the Kenyan banking sector relates to *market concentration*. At present, there are 42 banks operating in Kenya. These are often categorised and discussed in terms of their CBK "Tier" or peer-group, which is a ranking based on a composite index of net assets, customer deposits, capital and reserves, number of deposit accounts and number of loan accounts. There are three peer groups defined by the CBK. Of these the large peer group (in order of size of assets) consists of the following:

- Kenya Commercial Bank (KCB), which is the largest by asset size and number of branches (197 branches);
- Co-operative Bank, which has strong relationships with SACCOs and has 142 branches;
- Commercial Bank of Africa (CBA), which has a more limited retail arm (with 31 branches) but a large mobile platform that it has leveraged to become the largest holder of accounts;
- Equity Bank, which has the largest number of accounts after CBA and the largest branch network after KCB (167);
- Standard Chartered, which is a large, foreign owned bank with a stronger corporate and commercial focus relative to retail, and a smaller number of branches (37);
- Barclays, which is a large foreign-owned bank with a strong retail network (108 branches); and
- Diamond Trust Bank, which has a focus on SMEs and 59 branches.

While these banks account for 58% of the market in terms of assets, they account for 76.1% of the number of loan accounts and a massive 88.7% in terms of deposit accounts. While there are a further 11 medium peer group banks and 21 small banks they account for a smaller share of the market and some of these banks focus on specific geographical areas or niches.

A closer look at the available data on retail banks reveals that there is a much higher level of concentration among the largest banks. Four of the large retail banks alone (CBA, Equity Bank, KCB and Co-operative Bank) accounted for approximately 80% of deposit and loan accounts in 2015 (Figure 6). Furthermore, 90% of all agents are in three of these banks, namely KCB, Co-operative and Equity. By most measures, this would suggest a fairly concentrated market and potentially one in which these large banks have a level of market power.

**Figure 6: Market shares by number of accounts**




*Source: CBK data*

Furthermore, given variation in the sizes of the branch network, deposits, target market and focus, the data suggests that there are further nuances in the market that may not have been fully explored in the Phase I inquiry. In particular, there is evidence that the banks are differentiated and that it may be possible to segment banks based on a range of other characteristics of the bank and its target consumer.

Banks may be differentiated based on whether the bank is focused on urban areas only, or is targeting rural and outlying areas (requiring a bigger level of branch or agent infrastructure) and whether the bank is focused on lower income or higher income consumers, which may affect the type of product offering, the pricing structure and the way in which information is presented, among other factors. It is also possible to differentiate between niche or specialist banks and general retail banks. Furthermore, there may be a retail mass market segment that is differentiated from banks that are focused on commercial banking. For example, Standard Chartered accounts for 7% of personal savings deposits and 8% of personal term deposit values[88] but potentially does not compete substantively with banks targeted at the mass-market, given its different consumer profile. These include:

- the high proportion of accounts over Ksh 100,000 (28% of its accounts are above Ksh 100,000 in comparison with Equity which has 3% of its accounts above Ksh 100,000 or KCB which has 4.5% of its accounts above Ksh 100,000); and
- higher average deposits (Ksh 716,591) compared to average deposits for all banks (Ksh 89,145), and compared with deposits at mass-market banks such as Equity Bank (Ksh 24,000).

If the market is differentiated, it is possible that markets are narrower than a single, broad market for banking. If so, it is likely that banks have higher market shares within a narrower market and therefore stronger market power, based on limited substitutability due to specialisation. Market definition is beyond the scope of this study, but we note that even if there is a broad market, the data shows an industry in which there are a few strong large competitors

[88] See Phase I report, cited above, Figures 26 and 27.

that have a measure of market power in the retail banking sector, supported by a competitive fringe of smaller and niche banks that compete to a lesser extent.

Another delineation in the market, which is not captured in the market shares provided above, is between digital and traditional banking. Digital banking products such as digital savings and digital credit are different from traditional bank products in various ways. The infrastructure required for digital products differs in that agent networks are more important than fixed networks (such as branch and ATM networks), and competitive advantages lie in the access to user data with good predictive value, as well as suitable technology.

For digital loans in particular, this includes acquisition of customer digital data and development of algorithms that are able provide banks with sufficient measures of consumer riskiness. As such, the digital market is one that is characterized by rivalry on a different basis, including through innovation. At present, however, it has high levels of concentration.[89] Assessing the digital savings and credit segment separately would show even higher levels of market concentration.

The related markets for mobile money services and mobile telecommunications services also impact the markets for banking products. For example, Safaricom's M-Pesa mobile money service has a quasi-monopoly status in respect of mobile money deposits in Kenya. The banks must make use of mobile networks to provide access to mobile money, mobile deposits and loans, and Safaricom has a market share of significantly more than 70% in respect of mobile telecommunications services in Kenya.

Safaricom's two digital credit partners, KCB (for the KCB M-Pesa service) and CBA (for the M-Shwari service), have direct access to the M-Pesa platform (with no charges for transferring money to and from M-Pesa) and are not charged directly for using the Safaricom network for their mobile deposit and lending products, which provides M-Shwari and KCB M-Pesa with significant market advantages. This suggests that the digital savings and credit segment is even more highly concentrated than the market segment for mass-market banking.

#### 3.2.5 Demand-side competition issues

In addition to the above supply-side issues that potentially affect competition in the Kenya banking sector, some demand-side issues have also been identified. There is evidence that retail consumers tend to concentrate deposits in large banks despite better interest rates available from smaller banks, and do not negotiate for better rates.

First, the high transaction costs of switching banks has been identified as blunting competition, particularly in rural areas where access to branches is limited. Second, a lack of price transparency for bank products may make comparisons between products difficult or impossible. Lastly, relatively low financial literacy and widespread distrust of banks appear to further weaken market discipline from the demand side. These demand-side factors are the main focus of this Inquiry, and we return to them in Sections 4, 5 and 6.

### 3.3 Demand-side initiatives

Several recommendations have previously been made in light of the potential competition issues identified above. While various recommendations relate to policy and regulatory reforms

[89] Commercial Bank of Africa (CBA) alone, as a result of its M-Shwari mobile savings and credit product, provided 30% of deposit and 44% of loan accounts in 2014 of the whole market (including traditional banks).

that are beyond the scope of this project (such as creation of an electronic moveable assets register), there are several that focus specifically on stimulating competition on the demand side and improving consumer protection. These included the following:

- using a transparent pricing framework known as the Kenya Banks' Reference Rate (KBRR) when presenting interest rates to consumers;
- required disclosure of bank charges, including total cost of credit and an annual percentage rate (APR) for loans;
- implementing revised credit reference bureau regulations to enable the sharing of positive credit information, and expanding information sharing to other credit providers; and
- enhancing consumer protection and education on financial services.

These interventions fundamentally concern information asymmetries between banks and consumers. They seek to improve consumer understanding of pricing, which should enable consumers to make better informed choices. They also seek to ensure that banks have access to information about consumers enabling more banks to provide risk-based services where otherwise they might not.

This Inquiry builds on these initiatives. Section 4 seeks to understand better the vulnerabilities of the consumer and the dynamics of information asymmetries. Section 5 discusses banks' practice dealing with consumers in traditional banking, including weaknesses in disclosure that results in a lack of transparency, particularly in pricing in traditional banking. Section 6 then looks at these issues in the area of digital banking.

# 4. How consumers engage

We begin our discussion of demand-side competition issues by examining what is known about the Kenyan consumer and his or her engagement with the factors that drive competition. First, we review in Section 4.1 how consumers choose their banks, including how they acquire information. We then consider in Section 4.2 the means through which consumers interact with and consider pricing information in particular. Lastly, we consider in Section 4.3 competition on non-price factors such as reputation, accessibility, trust and quality of service.

## 4.1 How consumers choose

Understanding the role that consumers can play in applying competitive pressure on banks depends on understanding how they choose between banks and what information they use to support their choice.

The Inquiry found a range of factors to be important to consumers in selecting their bank. In particular, the qualitative interviews showed that consumers consider a mix of price-based and non-price based factors in selecting a bank. While interest rates and prices are important, other factors including reputation and accessibility are also considered.

The specific factors influencing consumers vary to some extent based on demographics. In the Kenyan banking sector, consumers have disparate levels of education, financial literacy and

income. These attributes feed into how a consumer chooses a bank as well as the consumer's ability to navigate the pricing structures and to negotiate with banks or switch. High-income consumers are more likely to show concern about the status of a bank while low- and middle-income consumers focus more on considerations such as accessibility and interest rates.[90]

The Inquiry found several features of the market relating to consumer choice that suggest that, overall, consumers have weak countervailing bargaining power when dealing with banks, making it all the more important to minimise information asymmetries (as discussed in Section 5).

#### 4.1.1 Information gathering

***Sources of information***

This Inquiry found from its qualitative interviews that consumers often conduct some information gathering on loan, savings and transaction accounts prior to entering a branch or exploring a digital service on their phones.[91]

The Inquiry's qualitative interviews showed that low- and middle-income consumers tend to rely on recommendations from friends and family, weighing heavily the experiences of senior family members, as well as SMS-based promotions.[92] High-income consumers are more likely to use online resources, print materials and advice of professional advisors in their information gathering.[93] Consumers mentioned media advertisements as a more common source of information on potential savings and transaction accounts than on loans.[94] The qualitative interviews also showed that consumers often learn about banks and their products through bank roadshows or bank visits to workplaces, presumably coordinated with employers.

With respect to digital lending and savings products, consumers similarly tend to rely on recommendations from family and friends, in addition to SMS and other mass marketing and advertisements. [95] Not all consumers trust information that was supplied by the mobile platform, and those that do not are more likely to rely on friends and family. [96] For mobile banking, convenience is a priority and often the basis for a recommendation. [97] When selecting a mobile platform, consumers are often guided by existing linkages with their current mobile network operator or provider of traditional banking services, resulting in status quo (or default).[98]

| **Box 1. Sources of information on traditional bank accounts prior to visiting branch** |
| --- |
| *"[F]amily and friends can help you know which bank can help and which one has benefited them for sure. They will also tell you the one that never benefited them"*[99] |

[90] Inquiry's Consumer Research Phase I Report, pp. 13-14, 33-34.
[91] Inquiry's Consumer Research Phase I Report, pp. 13, 33.
[92] Inquiry's Consumer Research Phase I Report, pp. 13, 33.
[93] Inquiry's Consumer Research Phase I Report, pp. 13, 33.
[94] Inquiry's Consumer Research Phase I Report, p. 33.
[95] Inquiry's Consumer Research Phase I Report, p. 64
[96] Inquiry's Consumer Research Phase I Report, p. 64
[97] Inquiry's Consumer Research Phase I Report, p. 65
[98] Inquiry's Consumer Research Phase I Report, p. 64
[99] Inquiry's Consumer Research Phase I Report, Annex 2.2.1, Transparency Low Income – Machakos, FGD, p. 16.

*"[A bank's name] is very important for me[.] [N]ormally I like a bank where am comfortable and I like the staff and the people there. And I like also that when I look at the news they are doing well. […][A]lso I like recommendations from friends and family, that's one of the reason that I changed one of my banks because I was happy with it.* [100]

*"I mostly go to the internet first and then I look around to see which the best savings solutions is. And secondly, I ask my friends and older people with experience with savings. . ."* [101]

***Interviewer:*** *"How do you get information about savings and deposit products?"*
***R1:*** *"Though newspaper, television advertisement, pamphlets."*
***R2:*** *"Mass media, in the banks, short message service and bank personnel."*
***R3:*** *"Pamphlet from the bank, television, radio and groups that walk around to create awareness."*
***R4:*** *"Through the media, newspaper, bank exhibition, people walking around to create awareness."*
***R4:*** *"Mass media, road shows, radio, pamphlets from the bank and social media."* [102]

***Interviewer:*** *"[R5], before you opened [your account at] KCB, where did you get that information?"*
***R5:*** *"The bank people came at my workplace."*
***Interviewer:*** *"It's not you who went there?"*
***R5:*** *"No"*
***Interviewer:*** *"[R4]?"*
***R4:*** *"The bank people brought us information."*[103]

*"[N]owadays all banks are allowed to enter our company, so they come to our company and they tell us all the products that they offer. And also they give us written materials about the products, the written materials have all those charges and for me I like reading those materials."* [104]

*"I opened a savings account with Co-operative Bank because. . . they were giving offers, they were walking door to door doing promotion. That's why I also joined K-Rep and CFC, they were walking from door to door and also where you work."* [105]

*"There are road shows from banks that happen around the market or on the road sides, with loud music which gets your attention. They say if one has an ID they can open for you an account immediately. This makes it easier unlike going to the bank to queue. and they also tell you that opening the account is free and tell you about the interest. They sit you down and tell you all you need to know one-on-one. This is better than going to the bank, waiting for the queue. But during the road shows the bank agents are many they put up the tents around and when you go there they attend to your needs."* [106]

***Interviewer:*** *"How do you get information about loan products?"*
***R1:*** *"From bank brochures and mass media, and sometimes they send their staffs to meeting like village Barraza to talk about the loan products."*
***R6:*** *"Through bank staff and posters, in meetings they send their staffs to advertise."*
***R2:*** *"I get information though their meetings and leaflets."*
***R3:*** *"Through the television, pamphlets, Barraza and we give them a chance to explain."*
***R4:*** *"Mass media and bank staff sent to the fields."*
***R5:*** *"Brochures, Barraza and bank staff visit to our offices, social media, Facebook, twitter, WhatsApp."*[107]

[100] Inquiry's Consumer Research Phase I Report, Annex 3.2., IDI-5, p. 6.
[101] Inquiry's Consumer Research Phase I Report, Annex 3.2., IDI-5, p. 2.
[102] Inquiry's Consumer Research Phase I Report, Annex 2.2.2, Transparency Middle Income – Marang'a, FGD, pp.6-7.
[103] Inquiry's Consumer Research Phase I Report, Annex 2.2.1, Switching Middle Income, Naivasha, FGD, p. 18.
[104] Inquiry's Consumer Research Phase I Report, Annex 2.2.1, Switching Low Income – Naivasha, FGD, p. 17.
[105] Inquiry's Consumer Research Phase I Report, Annex 2.2.1, Switching Low Income – Naivasha, FGD, p. 7.
[106] Inquiry's Consumer Research Phase I Report, Annex 2.2.1, Transparency Low Income – Machakos, FGD, p. 6.
[107] Inquiry's Consumer Research Phase I Report, Annex 2.2.2, Transparency Middle Income – Marang'a, FGD, pp. 21-22.

***Distrust of banks as a source of information***

The Inquiry's qualitative interviews regarding consumer information revealed significant distrust among consumers of information about financial products that they receive from other bank staff.[108] In the qualitative interviews, many low- and middle-income consumers said they did not trust the information provided by general bank staff, unless they spoke to a manager at the branch. [109]

This general distrust of banks as a credible source of information may in part explain why consumers look to other sources, such as friends and family, to help select banks and bank products Despite this general distrust of banks, the qualitative interviews show that across income groups consumers do tend to trust the information that they get about products from their own bank. Bank managers were trusted the most, but there was a great deal of trust in bank staff as well. However, bank agents were generally not trusted or considered particularly knowledgeable or competent.

**Box 2. Consumer distrust of bank staff in providing information**

*"You cannot trust most of [the staff.] [M]ost of the time when you go to the bank you will come out of there[ ] angry. When you are not satisfied you can go to the manager and he/she will help you and there is no way they will make you angry. [Managers] want to safeguard their position, because if anything goes wrong [they will be held responsible], not the other staff."*[110]

*"At that time [the bank] had [an] interest in me [opening an] account and [becoming] their client and they only tell you the benefits of the account not the disadvantages."*[111]

***Interviewer:*** *"[A]re [you] confident in getting information from staff at the main branch?"*
***R3:*** *"Yes but not sales representative because they are working on commissions and may be lying."* [112]

The qualitative interviews also showed that while trust in information provided digitally is stronger than with traditional banks, not all consumers trust information that was supplied by the mobile platform. Those that do not are more likely to rely on friends and family.[113]

For digital lending and savings, convenience is a priority and often the basis for a recommendation. [114] When selecting a mobile platform, consumers are often guided by existing linkages with their current mobile network operator or provider of traditional banking services.[115]

### 4.1.2 Financial literacy and choice

Various studies highlight the effect of increased financial sophistication and related variables on demand for banking products. For example, demographic factors such as income level, gender and formality of occupation, as well as skills such as proficiency in English, financial

[108] Consumer Research Phase I Report, p. 13.
[109] Consumer Research Phase I Report, p. 19.
[110] Consumer Research Phase I Report, Annex 2.2.1, Switching Low-Income – Naivasha, p. 38.
[111] Consumer Research Phase I Report, Annex 2.2.2, Transparency Middle Income – Machakos, FGD, p. 25.
[112] Consumer Research Phase I Report, Annex 2.2.3, Transparency Middle-Income – Nairobi, p. 27.
[113] Consumer Research Phase I Report, p. 64
[114] Inquiry's Consumer Research Phase I Report, p. 65
[115] Inquiry's Consumer Research Phase I Report, p. 64

and numeracy skills, awareness of financial products, and beliefs such as trust in banks, result in increased financial inclusion.[116]

In addition, financial literacy plays a role in a consumers' ability to compare prices. Early studies suggest that a segment of the Kenyan population has low financial capability. For instance, one 2009 study shows low levels of financial literacy and capability among Kenyan consumers.[117] This has been confirmed in subsequent studies with both the Financial Inclusion Insights Survey 2015 and the FinAccess 2015/16 confirming that a proportion of consumers have extremely low levels of financial literacy.[118]

The FinAccess Survey illustrated this with consumer responses to the question "You take a loan of Ksh 10,000 with an interest rate of 10% a year. How much interest would you have to pay at the end of the year?" over 60% of respondents did not give the correct answer with 32% providing an incorrect answer and 29% not responding. The FinAccess Survey found significantly low levels of arithmetic understanding.[119]

This also has emerged in more qualitative data. In a 2009 FSD study on interest rates,[120] focus group participants showed little awareness of interest rates and the calculation thereof as well as associated fees for loans they held. A 2011 FSD Consumer Diagnostic Study[121] using focus group discussions found that customers were often unable to accurately assess loan charges.

This pattern also emerged in this Inquiry's focus groups and qualitative interviews. Across all income levels, there was a great deal of confusion over pricing/costs associated with different financial instruments. Across all groups, there was limited awareness of concepts such as the KBRR, APR, treasury bills, and total cost of credit. Among those who had at least heard of these concepts, very few could explain what they were or how they worked.

While interest rates were often cited as a primary means of comparing products, knowledge of what those rates meant or how they were calculated was often lacking. Many participants simply did not know or understand the costs imposed by their banks, while others were able to list the kinds of costs imposed (insurance, withdrawal charges, etc.) but were unable to say how high these charges were or how they were actually implemented.

While participants in the Inquiry's focus groups and qualitative interviews might have been able to report the interest rate they were being charged, many were unable to clarify whether this was a monthly or annual rate. Individuals focused on the actual amount of interest to be repaid as opposed to the rate. This inability to understand interest rates as opposed to lump sums led to the result that low income participants actually ranked interest rates on M-Shwari loans (effectively, 7.5% per month) as being the lowest on offer, followed by banks and SACCOS.

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[116] See, e.g., Bedi, Tara and King, Michael, "Formal Financial Inclusion in Kenya: Understanding the Demand-Side constraints," Kenya's Financial Transformation in the 21st Century, Heyer and King, Chapter 3.

[117] Collins, D., Zollman, J and and Maina, B. "Financial Capability in Kenya: Findings from FinAccess 2009," Available here

[118] For example, in the FII survey, in response to a question on the amount of money they would have if they invested Ksh 100 at 2% over 5 years, only 57.15% stated that it would be more than Ksh 100 with the rest answering wrongly or refusing to answer. Similarly, only 49.40% of respondents answered correctly that a loan of Ksh 100 attracting interest of 2% would require a total repayment of more than Ksh 100 in a year. The number of incorrect responses and non-responses increased in a more complex variation, which took into account inflation.

[119] Another question was a simple arithmetic division. "You are in a group and win a promotion or competition for Ksh 100,000. With 5 of you in the group, how much do each of you get?" 42% of respondents did not get the correct answer, with 20% of respondents providing an incorrect answer and the remainder stating that they did not know the correct answer.

[120] FSD Kenya, "Definition of a standard measure for consumer interest rates in Kenya, a scoping study," March 2009.

[121] FSD Kenya "Consumer Protection Diagnostic Study: Kenya" January 2011.

This erroneous perception was a consensus view among this group. Once such a perception becomes established as a norm, it can have significant negative consequences for borrowing behaviour.

This is particularly problematic. The [CONFIDENTIAL] highlights that information is often provided to customers based on their probing and questioning.[122] Banks share less information with customers who do not probe.

A lack of financial literacy is likely to hinder choice and switching by consumers as they are unable to fully understand products and pricing with view to comparing them, and may also be unable to make a correct choice.

**Box 3. Customer understanding of financial terms**

***Interviewer:*** *"What do you understand if you hear [total cost of credit]?"*
***R3:*** *"I think it's the cost that you incur in the bank."*
***R4:*** *"I think it's the shares you have and benefits and also debts."*
***R5:*** *"I don't know."*
***R2:*** *"I think it's the cost you incur on the card that you are given."*[123]

***Interviewer:*** *"[W]hat do you understand by Kenya Bank Reference Rate?"*
***R2:*** *"[I]t's like the way they were standardizing all the banks to be charging the same amount of interest rate what you will be given as a loan. The rates of the interest that is how I understand it."*
***R3:*** *"I have never heard it but [laughs] I can think because most of the details like that I hear on TV as they discuss but I have not heard it from the bank. I think is from the Central Bank, the platform or rate taken by banks."*
***R1:*** *"I think those are the rates that are charged by the banks, they vary, may be they change as time goes. I think that are the reference they go about as they change their rates."*
***R5:*** *"Let's say is a standard percentage of a group of money."*
***R4:*** *"I think is the rate the bank has given out to their customers, so they give it a certain jurisdiction, you are not supposed to cross this line, so it's within that area of the banks"*[124]

***Interviewer:*** *"[What is the meaning of] Total Cost of Credit (TCC)?"*
***R1:*** *"I don't know."*
***R5:*** *"I don't know."*
***R4:*** *"I don't know."*
***R3:*** *"I don't know."*
***R6:*** *"It's a statement of all the loans I have ever taken and how I have repaying them."*
***R2:*** *"It's the movement of your loan. When repaying your loan, sometimes you could be having arrears. So it's the process involved."*[125]

***Interviewer:*** *"[What is the meaning of] Total Cost of Credit or TCC?"*
***R5:*** *"This is the credit or amount you have accumulated in the bank."*
***R4:*** *"Total amount you have credited in your account."*
***R3:*** *"Is the total amount of money that you have withdrawn and borrowed from the bank and your usage in the bank."*
***R2:*** *"Total amount of money you have in your account."*
***R6:*** *"Total interest you have paid the bank."*
**R1:** "These are all the charges charged with the bank as a result of having an account with them."[126]

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[122] [CONFIDENTIAL]

[123] Inquiry's Consumer Research Phase I Report, Annex 2.2.1, Switching Low Income – Naivasha, FGD, p. 3.

[124] Inquiry's Consumer Research Phase I Report, Annex 2.2.1, Switching Middle Income – Naivasha, FGD, pp. 6-7.

[125] Inquiry's Consumer Research Phase I Report, Annex 2.2.2, Switching Low Income – Kitui, FGD, p. 5.

[126] Inquiry's Consumer Research Phase I Report, Annex 2.2.2, Transparency Middle Income – Marang'a, FGD, pp. 4-5.

### 4.1.3 Perceived complexity in product choice

Furthermore, in the Inquiry's qualitative interviews, respondents talked of being overwhelmed and confused by the amount of loans and savings products, referred to in behavioural terms as "choice overload."[127] Bank employees can play an integral role in mediating this by preselecting products for consumers. This, however, provides them with a level of power over which products consumers choose between.

In addition, there has been concern over the complexity of processes at banks. In an FSD study focused on interest rates in 2009,[128] focus group participants stated that bank procedures were complex and cumbersome. Qualitative interviews conducted as part of this Inquiry similarly indicate a perception that banks are more difficult to use than other financial institutions such as SACCOs.

**Box 4. Customer experience of complexity in choosing loans**

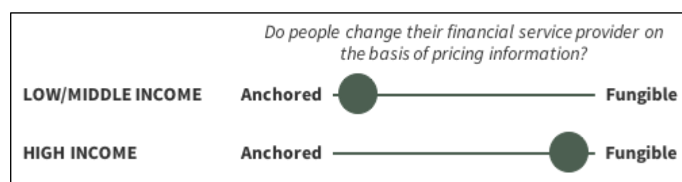
*"They confused me with many loan types, to the extent I ended up choosing one, not because it was the best, but because I was so confused."* [129]

"Loan products are structured differently and doing an analysis to know which one fits me is the problem […] At some point I was thinking of moving from NIC bank to I&M bank [...] All the information was in front of you, but really being able to weigh it up was difficult."[130]

### 4.1.4 Anchoring and sticky habits

The qualitative interviews suggested that some consumers would maintain familiar accounts and services despite fluctuations in price.[131] There are various reasons for this including familiarity with the product, links to MNOs (for digital products) and fears that other providers would have hidden costs and not meet their needs.

**Figure 7: Consumer switching on the basis of price**




*Source: Inquiry's Consumer Research Phase I Report, Annex 10, slide 15*

In a market characterised by distrust of banks generally, these factors may be particularly strong where a consumer has become familiar with his or her own bank. To switch to a new provider, a consumer must overcome a trust gap. This could potentially serve as a barrier to making a switch, even when the switch is economically favourable.

[127] Inquiry's Consumer Research Phase I Report, Annex 10, slide 24.

[128] FSD Kenya, "Definition of a Standard Measure for Interest Rates in Kenya: A Scoping Study" March 2009.

[129] Inquiry's Consumer Research Phase I Report, Annex 10, slide 24.

[130] Inquiry's Consumer Research Phase I Report, Annex 10, slide 24.

[131] Inquiry's Consumer Research Phase I Report, Annex 10, slide 15.

**Box 5. Banks can build trust with customers making switching less likely**

*"I think it's better the devil you know[.] I understand the charges within my bank, most of them. I have some rapport with the people at the bank, I understand my online platform and my mobile payment system, so just the cost of transition will probably make me hesitate."* [132]

***Interviewer:*** *"Okay, the accounts you have and the banks you use can you say you trust them?"*
***R3:*** *"Yes."*
***R4:*** *"Yes, I trust Family [Bank]."*
***R5:*** *"I trust mine."* [133]

***Interviewer:*** *"Would you say you trust your current bank or other provider?"*
***R5:*** *"Yes."*
***R6:*** *"Yes."*
***R4:*** *"Yes, I trust them."*
***R2:*** *"Yes, I trust them."*
***R1:*** *"Yes, I trust them."*
***R3:*** *"I trust them."* [134]

*"Yes, I do [trust my current bank]. I think it's a reputable institution, so it's basically giving me confidence."* [135]

### 4.1.5 Employer influence on choice

In the Kenyan banking system, a significant proportion of bank account choice for personal bank accounts is influenced by the relationship between the individual's employer and their bank.

In the case of savings and transaction accounts, consumers often based their selection of bank on the relationships that exist between their employers and banks. As [CONFIDENTIAL] explained in its submission, some employers have pre-arranged banking schemes with only one or a few banks. [136] Some employers require employees to open accounts with a bank where the employer has a corporate account, presumably a condition of the employer getting favourable banking terms for its corporate account. [137]

Some employers provide a set of "preferred" banks for employees to select. Opening an account at one of these banks may allow the employee faster access to salaries. In addition, these schemes often include access to "check-off loans." Employees may be motivated to establish a relationship with one of these banks with the thought of applying for such a loan in the future.

As noted earlier, check-off loans are a convenient form of credit in which an employer arranges with a lending bank to directly and regularly pay a portion of the borrower's salary to the lending bank as repayment of the loan. Check-off arrangements are when the employer enters into formal arrangements with one or a few banks to make these loans available to employees. By their nature, check-off loans limit consumer choices to those banks that an employer has pre-selected.

The impact of employers on the market is likely to be mixed. An employer's incentives in selecting counterparts may not be aligned with those of its employees as a bank may offer the employer commercial banking benefits that benefit the employer in order to enter into a check-

[132] Consumer Research Phase I Report, Annex 3.2.1, IDI-6, p.17.
[133] Consumer Research Phase I Report, Annex 2.2.1, Switching Low Income – Naivasha, FGD, p. 32.
[134] Consumer Research Phase I Report, Annex 2.2.1, Switching Low Income – Kitui, FGD, p. 31.
[135] Consumer Research Phase I Report, Annex 2.3, IDI – 4, p. 9.
[136] [CONFIDENTIAL]
[137] [CONFIDENTIAL]

off arrangement. Furthermore, banks may be competing for the business of the employer, not the employee. This limits an individual's choice and bargaining power in relation to the bank selected by his employer, though it can be noted that they are still in most instances able to multibank and to seek alternative forms of credit.

However, as employers are likely to be representing a range of individuals (as well as potentially commercial accounts) they are likely to have far greater bargaining power with banks and able to negotiate better deals than individuals can separately. Interviews with banks suggested that certain employers such as the teachers' union exert considerable countervailing power. The downside to this is that individuals outside of these arrangements may find themselves in a more vulnerable position.

This Inquiry's qualitative interviews provided additional support in showing that consumers often select bank accounts based on the relationship between the bank and their employer

**Box 6. Relationships with employers drives bank selection**

*"I chose Cooperative bank because my employer pays me with that account but I transfer the money to Family bank because I need to save some amount for my children."* [138]

*"I opened an Equity [Bank] account because it's that account for my employer so my salary is sent there."* [139]

*"[W]hen I opened an account I was working with a certain NGO and I wanted them to pay me through that account."* [140]

*"[W]hen I first opened an account I was forced by my employer, the government, because they did not pay salaries in hard cash so I was forced to go look for an account."* [141]

As such, while consumer power is low in the market as a whole, there is a measure of countervailing power in limited instances, particularly where the employer negotiates with the bank on behalf of the consumer.

## 4.2 How consumers engage with pricing

Our focus on the demand side of the market includes researching and understanding the competitive pressures that are being placed on firms within an industry by consumers. A key consideration is understanding how consumers behave in relation to prices, quality and service. For example, if increases in prices (or decreases in quality or service) lead to consumers switching, market power and its abuse is likely to be more limited.

However, if consumers do not understand pricing and underlying services and/or are unable to switch between providers, companies are able to price at supra-competitive levels and thereby increase profits to the detriment of consumers. This means that an important part of understanding whether pricing in a market is competitive or not is understanding behavioural factors such as how consumers understand and compare prices, how they react to price differences and whether they interact and negotiate with banks.

[138] Inquiry's Consumer Research Phase I Report, Annex 2.2.2, Switching Low Income – Kitui, FGD, p. 8.
[139] Inquiry's Consumer Research Phase I Report, Annex 2.2.2, Switching Low Income – Kitui, FGD, p. 8.
[140] Inquiry's Consumer Research Phase I Report, Annex 2.2.2, Switching Middle Income – Kitui, FGD, p. 9.
[141] Inquiry's Consumer Research Phase I Report, Annex 2.2.1, Transparency Middle Income – Machakos, FGD, p. 8.

### 4.2.1 Interest rates

During the qualitative interviews, numerous respondents mentioned interest rates as a factor in choosing a bank. However, it was often secondary to other factors discussed later such as bank stability. In addition, outside of the product groups mentioned previously (which rely to an extent on corporate or group buyer power), consumers appear to be far less empowered to compare interest rates or negotiate for a better interest rate. In addition, there is clearly a part of the population that are likely to be "price-takers" because their access to credit is still fairly limited.

The low-income market is characterized by high levels of volatility in income and expenditure.[142] They also face risks including emergencies and large shocks (e.g. illness and death in the family, or loss of employment) that could occur.[143] The 2009 FSD study on interest rates showed that product take-up for loans was not based on prices but was driven primarily by emergencies.[144] This Inquiry's qualitative interviews show that some borrowers seek loans on a "needs" basis, including emergencies.[145]

The FII 2016 survey shows that a significant proportion of respondents that borrowed money used it for non-routine purchases. In particular, over 20% of those taking loans used it for emergency or medical expenses while a further 25% used it for educational expenses such as school fees. For these types of borrowers, interest rates are often secondary to access to credit. As such, their demand is fairly inelastic and they do not have negotiating power, nor do they necessarily shop around.

**Box 7. Consumer engagement with interest rates**

***Interviewer:*** *"Now, when you look at the interest rates of banks and the fees that is deducted when making transactions or deposits, which element do you consider the most when deciding to open an account?"*
***R:*** *"Mostly it's the fees that is deducted but also the interest rates and if they are cheap."*
***R1:*** *"The fees that is deducted but when you consider a loan, you must also consider the interest rates."*
***R3:*** *"I look at the interest rates they want you don't go to a bank with a high rate while you live one with 5% rate you should go to one with low interest so they take little from you."*
***R:*** *"I took an urgent loan that I did not look at interest rate or repayment period. I was offered a loan and after a while I took it."*[146]

*"As of right now they have all gone down because of the new banking law so umm now it's fair because the banks which I bank with one of them had very high rates before compared to others but that's what would have pushed me to other banks to get it but then now that the world would seem and I know they can't so I would rather stick to the bank that am using."*[147]

### 4.2.2 Charges and fees

Along with interest rates, bank charges are a key component of pricing faced by consumers. Earlier qualitative studies have suggested that prices are not a central consideration to

[142] Zollmann, J. (2014). Kenya Financial Diaries: Shilingi kwa shilingi – The financial lives of the poor, Nairobi: FSD Kenya and Zollman (2015) Two steps back: How low income Kenyans think about and experience risk in their pursuit of prosperity, Nairobi:FSD Available here.

[143] Johnson, S (2015) "Capacities to aspire and capacities to save: a gendered analysis of motivations for liquidity management" Nairobi:FSD. Available here.

[144] FSD Kenya, "Definition of a standard measure for consumer interest rates in Kenya, a scoping study," March 2009.

[145] Inquiry's Consumer Research Phase I Report, p. 59.

[146] Inquiry's Consumer Research Phase I Report, Annex 2.2.2, Transparency Low Income – Murang'a. p.15

[147] Inquiry's Consumer Research Phase I Report, Annex 3.2, IDI 5, pp12

consumers and there are weak incentives to change behaviour based simply on price, particularly where deposit accounts are concerned.

One survey of consumers at banks in Nairobi county found that transaction costs did not "deter customers" from financial services, including deposit accounts, as costs were perceived to be low, even though consumers felt that the costs of borrowing were high.[148]

Results from the Financial Diaries project supports this, noting that "when it comes to deposit accounts, costs – those associated with maintenance and transaction fees – are rarely mentioned as barriers to usage…It does suggest, however, that cost is not the only, and perhaps no longer even the most important barrier to usage in Kenya."

The Financial Inclusion Insights survey 2015/2016 reported that only 3.14% of customers state that the main reason they do not borrow from banks is that fees are too high while 2.75% do not borrow from mobile providers for that reason. Similarly, 11.6% (traditional) and 7.18% (mobile) of consumers do not borrow as the level of interest rates are too high. This suggests that consumer charges (including fees and interest rates) are not a primary concern.

This does not mean that fees and charges do not matter to Kenyan consumers. They clearly do. For example, of customers reporting being informed of the conditions associated with their accounts when they open their accounts, high proportions of customers ([CONFIDENTIAL][149] and 32% in a 2016 KPMG survey[150]) were dissatisfied with the total fees, interest and charges on their accounts.

It appears that there is a lack of engagement with charges due to the consumer's focus on access to credit, as well as the complexity of fees and charges, consumers' lack of understanding of them, and general distrust of banks.

In addition, the Inquiry's qualitative interviews suggest that consumers' distrust for banks is particularly directed to what they view as "hidden costs," i.e., charges that the banks do not disclose. On loan accounts, these were often in the form of "appraisal" and other similar fees that are subtracted from the amount of a loan disbursed, giving the customer the appearance that he or she is receiving less than was promised. In savings and transactions accounts, these perceived hidden costs are often in the form of unexpected ledger, transaction, withdrawal and ATM fees.

This is supported by data from the FinAccess Survey 2015/16, which shows the reason why participants closed a bank account. Although the overwhelming reason for account closure relates to a loss of income or business "hidden charges," and "lost money" or "money taken by banks" also feature as significant explanations.

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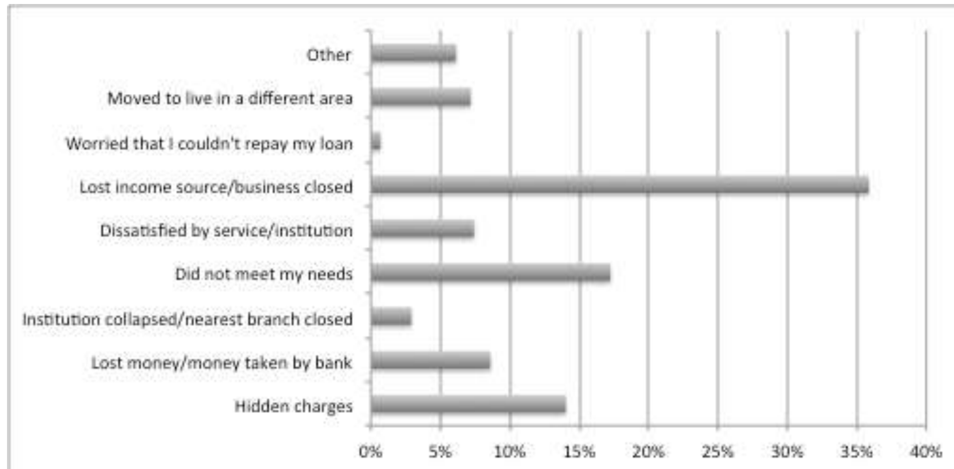
[148] Inganga, BW, Njeru, A, Ambui, K, Ondabu, I, "Factors Affecting Customer Demand of Financial Services Offered By Commercial Banks in Nairobi County," International Journal of Scientific and Research Publications, Volume 4, Issue 11, November 2014, available here

[149] [CONFIDENTIAL]

[150] KPMG. (2016). *Africa Banking Industry Customer Satisfaction Survey.*

**Figure 8: Reasons for closure of bank account**




*Source: FinAccess 2016*

**Box 8. Customer distrust of banks due to hidden charges**

*"With the bank, they will tell you about their goodness but your friend will tell you of their badness as well" [5 other respondents all indicate agreement]*[151]

*"[My friends] say that there are banks that are good while others if you are given a loan you will regret how they treat you, that's what always make me not take a loan from any bank. . . They say that when they take a loan later on they find that the money that they are being charged is higher than the agreed cash at first."*[152]

*"There are some banks that will tell you that the loan limit is higher than the amount you need and maybe you only need the small amount for some reason. So they want to give you a higher amount which may be difficult for you to repay."* [153]

*"There are some banks that deduct your money and if you ask they don't explain why."*[154]

*"[T]here is a friend of mine and they were not told of the administrative charges and they were charged very big administrative fee, so that gave me dissatisfaction."* [155]

*"[T]here are some who are conmen. You may find that now you are ok then after some time like two years the bank collapses because they are bankrupt and you lose your money. So I don't trust them 100%, [rather,] it's 50%."*[156]

*[W]hen [the banks advertise] a loan, they tell you of the loan interest rate or if it will be a small percentage but when you go to them, you find that what they had been advertising is not what is there. . . You get discouraged and frustrated so you just leave it.* [157]

This would suggest that, far from concluding that there is no need to intervene in pricing, it may be all the more important to intervene to improve transparency of charges and reduce information asymmetries between consumers and banks. The transparency barriers are discussed in Section 5 and the remedies relating to price transparency and price comparison services are discussed in Sections 7.2 and 7.3, respectively.

[151] Consumer Research Phase I Report, Annex 2.2.2, Transparency Low Income – Murang'a, FGD, p.16.
[152] Consumer Research Phase I Report, Annex 2.2.1, Switching Low Income – Naivasha, FGD, p. 17.
[153] Consumer Research Phase I Report, Annex 2.2.1, Switching Low Income – Naivasha, FGD, p. 26.
[154] Consumer Research Phase I Report, Annex 2.2.1, Switching Low Income – Naivasha, FGD, p. 27.
[155] Consumer Research Phase I Report, Annex 2.2.1, Switching Middle Income – Naivasha, FGD, p. 24.
[156] Consumer Research Phase I Report, Annex 2.2.2, Switching Middle Income – Kitui, FGD, p. 35.
[157] Consumer Research Phase I Report, Annex 2.2.2, Transparency Low Income – Marang'a, FGD, p. 7.

## 4.3 How consumers engage with non-price factors

Prior qualitative studies have suggested that consumers select banks on a variety of non-price related factors. We review in turn:

- perceived stability and status, i.e., reputation;
- accessibility; and
- quality of service.

### 4.3.1 Reputation

Given that several banks in Kenya have been placed into receivership, one might expect consumers to be concerned with the stability of institutions with whom they deposit money. Previous research such as the National Treasury's Cost of Credit Report,[158] observes that consumers require a risk premium to bank at certain smaller banks that are perceived to be risky.

Aligned with these findings, this Inquiry's qualitative research suggests that consumers value stability and the reputation of a bank, which are often important considerations in choosing an institution. In addition, there appears to be an element of differentiation based on income, with high income respondents placing particular emphasis on the perceived status of a bank.[159]

**Box 9. Role of reputation in account choice**

*"[A bank's name is] very important because of what has happened in the recent past with banks closing down, so you'd want to invest in a bank that is unlikely to go through receivership by the Central Bank. . . I would be very skeptical in joining [a bank that is not doing well] unless for a very short period of time, like a month-maximum."*[160]

*"I think now after the collapsing of Imperial Bank and what happened to Chase Bank, [a bank's name is] now important"*[161]

*"[T]here are some who are conmen. You may find that now you are ok then after some time like two years the bank collapses because they are bankrupt and you lose your money. So I don't trust them 100%, [rather,] it's 50%."*[162]

*"Since the collapse of BCCI bank when I was young I swore that I will bank with first tier banks because of compliance and legal issues which means there is a lot of stability rather than a financial bank where you can do everything with ease."*[163]

*"The first bank I opened an account with was from a friend who works there and then there are those accounts you open with because of the organisations you work with, I also do consider stability."*[164]

***Interviewer:*** *"What would make you reluctant to move to another financial institution?"*
***R6:*** *"For me its all about security."*
***R3:*** *"I value stability. . ."*[165]

[158] Committee on Cost of Credit and Constraints in Mortgage Finance (2014), cited above.

[159] Inquiry's Consumer Research Phase I Report, Annex 10, Slide 26.

[160] Inquiry's Consumer Research Phase I Report, Annex 3.2., IDI-2, p. 4.

[161] Inquiry's Consumer Research Phase I Report, Annex 3.2., IDI-4, p. 6.

[162] Inquiry's Consumer Research Phase I Report, Annex 2.2.2, Switching Middle Income – Kitui, FGD, p. 35.

[163] Inquiry's Consumer Research Phase I Report, Annex 2.2.3, Switching Middle Income- Nairobi, FGD, p. 9.

[164] Inquiry's Consumer Research Phase I Report, Annex 2.2.3, Switching Middle Income- Nairobi, FGD, p. 9.

[165] Inquiry's Consumer Research Phase I Report, Annex 2.2.3, Switching Middle Income- Nairobi, FGD, p. 21.

### 4.3.2 Accessibility

Another non-price factor that plays a role in consumer choice of banks is accessibility. While the introduction of agent and mobile banking has reduced consumer reliance on branches, many respondents in the Inquiry's qualitative interviews highlighted the importance of accessibility of branches.

The role of accessibility in consumer choice is an important factor to consider when understanding the market shares of the larger banks. This is due to the fact that the banks with a larger share of deposit accounts (KCB, Co-operative, CBA and Equity) also have a large number of branches. In addition, KCB, Co-operative and Equity have over 90% of agents with 16,734, 11,948, and 7,956 respectively in 2015.[166]

There are continuing developments with banks competing for access. Barclays, for example, has increased its number of agents by partnering with the Postal Corporation of Kenya so that agency transactions can be undertaken at a range of PCK branches. Accessibility also explains the popularity of mobile banking services and their fast growth.

**Table 4: Number of branches by bank**

| | |
|---|---:|
| Kenya Commercial Bank | 197 |
| Co-operative Bank | 142 |
| Commercial Bank of Africa | 31 |
| Equity Bank | 167 |
| Standard Chartered | 37 |
| Barclays | 108 |
| Diamond Trust Bank | 59 |

*Source: CBK, Bank Supervision Annual Report 2015*

**Box 10. Role of accessibility in choosing an account**

***Interviewer:*** *"Why don't you close the accounts that you are not using?"*
***R2:*** *"The 1st tier banks are in big cities alone so that is why I have an account with other accounts which can be found in rural area too."*
***R4:*** *"Accessibility as I said there is an account where I save every month but that money I use it in December."*
***R5:*** *"I do not have any savings account but as she has said its mainly due to accessibility."*[167]

### 4.3.3 Quality of service and customer satisfaction

Another dimension of competition that is commonly expressed across markets is the role of quality of service. Research on customer satisfaction with banks' quality of service is mixed.

While quality of service is generally not used for the selection of a bank, dissatisfaction with service is a significant impetus to switch. According to a 2016 KPMG customer satisfaction survey, 40% of customers surveyed said that poor service is the primary driver of switching.[168] This is significantly higher than the next largest driver of switching, which was "interest rates and fees" at 17%. High levels of dissatisfaction with banks' quality of service accompanied by the absence of switching may be a sign that switching is difficult.

[166] CBK, Bank Supervision Annual Report 2015.
[167] Inquiry's Consumer Research Phase I Report, Annex 2.2.3, Switching Middle Income - Nairobi p.11
[168] KPMG. (2016). *Africa Banking Industry Customer Satisfaction Survey.*

This does not mean that there are high levels of dissatisfaction with quality of service, only that they are a more predominant cause of changing bank than pricing and other causes. Indeed, despite high levels of distrust and dissatisfaction and distrust in the level of fees and charges, several recent customer satisfaction surveys indicate that customers generally express a high level of satisfaction with the quality of service provided by their banks.[169] The surveys find that customer satisfaction is generally a good indicator of customer retention and that good service is rewarded with loyalty. Conversely, poor service is the top reason given by consumers that they would consider switching banks, indicating that customers regard service as a particularly important differentiating factor when comparing banks.

There is similarity across surveys about the factors that drive customer satisfaction. Customers generally report being very satisfied with the knowledge that sales agents exhibit about the banks' products, the suitability of the banks' products to their needs, and services and the service they receive from sales agents.

One customer satisfaction survey suggested that customers do not feel that application procedures are onerous (i.e., applications do not require more effort than expected)[170] However, in the FSD study on interest rates in 2009,[171] the focus group participants stated that bank procedures were complex and cumbersome.

Qualitative interviews conducted as part of this Inquiry were mixed. Some participants indicate a perception that banks are more difficult to use than other financial institutions such as SACCOs. However, others described account-opening procedures as straightforward and convenient. Many participants noted the active outreach by banks in the form of roadshows and workplace visits to recruit new customers.

**Box 11. Difficulty and complexity of banks versus other financial institutions**

*"[T]he process of going through the forms and explaining it you [was difficult when I applied for a loan]. After that you are given documents to sign and have to get signed, that was the part I thought was a bit too much."*[172]

*"At first I only had an account at Equity [Bank], then the bank started imposing other rules that I couldn't follow like when you want a loan there were long processes[.] [T]hat's why I shifted to a SACCO."*[173]

*"[T]o tell you the truth[,] getting a loan from the bank is a lot of work. . . [I]t's eas[ier] to get a loan from the [SACCO] than [from a] bank."*[174]

*"Sometimes you can go to the bank and queue when you reach the counter the service provider leaves the counter so you are forced to wait there for a long time. . . and sometimes you find also that the person serving you is not friendly, they don't treat you as a customer there."*[175]

[169] Kombo, F. (2015). Customer Satisfaction in the Kenyan banking industry. Journal of International Studies, 174-186. In a survey of 403 bank customers conducted in October – November 2015, Kombo reports an overall satisfaction rate of 64%. This is in line with a 2016 KPMG survey which reported customer satisfaction scores above 70% on a number of metrics. Satisfied customers seem to be strong advocates for their banks with 63% of respondents in the KPMG survey reporting that they had recommended their bank to a friend or family member in the 12 months preceding the survey. Kombo cites an Infotrak survey conducted in 2014 which reported customer satisfaction levels above 70%.

[170] [CONFIDENTIAL]

[171] FSD Kenya, "Definition of a Standard Measure for Interest Rates in Kenya: A Scoping Study" March 2009.

[172] Inquiry's Consumer Research Phase I Report, Annex 2.2.2, Transparency Low Income – Murandg'a, FGD, p. 31.

[173] Inquiry's Consumer Research Phase I Report, Annex 2.2.1, Switching Low Income – Naivasha, FGD, p. 7.

[174] Inquiry's Consumer Research Phase I Report, Annex 2.2.2, Switching Middle Income – Kitui, FGD, pp. 12-13.

[175] Inquiry's Consumer Research Phase I Report, Annex 2.2.1, Switching Low Income – Naivasha, FGD, p. 27.

In addition to the charges associated with maintaining accounts, factors that contribute to dissatisfaction include difficulty of accessing loans (reported as low satisfaction with availability of loans in the KPMG survey[176]), waiting time within branches, and slow response time to queries and complaints.

There do appear, then, to be concerns in relation to quality of service in the banking sector. However, this does not mean that intervention is necessarily required from a competition perspective. Indeed, consumer engagement with quality of service appears to be strong, being an important factor in changing banks. This is relevant when considering whether a remedy relating to quality of service might increase competition among banks (see Section 8.1).

# 5. Transparency, information asymmetries and switching in traditional banking

There are two main points at which consumers exert competitive pressure on banks. The first is when they are choosing a product, and select and negotiate for that product and the second is the point at which they decide to switch. The customer's ability to successfully identify and select an alternative product as well as their ability to actually implement a switch is pivotal to the exercise of competitive pressure on the banks from the demand side.

In this Section, we discuss concerns about information asymmetries and switching in the traditional Kenyan banking sector, focusing on disclosure practices relating to the choice and costs of services. We discuss first how consumers are presented with products to consider in Section 5.1. We then look in Section 5.2 at lending and how the cost of borrowing is disclosed, focusing in particular on the regulatory requirement to disclose the total cost of credit (TCC). In Section 5.3, we consider how the costs of savings and transaction accounts are disclosed.

In each of these cases, we find that there are significant weaknesses in the banks' disclosure practices in dealing with customers, and that in some cases (particularly relating to disclosure of the TCC and assessing the needs of customers), the weaknesses appear in part to stem from noncompliance with regulation. The Inquiry, carried out under the auspices of the CAK, is not a compliance investigation under the Competition Act – much less the CBK's Prudential Guideline on Consumer Protection. It has not carried out research to a degree of rigour that would be required for conclusions as to compliance and enforcement to be brought. However, as set out more specifically in Section 7.2, the Inquiry does recommend that the CBK review bank disclosure practices from the perspective of ensuring compliance with the Guideline.

This lack of transparency, particularly in pricing, reinforces the information asymmetry arising particularly where consumers have low financial literacy, and reduces the ability of consumers to shop around, whether when initially selecting a bank and product or when they might consider switching. A key barrier to exerting competitive pressure on banks is the difficulty consumers face in making comparisons between banks. Banks do not sufficiently assess needs and guide customers, and do not provide disclosure of charges and fees sufficiently clearly or early enough.

[176] KPMG. (2016). *Africa Banking Industry Customer Satisfaction Survey.*

The deficiencies in today's practices help to explain the lack of consumer engagement with pricing and the distrust of banks discussed in Section 4, and lead to consideration of remedies relating to pricing transparency in Section 7.2.

Having considered bank disclosure practices, we turn in Section 5.4 to another aspect of price transparency emerging in the Kenyan market, namely the emergence of price comparison tools. If effective, these have some potential to help reduce the information asymmetry by doing some of the price comparison work for consumers. We discuss the new KBA and planned Think Business price comparison tools. These feed into consideration in Section 7.3 of whether it is useful or necessary to support or guide these industry-led initiatives through regulation.

The transparency and price comparison tools discussed are important both for a consumer's initial choice of bank and for switching. The problems identified are barriers to competition generally, including switching in particular. In Section 5.5, we discuss additional switching barriers, although the primary ones in the Inquiry's view remain the lack of transparency and comparability of pricing discussed in Sections 5.2.1, 5.2.2 and 5.3.

## 5.1 Information about which products to consider

Customers rely on a number of external sources when considering loan, savings and transactions products, in part because customers often distrust bank staff. However, because customers have a difficult time making meaningful comparisons among products, they are particularly reliant on bank staff to guide them through the selection process. The Inquiry's qualitative interviews show that this is particularly true for low- and middle-income customers.[177] Ideally, bank staff would engage in multiple steps aimed at assisting consumers. This includes engaging in a needs analysis and introducing suitable products. However, evidence suggests this is not being undertaken.

### 5.1.1 Needs assessments

As described in Annex 1 (Customer journeys), bank staff will assess a customer's needs, introduce and recommend suitable products and disclose terms and conditions, including interest rates, fees and penalties. In the qualitative interviews, some customers said they had a difficult time choosing a product if they were not advised properly by bank staff. When too many products were introduced, it made their choice more difficult due to what is called in behavioural terms "choice overload." [178]

The qualitative interviews also showed that low-income customers placed particular weight on bank staff's recommendations because they felt that had limited opportunity and capability to compare other services or products.[179]

Banks are required by the CBK's Guideline on Consumer Protection (the Guideline) to assess the needs of customers.[180] Yet in the Inquiry's mystery shopping exercise, only 26 of 59 (44%)

[177] Inquiry's Consumer Research Phase I Report, p. 39.

[178] Inquiry's Consumer Research Phase I Report, p. 19.

[179] Inquiry's Consumer Research Phase I Report, p. 19.

[180] Section 3.2.1(c)(iv) of the Guideline requires that banks not: take advantage of a consumer who is not able to understand the character or nature of a proposed transaction. [A bank] shall therefore inquire of the consumer's specific needs and shall provide suitable products or services relevant to those needs. While Section 3.2.2(i) of the Guideline states "Depending on the

of loan shoppers had their needs assessed by bank staff (see Figure 9).[181] Needs assessments were more likely among loan shoppers with higher incomes. Only 1 of 16 (6%) low-income loan shoppers had staff inquire about specific needs as compared to 12 of 26 (46%) for middle income loan shoppers and 13 of 17 (77%) for high-income loan shoppers.[182] In addition, the needs assessments for high-income loan shoppers tended to be more involved. [183]

The Inquiry's mystery shopping exercise indicates that bank staff also routinely fail to assess the needs of savings and transaction account shoppers. Only 11 of 21 savings account shoppers (52%) had their needs assessed by bank staff. [184] High-income savings account shoppers were more likely to be asked about their needs than low-income shoppers (see Figure 10).[185] 11 of 17 transaction account shoppers (65%) had their needs assessed by bank staff. [186] Contrary to the results for savings account acquisition, low-income shoppers were more likely to be asked about their needs than middle-income shoppers (see Figure 10).[187] However, in both cases, needs assessment were generally light, focusing on whether the customer was interested in savings or transactions, rarely involving a more in-depth exploration.[188] While savings and transactions accounts are arguably fairly generic, differences in premium interest rates, savings terms, penalties for prematurely accessing savings account funds and transaction charges may make particular products more suitable than others for certain customers depending on their needs.

The pervasive lack of needs assessments for low- and middle-income shoppers could indicate a failure of bank staff to ascertain what these customers require, making it less likely that they are matched with appropriate products by the bank staff. However, it might be explained simply by a lack of sufficient product diversity targeted towards lower income shoppers.

nature of the transaction and based on information provided by a customer, [a bank] should assess and understand the needs of the customer before rendering a service." In addition, Section 3.2.4(a)(ii) also requires banks, when giving advice to customers, ensure that "any product or service which the institution recommends to a consumer to buy is suitable for the consumer."

[181] Inquiry's Consumer Research Phase I Report, p. 15.

[182] Inquiry's Consumer Research Phase I Report, p. 16.

[183] Inquiry's Consumer Research Phase I Report, p. 15.

[184] Inquiry's Consumer Research Phase I Report, p. 36.

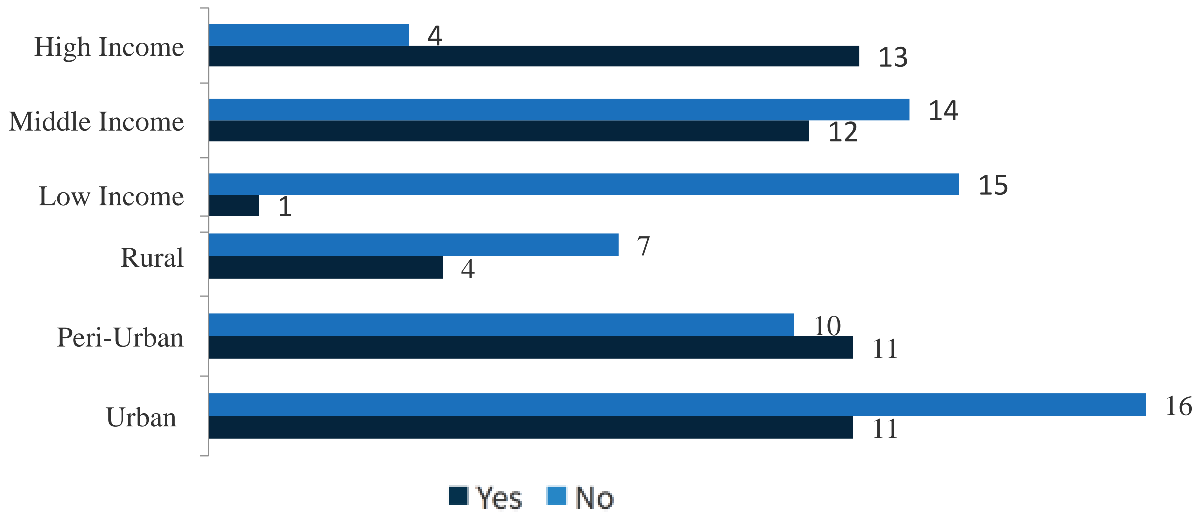
[185] Inquiry's Consumer Research Phase I Report, p. 36.

[186] Inquiry's Consumer Research Phase I Report, p. 36.

[187] Inquiry's Consumer Research Phase I Report, p. 36.

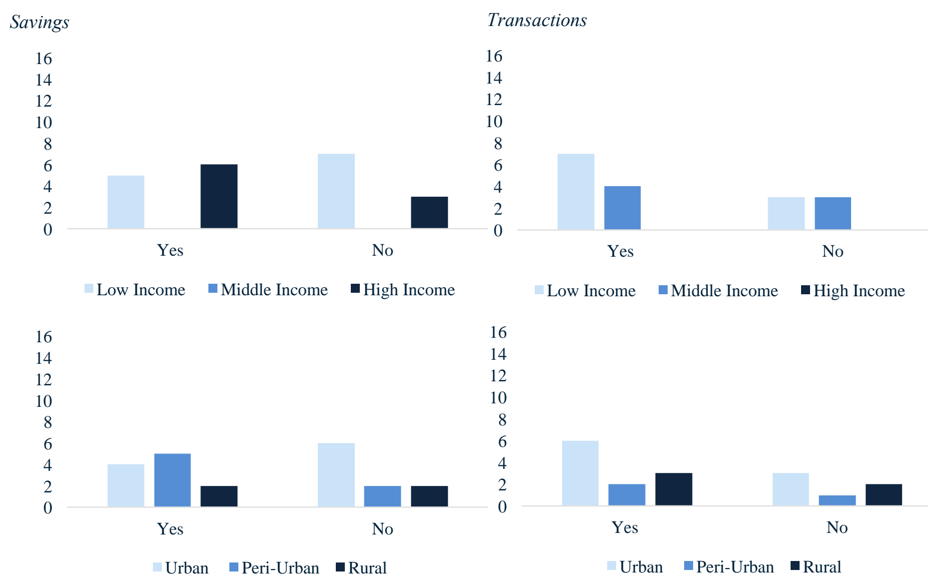
[188] Inquiry's Consumer Research Phase I Report, p. 36.

**Figure 9: Frequency of needs assessments for loan-seeking mystery shoppers**




*Source: Inquiry's Consumer Research Phase I Report, p. 16.*

**Figure 10: Frequency of needs assessments for savings/transaction account-seeking mystery shoppers**




*Source: Inquiry's Consumer Research Phase I Report, p. 37.*

These findings show that banks routinely omit needs assessments. Without these assessments, it is difficult to see how banks can comply with their obligations to understand the needs of their customers and to reflect these needs in their product recommendations.

### 5.1.2 Product introduction

In the Inquiry's mystery shopping exercise, bank staff tended to only introduce a single product, regardless of income level (see Figure 11).[189] In the case of loans, only low- and middle-income customers were offered no products at all, which may be a result of bank staff determining that

[189] Inquiry's Consumer Research Phase I Report, p. 18.

they would not qualify for a loan.[190] The products were presented orally with only a few instances of detailed written descriptions offered.[191]

**Figure 11: Number of loan products offered**

*Source: Inquiry's Consumer Research Phase I Report, p. 18.*

In savings, high-income customers were more likely to be offered more products, and low-income customers were more likely to be offered no products at all. In transactions, middle-income customers were more likely to be offered more products, and low-income customers were more likely to be offered no products at all (See Figure 12).

[190] Inquiry's Consumer Research Phase I Report, p. 18.

[191] Inquiry's Consumer Research Phase I Report, p. 17.

**Figure 12: Number of savings/transaction account products introduced by bank staff**

*Source: Inquiry's Consumer Research Phase I Report, p. 40.*

The general low number of products offered might serve as a limitation on customers' ability to select from a pool of competing products within a particular bank. In addition, this lack of diversity could inhibit switching if borrowers are not offered a product that is easily comparable to their existing loan product from another bank.[192]

However, it may be the case that bank staff assess low- and middle-income customers as ineligible for many products, limiting the products they can present. Also, these concerns need to be tempered by the fact that, as indicated in the qualitative interviews, some customers feel overwhelmed when presented with multiple products (see Section 4).[193] In the case of loans and savings, the small number of products offered may reflect a lack of diversity in the banks' products due to the mandated interest rate caps and floors that have essentially made loan and savings rates uniform.

After introducing products, bank staff frequently recommended a "best fit" product for the shopper. Of the 54 loan shoppers who had any products offered, 33 (61%) were given such a recommendation.[194] 11 of the 19 (58%) shoppers who were offered savings products, and 13 of the 16 (81%) shoppers who were offered transactions products had a "best product" recommended by bank staff.[195] This was generally the first product offered, unless the customer exerted some pressure. [196] Because most shoppers did not have their needs assessed and were

[192] Inquiry's Consumer Research Phase I Report, p. 18.

[193] Inquiry's Consumer Research Phase I Report, p. 19.

[194] Derived from Inquiry's Consumer Research Phase I Report, Annex 8 & 9.

[195] Inquiry's Consumer Research Phase I Report, p. 41, Annexes 8 & 9.

[196] Inquiry's Consumer Research Phase I Report, p. 40.

only initially offered a single product, the selection of a best product may not have been a meaningful exercise.[197]

It was not clear to the Inquiry based on the information before it whether customers were being recommended unsuitable products, or not being recommended products that they could have been eligible for, or which might have been more suitable than any that were recommended.

However, what was clear from the qualitative interviews and the mystery shopping exercise show that bank staff members play a critical role as gatekeepers to bank products. Staff can serve as a facilitator by assessing needs, matching customers with appropriate options and helping customers to identify the best fit. Staff can also serve a barrier by ignoring customer needs, failing to introduce appropriate products or unilaterally and mechanically determining which product is "best" for the customer. The lack of proactive needs assessments appears to reflect a lack of competitive pressure and, particularly where consumers are dependent on staff, constitutes a barrier to shopping around and switching.

## 5.2 Costs of borrowing

In addition to the role of bank staff in regulating access to products, customers also rely on them to disclose the features, costs and penalties of these products. Accordingly, clear and complete disclosure of product features by bank staff, including their costs, is essential for customers to make informed decisions when selecting these products.

The nature and extent of disclosure will impact a customer's ability to make meaningful comparisons. If a customer does not understand an aspect of a product, such as interest rates or fees, then he or she cannot compare that aspect between products. If disclosures are not in writing, then this may impede the customer's ability to retain the information when comparing to other products.

Hence the Guideline requires banks to inform customers of the relevant interest rates, explain how these rates are calculated and to provide repayment schedule.[198] Banks are also required to make disclosures of fees, charges and penalties under the Competition Act[199] and the Banking Act.[200] (See generally Section 2.2.)

[197] Inquiry's Consumer Research Phase I Report, p. 18 and 40.

[198] Section 3.4.5(i) requires that for all interest-bearing deposits and loans, banks must, inter alia:(c) inform the consumer of whether the interest is fixed or variable; […]

(e) explain the method used to calculate interest rates; […]

(g) provide a repayment schedule over the term of the loan indicating periodic principal repayments and interest charged.

[199] Similar requirements can be found in the Competition Act. Section 56(3) of the Competition Act states: A person shall not, in the provision of banking, micro-finance and insurance and other services, impose unilateral charges and fees, by whatever name called or described, if the charges and the fees in question had not been brought to the attention of the consumer prior to their imposition or prior to the provision of the service. Section 56(4) of the Competition Act states: A consumer shall be entitled to be informed by a service provider of all charges and fees, by whatever name called or described, intended to be imposed for the provision of a service.

[200] The Banking (Amendment) Act, No. 25 of 2016. Section 31A of Banking Act was recently amended to require that banks "before granting a loan to a borrower disclose all the charges and terms relating to the loan."

### 5.2.1 Disclosure of costs generally

Prior studies of bank lending suggest that bank disclosure relating to loans is inadequate. The [CONFIDENTIAL][201] showed that over 40% of shoppers were not informed of the loan amount, duration of loan, total cost of capital and additional fees and in particular, interest rates, the repayment amount and repayment period were not sufficiently explained. Furthermore, it noted that customers were not provided with written documentation that could be used as a reference point. It also highlighted a bias in information sharing, with bank employees sharing more information with formally dressed individuals than informally dressed individuals. Overall, only 59% of shoppers involved in the survey felt that they got enough explanation on the loan product from the sales representative.

The results of the mystery shopping exercise conducted by this Inquiry raise questions about whether there may be significant failures to comply with mandatory disclosure requirements.[202] In the case of loans, of 38 mystery shoppers who had applicable interest rates disclosed, only 7 (18%) had these explained to them, with the remainder having the rate merely mentioned. Only 6 received written disclosure of the interest rate (16%) with the remainder receiving it verbally.[203] Only 10 of these 38 shoppers (26%) were informed of whether rates were fixed or variable and only 2 of those 10 received that disclosure in writing.[204] In discussing interest rates, the term “Annual Percentage Rate” (APR) was rarely used and “total cost of credit” was infrequently mentioned (cost of borrowing disclosure is discussed separately below).[205] Of the 21 shoppers who were informed of repayment duration, only 8 (38%) had this explained (the remainder only had these mentioned) and only 3 (14%) were given the duration in writing (the remainder received it verbally).[206]

**Box 12. Insufficient disclosure on loans by bank staff**

***Moderator**: “Do you think some details that were important were left out?”*
***R2**: “[Yes,] [o]n the part of interest rate since they just mentioned it and never showed me how it is calculated[.] I [later] came [to] realize that I was paying a lot of money.”*
***Moderator**: “If you were to change anything about the pricing, information you were given. What would you change?”*

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[201] [CONFIDENTIAL]

[202] For example, only 38 of 59 shoppers had loan interest rates disclosed. Inquiry’s Consumer Research Phase I Report, Annex 8. However, these and similar statistics must be understood in context. Only 54 of the 59 shoppers were even shown loan products and, of these 54, 42 shoppers did not ultimately qualify for loans. Reasons given for failure to qualify included lack of shopper’s prior history at the bank or shopper’s employer’s relationship with the bank, restrictive individual salary, and businesses with diminished financial capacity. Inquiry’s Consumer Research Phase I Report, pp. 18, 23. Many of these determinations were made early in the loan shopping process as bank staff could quickly ascertain whether shoppers met these threshold eligibility requirements. It is certainly plausible that additional disclosures would have been made if shoppers were deemed to qualify or be likely to qualify for loans. Also, as a limitation on the nature of the mystery shopping, even those that did qualify for loans never reached the point where they were in a position to sign loan documents. Additional disclosures may have occurred prior to execution of these documents. Shoppers were encouraged to progress through all possible steps of the loan application process as was possible. Even if they were deemed ineligible, they were encouraged to seek out information about products. Email from Busara, 31 May 2017. However, deemed ineligibility certainly made progressing to some steps in the journey impossible. Even if shoppers persisted, bank staff may reasonably have concluded that further disclosures were no longer appropriate. Accordingly, this Inquiry’s findings are more focused on the nature and timing of the disclosures that were made and how they likely affect customers in their ability to compare bank products.

[203] Inquiry’s Consumer Research Phase I Report, Annex 8.

[204] Inquiry’s Consumer Research Phase I Report, p.23 and Annex 8.

[205] Inquiry’s Consumer Research Phase I Report, p. 23.

[206] Inquiry’s Consumer Research Phase I Report, p. 25.

***R2**: "I [would] change the process on how they tell us about interest rate like to help show how the calculation is done and how they arrive at the figure so that one can understand better."*[207]

***Moderator:** "[I]s the information [banks provide about loans] little or too much?*
***R1**: "It's little because at times when you want to take loans, you find there are amount that will be deducted that you were not told about. Like for example if you check your pay slip, you will find that what is in the bank is more than what is in the pay slip."*[208]

***Moderator:** "Would you say you understand fully how much it costs to take out a loan?"*
***R2:** "No, I don't understand. They only say they have deducted the transaction fees. It's not easy to calculate the interest charged on the loans."*
***R5**: "I will only understand it after like 3 to 4 months, it's difficult because there are some calculations that it's them who understand."*
***R3**: "No, I don't know."*
***R4**: No it's difficult to understand.* [209]

***Interviewer:** "[W]hen you go to the bank and they tell you about the interest rates and the fees charged, do you understand what they mean?*
***R:** "They will definitely tell you but you will not understand and maybe it means that they will charge a higher interest. . . doing the calculations for that money is hard to understand sometimes."*[210]

*"It is quite difficult because they can easily convince you to take a loan with them and once you have the loan with them you encounter charges that you were not told about making someone's life very miserable."*[211]

*"The confusing bit was how to repay the loan because I could not understand the percentages indicated there. [The bank staff explained it] but I did not quite understand because had I understood I would have asked them to give me a little bit more time before starting to repay the loan."* [212]

### 5.2.2 Disclosure of the total cost of credit

A key part of the disclosure of costs specifically relates to the total cost of credit (TCC). Section 3.4.5 of the CBK's Prudential Guideline on Consumer Protection requires banks to disclose to borrowers the TCC, which is defined as "the total amount payable for credit, including all fees and other charges from the lender, after deducting the original loan amount." The Guideline provides further guidance on how TCC should be calculated.

> *The total cost of credit is calculated by adding together all costs which the borrower would need to pay over the period of a loan. That is, it is the total sum which the borrower would need to repay, less the capital sum which is to be borrowed. The costs which the borrower would need to pay include interest payments, together with any fees, charges and commissions. These costs will also include other charges paid to third party providers for purposes of the loan such as legal fees, brokerage, insurance, valuation and government levies among others.*

In the mystery shopping exercise, only 1 of 54 shoppers (2%) who were shown loan products had the total cost of credit disclosed, and this disclosure was only made after the shopper requested the disclosure.[213] This is despite the fact that 17 of 54 shoppers (31%) who were

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[207] Inquiry's Consumer Research Phase I Report, Annex 2.2.1, Switching Low Income – Naivasha, FGD, p. 31.
[208] Inquiry's Consumer Research Phase I Report, Annex 2.2.1, Transparency Low Income – Machakos, FGD, p. 15.
[209] Inquiry's Consumer Research Phase I Report, Annex 2.2.1, Transparency Low Income – Machakos, FGD, pp. 26-27.
[210] Inquiry's Consumer Research Phase I Report, Annex 2.2.2, Transparency Low Income – Murang'a, FGD, pp. 7-8.
[211] Inquiry's Consumer Research Phase I Report, Annex 2.2.2, Transparency Middle Income – Marang'a, FGD, p. 10.
[212] Inquiry's Consumer Research Phase I Report, Annex 2.2.2, Transparency Low Income – Murang'a, FGD, p. 32.
[213] Inquiry's Consumer Research Phase I Report, p. 23.

shown loan products were ultimately determined to qualify for loans.[214] However, the Guideline only requires that TCC disclosure is made before concluding a loan agreement. Given the opportunity, more banks may have made this disclosure as the process continued. This does nevertheless indicate a practical issue with the timing of current practices around the timing of TCC disclosures, as discussed in Section 5.2.3.

This Inquiry has found other deficiencies in TCC disclosure. In practice, this disclosure suffers from two key deficiencies that weakened the opportunity for effective competition, one relating to timing and the other to content. We discuss each in turn.

TCC disclosure often suffers from a deficiency in form. The Kenya Bankers Association (KBA) has created a template for disclosure of TCC that incorporates all of the elements of the definitions found in the Guideline (see Figure 13). The template is available on the KBA's website[215] and can be brought by consumers to bank branches. Many banks, such as [CONFIDENTIAL], have adapted the template as their standard form of TCC disclosure to consumers.[216]

[214] Inquiry's Consumer Research Phase I Report, p. 23.

[215] The KBA's TCC template can be downloaded here: http://www.cost-of-credit.com/index.php/site/downloads (last visited 26 May 2017).

[216] [CONFIDENTIAL]

**Figure 13: The KBA's TCC disclosure template**

# Total Cost of Credit

ESTIMATED SUMMARY OF LOAN COSTS*

Total Cost of Credit refers to the total amount payable for a loan, including all bank fees and charges, and estimated third party costs such as legal fees, and valuation and stamp duty in the case of loans secured by a physical asset.

Before signing a loan agreement, a customer should request the bank to provide them with a Total Cost of Credit breakdown as well as the Loan Repayment Schedule. This will not only empower the customer to make an informed decision, but also will enable the customer to compare the fees and charges within the market.

## General Information

Please fill the blank spaces below with your bank loan officer:

1. Loan Type
(E.g. Personal Loan, Mortgage, Business Loan)
2. Loan Amount
3. Type of Interest Rate
(E.g. Reducing Balance, Flat Method)
4. Interest Rate Period
(E.g. Monthly, Annual)
5. Standard Interest Rate
   a. Kenya Banks Reference Rate/KBRR

**Note:** Banks add an interest rate premium to the KBBR. This premium is based on the bank's risk margin, the bank's cost of doing business, and return on equity.

2. Fixed or Variable Interest Rate
3. Loan Period Time
(E.g. Months, Years)
4. Loan Period (Tenor)

## Additional Bank Charges

1. Application & Processing Fee
2. Monthly Service Fee

## Third Party Costs:

1. Brokerage Fees
2. Attorney & Notary Fees
3. Total Credit Life Insurance
4. Other Insurance Specific to Taking out Credit
5. Government Levies
6. Valuation

## Other Costs:

1.
2.
3.

**Note** This Total Cost of Credit* template can be used by Bank Loan Applicants. This is a sample document and is not a legally binding document. Loan costs may vary depending on the terms of the Financial Institution providing the Credit facility.

**More Resources:** Visit the Kenya Bankers Association web site www.kba.co.ke to download the "Total Cost of Credit" template and more consumer information, including the "Consumer Guide to Banking in Kenya" (2013 edition).

KENYA BANKERS
ASSOCIATION
One Industry. Transforming Kenya

*Source: Kenya Bankers Association*

Even using this template, TCC can be complex, listing the principal amount, interest rate and an array of bank charges and third-party costs. Despite listing these costs, the KBA template does not have a field that shows the sum of all interest, costs and charges, i.e., the actual cost of borrowing.

So far the Inquiry understands, this form, if not modified it to include this arithmetic, will not fulfil the requirements in the Guideline. Some banks have modified the form and provide the sum total of the interest costs and charges and are therefore in compliance with the Guideline.[217] However, others have not.

[217] NIC Bank's form, for example, does not rely on the KBA template and provides a proper calculation of TCC.

Putting aside the regulatory requirements, the TCC form is in the Inquiry's view inadequate in disclosing costs to consumers to enable them to understand, assess and compare products. The qualitative interviews indicate that monthly payment amount is extremely important to many consumers who have difficulty understanding rates and overall borrowing costs. The TCC template omits disclosure of the monthly (or other payment period) payment amount. As a result, the consumer cannot immediately, without carrying out some complicated arithmetic, determine how much he or she will have to pay on a monthly basis or the total amount it is costing to take out the loan.

In addition, the KBA, as an industry group, requires all of its members to disclose annual percentage rate (APR) which expresses the total cost of borrowing as a percentage rate. APR allows consumers to compare loan rates by taking into account not only the nominal interest rate, but also all bank charges and third-party costs. While two banks may offer the same nominal interest rates on their loans, the differences in such costs and charges can make one bank's loan significantly more expensive than the other. However, APR is strangely absent from this template, requiring banks to make a separate disclosure.

### 5.2.3 Timing of cost disclosures

Just as importantly as the content or omission of content of disclosures is their timing. Disclosures of costs are often not made until the end of a lengthy application process when the loan applicant receives confirmation that the loan will be authorised. As a result, customers may be unable to overcome inertia and compare the loan with competing products at other banks.

The Guideline requires disclosures at different stages of the customer journey:

- *Before a customer chooses* a product or service, a bank must "inform the customer of all charges, fees[,] penalties and any other financial liability or obligation which would be incurred arising from the use of the product or rendering of the service sought." [218]
- *After making a choice but before buying* the product or service, a bank must "provide the consumer with general information or a summary of the main features of the product or service including the interest rate, charges, fees or other financial obligation relating to the product or service." [219]

It appears that customers are often not being fully informed of the costs when choosing among products. While a customer's loan application will typically include conditions of the loan, the TCC is often only set out in detail at the time the loan is approved, sometimes a significant time after the loan application is submitted (e.g., two weeks).

This timing has two negative consequences. First, from a consumer protection perspective, the purpose of requiring TCC disclosure is to allow the customer to understand the total cost of the loan. This allows the customer to understand any "hidden" or unexpected costs so that the customers understand the product they are agreeing to purchase. Disclosing these costs early in the process would enable a customer to understand the true costs of the loan before investing significant time in the process. Disclosure of costs at such a late stage, even if the customer

[218] Section 3.2.3(a)(ii) of the Guideline requires that "prior to a consumer choosing a product or service" a bank must "inform the customer of all charges, fees[,] penalties and any other financial liability or obligation which would be incurred arising from the use of the product or rendering of the service sought."

[219] Section 3.2.3(b)(i) of the Guideline requires that once a customer has made such a choice but "before the customer buys the product or service", a bank must "provide the consumer with general information or a summary of the main features of the product or service including the interest rate, charges, fees or other financial obligation relating to the product or service." Section 3.4.4(ii) of the Guideline requires banks to inform customers of relevant interest rates. Similarly, section 3.4.5 of the Guideline which requires that costs be disclosed "prior to the consumer signing the [loan] contract."

deems them to be problematic, may not be sufficient to overcome psychological inertia. The customer is on the verge of obtaining a needed loan and may be more willing to endure excessive costs than if these were disclosed earlier in the process.

Second, this late disclosure impedes comparison among banks from a competition perspective. One benefit of TCC as a standard disclosure requirement is that it presents total borrowing costs in a uniform format, allowing comparisons to be made between product and between banks. When the TCC is disclosed late in the customer journey, the customer has invested significant time and effort with a single bank. A customer would then have to undergo the same process at second bank in order to get the TCC disclosures that would allow comparison. Thus, this late disclosure serves as a barrier to comparisons, to shopping around and thus to competition generally, including switching.

**Box 13. Cost of borrowing disclosure is unclear**

***Interviewer:*** *"[W]hen you go to the bank and they tell you about the interest rates and the fees charged, do you understand what they mean?*
***R2:*** *"They tell you but you do not understand the mathematics involved. They should just tell you like its 400shs so that you know how much is needed. When they start talking about percentage it gets confusing. Let them just give you the exact amount that will be deducted every month."*
***R6:*** *[W]hat they do is assume that everybody is learned when putting up the percentages. And that is not true. They are just making it complicated. What they would be doing is stating the exact amount that is to be repaid for a certain amount but not in percentage. That just complicates things further."*[220]

*"They never gave me the details and the loan one gets has charges that one cannot understand how they came up to the figure you are given as loan. If they could update you early it could be better. And their conditions there is nothing they can negotiate with their clients, you find they have charged some fee which you cannot understand."* [221]

*"There are so many things that they don't explain. . . When you go to get the money they tell you that you have been deducted some amount for advocate; that is when you are told but when you are filling the forms they don't tell you."* [222]

## 5.3 Costs of savings and transaction accounts

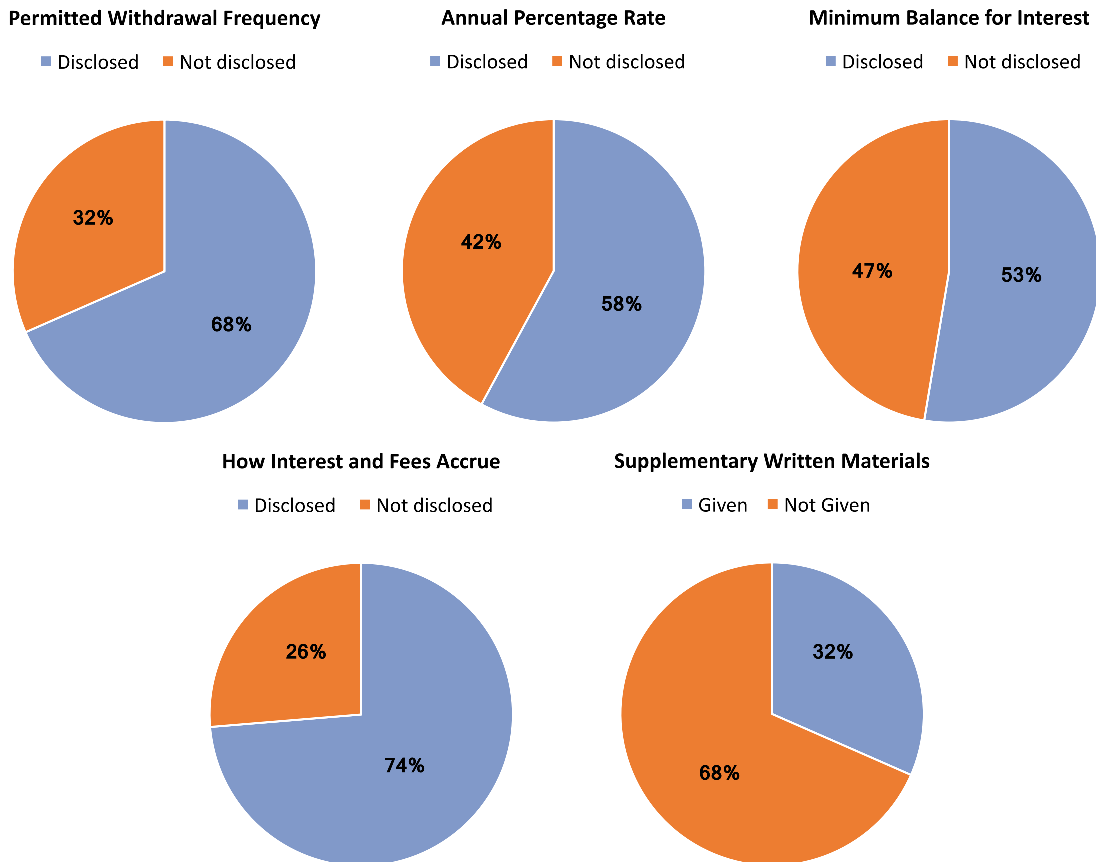
In general, the qualitative interviews reveal that many customers are unaware of the costs and fees associated with their savings and transaction accounts. In the case of savings accounts, the customers perceive that bank staff will emphasize the benefits of saving to customers without fully explaining costs of the account or limitations on withdrawals. [223]

There was also a sense that costs and fees associated with both savings and transaction account are not sufficiently disclosed in the account opening process. [CONFIDENTIAL] submitted the results of its recent "compliance check" which supports this finding.[224] It contacted 320 customers who opened accounts in September 2016. 89 customers (28%) reported that they were not aware of the fees and costs associated with the account.

[220] Inquiry's Consumer Research Phase I Report, Annex 2.2.2, Transparency Low Income – Murang'a, FGD, pp. 7-8.
[221] Inquiry's Consumer Research Phase I Report, Annex 2.2.2, Transparency Middle Income – Marang'a, FGD, p. 24.
[222] Inquiry's Consumer Research Phase I Report, Annex 2.2.2, Transparency Low Income – Murang'a, FGD, p. 26.
[223] Inquiry's Consumer Research Phase I Report, p. 38.
[224] [CONFIDENTIAL]

In the mystery shopping exercise, of the 19 shoppers who were offered savings products, 6 (32%) were not told about the allowed frequency of withdrawals from the account,[225] 8 (42%) did not have the annual percentage rate on the account disclosed,[226] 9 (47%) were not given information on the minimum balance necessary to receive interest,[227] 5 (26%) were not given information on how interest and fees would accrue,[228] and 13 (68%) were not given any supplementary written materials when they left the branch[229] (see Figure 14).

**Figure 14: Savings account disclosures**




*Source: Derived from data included in Inquiry's Consumer Research Phase I Report, pp. 38-42, 47, Annexes 8 & 9.*

In the case of transaction accounts, while the Inquiry's qualitative interviews indicate that fees for account opening and transactions were important to customers, they were often perceived as not being transparent. [230] Some customers were concerned about what they called "hidden" fees, which were rarely defined. [231] In the mystery shopping exercise, of the 16 shoppers who were offered transactions products, 5 (31%) were not informed of the account opening fee, 6

[225] Derived from Inquiry's Consumer Research Phase I Report, p. 38, Annexes 8 & 9.

[226] Derived from Inquiry's Consumer Research Phase I Report, p. 39, Annexes 8 & 9.

[227] Derived from Inquiry's Consumer Research Phase I Report, p. 41, Annexes 8 & 9.

[228] Derived from Inquiry's Consumer Research Phase I Report, p. 42, Annexes 8 & 9.

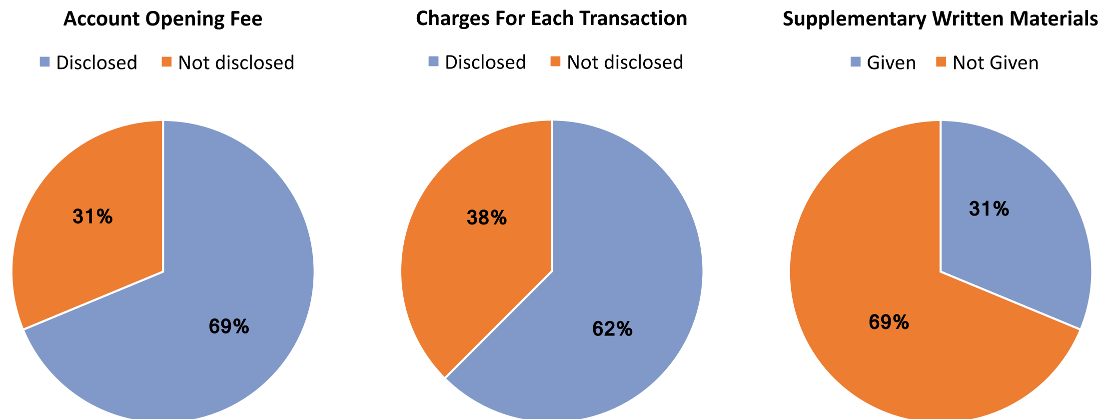
[229] Derived from Inquiry's Consumer Research Phase I Report, p. 47, Annexes 8 & 9.

[230] Inquiry's Consumer Research Phase I Report, p. 44.

[231] Inquiry's Consumer Research Phase I Report, p. 44.

(38%) were not informed of the charges for each type of transaction,[232] and 11 (69%) were not given any supplementary written materials when they left the branch[233] (see Figure 15).

**Figure 15: Transaction account disclosures**




*Source: Derived from data included in Inquiry's Consumer Research Phase I Report, pp. 40, 43, 47, Annexes 8 & 9.*

The mystery shopping findings show that large numbers of customers are not receiving basic disclosures on fees and charges applicable to the accounts, in violation of mandated disclosure requirements.

**Box 14. Lack of transparency on account costs**

*"I think if I was able to understand some of the charges and all other accounts and all other things that I do with my bank besides the loan, if I would be able to understand that I would have moved [banks]. . . is very difficult because you can never compare a product from one bank because in another bank it's very different."*[234]

***Interviewer:*** *"When you first opened a savings account were you given any information on the pricing?"*
***R3:*** *"I was not given."*
***R2:*** *"I was not given."*[235]

*"There are hidden charges [on my savings account] which I [did] not know about"*[236]

*"[W]hen you withdraw money from your [savings] account directly or through the phone there is an amount that is charged like 100shs. I want to know what that Ksh 100 is for. . . When I asked them about that, I told them that it was too much . . . they never said anything."*[237]

*"When I opened [a transaction] account . . . I deposited Ksh 1,000 at the beginning and Ksh 500 at the end of the day. . . [A]fter 3 months I received a call that I owed them Ksh 1,500 and I should pay that or I am listed with [the credit reporting bureaus] so I closed the account immediately because they did not tell me how [the account works]."*[238]

*"[W]hen I opened the account I deposited some amount[.] I checked the statement for the progress of my account after two months and found that they deduct every month. . . In most cases they convince people without explaining how they will be charging them before they open these accounts."*[239]

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[232] Inquiry's Consumer Research Phase I Report, p. 43.
[233] Inquiry's Consumer Research Phase I Report, p. 47.
[234] Inquiry's Consumer Research Phase I Report, Annex 3.2, IDI-6, pp. 14, 19.
[235] Inquiry's Consumer Research Phase I Report, Annex 2.2.3, Transparency Low Income – Nairobi, FGD, p. 14.
[236] Inquiry's Consumer Research Phase I Report, Annex 2.2.3, Transparency Middle Income – Nairobi, FGD, p. 17.
[237] Inquiry's Consumer Research Phase I Report, Annex 2.2.2, Transparency Low Income – Marang'a, FGD, p. 17.
[238] Inquiry's Consumer Research Phase I Report, Annex 2.2.1, Transparency Middle Income – Machakos, FGD, p. 7.
[239] Inquiry's Consumer Research Phase I Report, Annex 2.2.1, Transparency Middle Income – Machakos, FGD, p. 8.

***Moderator:* "[W]ould you say the quantity of information about savings/deposit account provide to you by the bank tends to be too much or too little?"**
***R2*: "It's little. . . At times their interest rates are so high, or they have monthly charges that are not clear, and its like they don't want to tell you what they are for."**
***R4*: "It's little."**
***R7*: "It's little; they make me have many thoughts because they can never tell the truth about their interest rates and you can never know if there are some deductions made, so that's something they are hiding. If you go to withdraw you find you have less than was expected, this makes me uncomfortable with them."**
***R5*: "Little; they don't always disclose full information. First of all you feel as if they are stealing from me. . . [Y]ou know there is some information they are hiding that you will never know and may be when you check on your account per annum, is when you will realize there are some deductions made that you don't understand and that's what is called a bank, what will you do."**
***R6:* "It's little. . ."[240]**

*"[T]hey told us there are no charges for opening an account but I realized they charged the fee for ATM card, when I went to withdraw I found that I had less cash, they told me they deducted Ksh 600 for the ATM which I was not aware of."[241]*

*"[M]ostly every bank depending on its policies will explain how the accounts are. . . but later on the information maybe contrary to how you understood. [S]ome [banks]. . . don't give full information like if you open this account this will be ledger fee and it will be like this. [Instead, most banks] concentrate on [getting you to open the account]."[242]*

***Interviewer:*** *"[W]hen you first opened an account, were you given any information on the pricing or interest rates?"*
***R1:*** *"They don't tell you about interest rates. They only tell you how much you will need to save in order to open the account."*
***R6:*** *They did not tell me anything. . . What they do is they hand you the brochures for you to go read for yourself assuming that you know how to read, not caring if you are learned or not and yet the fliers are in English, there are none in Kiswahili."*
***R3:*** *"They gave me no information. All they gave me was the forms to fill of which I did not understand some things and was forced to consult from a friend."*
***R5:*** *"Just about the amount needed to open the account and also about loans that they would advertise about to attract more people.[243]*

*"The information given [when opening a savings account] is tricky in the sense that when you think you are on the same truck with them, you are left with concerns because of the hidden charges you encounter as a customer and you were not told about. They hide under an umbrella sort of in a way they can swim away leaving you the challenge. . . It's the language and the way they give you the information they use complicated way which you won't understand."[244]*

*"I do not understand how banks calculate their interest rates yet it is through interest rates we are supposed to know which bank is more favorable to save in and which bank to trust since some banks collapse."[245]*

*"I think [banks] provide little to no information [on savings and transactional accounts] without being prompted. . . [B]anks will tell you as little as possible if you don't know how to ask the right questions. . . [I]t's hard to figure out what they are not telling you. I think that's the challenge. You don't know what they are keeping from you.*

[240] Inquiry's Consumer Research Phase I Report, Annex 2.2.1, Transparency Low Income – Machakos, FGD, pp. 14-15.
[241] Inquiry's Consumer Research Phase I Report, Annex 2.2.1, Transparency Low Income – Machakos, FGD, p. 19.
[242] Inquiry's Consumer Research Phase I Report, Annex 2.2.1, Transparency Middle Income – Machakos, FGD, p. 5.
[243] Inquiry's Consumer Research Phase I Report, Annex 2.2.2, Transparency Low Income – Murang'a, FGD, pp. 20-21.
[244] Inquiry's Consumer Research Phase I Report, Annex 2.2.2, Transparency Middle Income – Marang'a, FGD, p. 10.
[245] Inquiry's Consumer Research Phase I Report, Annex 2.2.3, Transparency Low Income – Nairobi, FGD, p. 7.

*You just have to try figure out if you're asking the right questions, and what else you could or would need to find out."*[246]

## 5.4 Initiatives to increase transparency through price comparisons

An important factor to consider in discussing transparency is what information sources exist that enhance' consumers' ability to search for and compare prices. As this report was completed, the Kenyan Bankers Association launched a cost of credit calculator that also provides price comparisons, the first of its kind in Kenya.[247]

The Inquiry understands that the KBA intends to develop a mobile phone app that would also allow comparisons to be made. Other work was well advanced by Kenyan firm Think Business with the support of Financial Sector Deepening Kenya to develop a PCW for financial services. In addition, South Africa based CompareGuru (previously branded Click n Compare) is reportedly establishing a service in Kenya,[248] but this has not yet launched other than a holding website.[249] We describe these below.

### 5.4.1 The KBA cost of credit website

The Inquiry reviewed the KBA cost of credit calculator, and found it to be a helpful contribution to the market.

The service enables calculation of the cost of credit for personal unsecured and secured loans for terms ranging from 1 to 10 years and for mortgages, thereby covering the most significant products in the retail bank lending market.

The information is relatively well presented. A search for a Ksh 1,000,000 loan from Diamond Trust Bank to be repaid quarterly over 60 months yielded the result shown in Figure 16. (The Inquiry has not verified the amounts against actual market rates, and so the amounts shown should only be reviewed to understand the presentation of the data and not the correctness of the figures.)

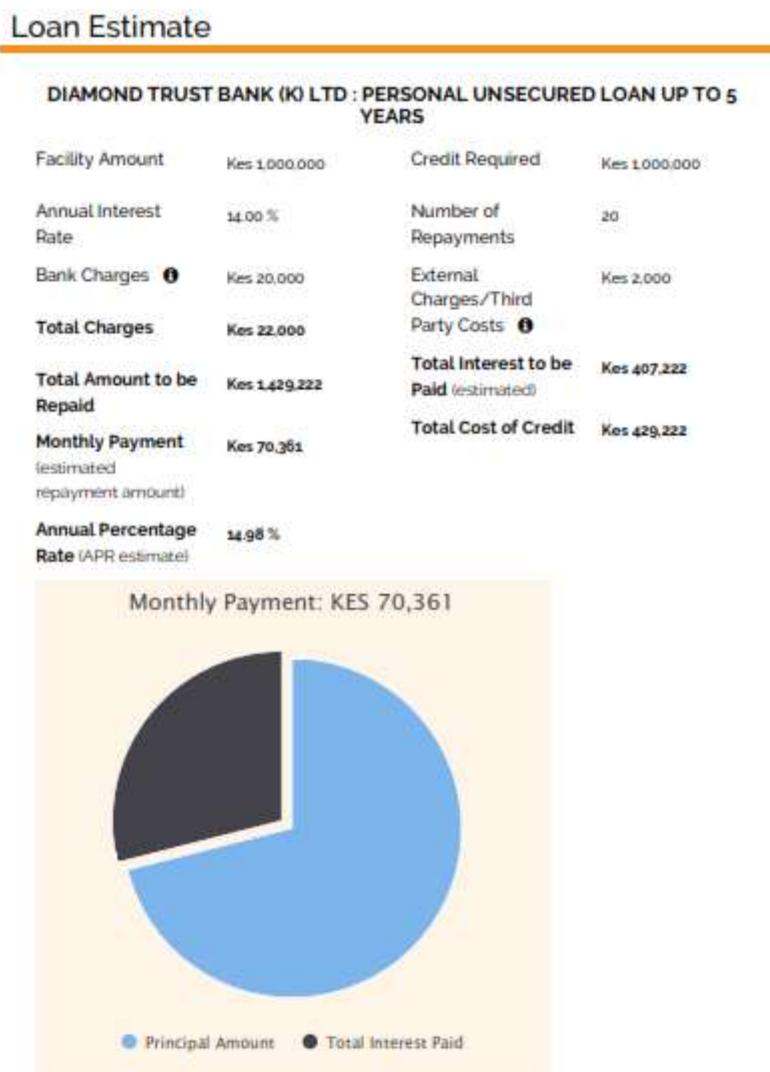
[246] Inquiry's Consumer Research Phase I Report, Annex 3.2, IDI – 6, p. 5.

[247] http://www.businessdailyafrica.com/markets/news/Banks-to-show-cost-of-credit-on-a-new-website-next-week/3815534-3948510-kp3hmtz/index.html

[248] http://ventureburn.com/2015/08/sa-comparison-site-click-n-compare-sets-up-shop-in-nigeria-kenya/

[249] http://compareguru.co.ke/

**Figure 16. Screenshot of search from the KBA's cost of credit website**




*Source: The KBA's cost of credit website*

The planned KBA cost of credit calculator also enables comparison of the monthly loan payment with the five 'top alternatives' from other banks. Thus, although it requires searching initially bank-by-bank (and so sequentially one after another), the comparison with five top alternatives gives a simple instantaneous comparison based on the monthly loan payment amount.

**Figure 17. Screenshot of the ‘top 5 alternatives’ from the KBA’s costofcredit website**

Based on the loan product selected, here are other bank products you can consider:

| Bank | Monthly Loan Payment |
|---|---|
| Guaranty Trust Bank Kenya Ltd | Kes 70,361.08 |
| Transnational Bank Ltd | Kes 70,361.08 |
| Habib Bank A.G. Zurich | Kes 70,361.08 |
| Habib Bank Ltd | Kes 70,361.08 |
| Guardian Bank Ltd | Kes 70,361.08 |

*Source: KBA’s costofcredit website*

Overall, this has the potential to provide a valuable contribution to enabling comparison, thereby reducing search costs. The cost of credit calculator for a given bank shows the monthly repayment amount and the sum total cost of credit, unlike the TCC standard form, which only shows the component parts of the cost of credit. Thus, two important data pieces for the customer are shown. As a matter of transparency, it enables a customer engaging in search using the internet to obtain the basic information required for the types of loans covered rather than having to wait for the bank to provide the TCC form after application is made and the loan is approved.

There are areas for potential improvement, and these arise partly because it is not set up primarily as a PCW but to enable customers to calculate their cost of credit of a given loan with a given bank.

Firstly, the customer must search each bank one-by-one rather than simply searching for the best deal. This may leave customers vulnerable to default bias as they search only banks with which they are familiar.

The “top 5 alternatives” comparison mitigates this problem to some extent, but these are only compared on the basis of the monthly repayment amount. They are not compared simultaneously by total cost of credit that would also take into account upfront fees that are not included in the monthly payments. The top 5 banks are not simultaneously compared with the initial bank searched: the customer must click to request the top 5 alternatives in the browser to obtain the comparison.

More importantly, the top 5 alternatives search function appears to compare banks only on the basis of the monthly repayment amount, and not the total cost of credit. So, when carrying out a search that found a lower total cost of credit for one bank than another, the lower priced bank is not differentiated from other banks when their monthly repayment amounts were the same.

For example, the KBA costofcredit site calculated (on 13 June 2017) that the total cost of credit for a personal unsecured 60-month loan of Ksh 1 million to be repaid quarterly was Ksh 429,222 from Diamond Trust and Ksh 462,222 from Equity Bank, a difference in cost of Ksh 33,000 due to higher bank charges of Equity Bank. With interest rates regulated at a common maximum, each bank showed the same monthly repayment amount of Ksh 70,361. When clicking on the ‘top 5 alternatives,’ all other banks showed the same monthly repayment.

Thus, the comparison facility does not differentiate to show the overall cheapest loan. This is arguably misleading and a significant problem in the design. Instead, it should ensure that the

consumer is informed of the lowest priced bank overall (in addition to comparing the monthly repayment amount).

Immediately before finalising this report, the Inquiry reviewed again the KBA costofcredit site. It appears to have revised the approach to list the top 5 alternatives by TCC rather than monthly payment amount. It will be important for the CAK and CBK to monitor the functioning of the comparison service to ensure that it is accurate and provides meaningful comparison information.

Furthermore, where prices for multiple banks are the same, it is not clear how the 'top 5 alternatives' are selected. There may be prejudice to some banks that are not included when others are. It might be better to disclose a full list of banks where their prices are the same, randomized to avoid repeat advantages where a standard order is used (e.g., alphabetical order).

Lastly, for purpose of producing comparative rankings in the 'top 5 alternatives,' the search function may be more detailed than necessary. The inputs are shown in Figure 18. The "Repayment Frequency" function may not be strictly necessary for purposes of generating comparative results, and may even result in excluding some loans that would otherwise be more advantageous with another repayment frequency. Loan value and duration may suffice to generate results informing consumers of the best-value loans.

**Figure 18. Search criteria entered in the KBA's cost of credit website**

QUICK COST OF CREDIT ESTIMATE

| | |
|---|---|
| SELECT BANK | Diamond Trust Bank (K) Ltd |
| LOAN TYPE | Personal Unsecured Loan Up to 5 years |
| REPAYMENT FREQUENCY | Quarterly |
| HOW MUCH ARE YOU BORROWING? | 1000000 |
| LOAN PERIOD | Months 60 |
| LOAN START DATE | 25/06/2017 |

☐ I agree to the terms and conditions (/site/terms-and-conditions)

Estimate

*Source: The KBA's cost of credit website*

The Inquiry understands that the KBA intends to develop a mobile phone app that would also allow comparisons to be made. Whether this will be as easy to use on a mobile phone as on a computer screen is likely important to its effectiveness as a tool for empowering consumer choice. Much will depend on the design and ease of the functionalities. Lastly, in any case, such a remedy is limited in impact to those with ready access to the internet, although this is the case with most PCWs.

### 5.4.2 Think Business price comparison website

Think Business is in the process of preparing a PCW. It has gathered pricing information from all Kenyan banks on their tariffs for retail and SME services and created a calculator enabling a consumer to compare the costs of a variety of services. For transaction accounts, for example, its calculator enables a comparison based on the consumer's usage of transaction account services, such as number of ATM withdrawals and number of cheques written per month. The consumer will enter these inputs and the calculator will show the cheapest and most expensive 10 banks in the market based on their charges. While the KBA costofcredit website focuses on credit, Think Business is currently focused on bank fees and charges.

The website is intended also to provide information on banks' financial performance and position in order to enable consumers to evaluate the stability of banks, particularly where they deposit funds with them. However, there may be inaccuracies in the information due to time lags and human error. Accordingly, consumers could only be certain that they are receiving accurate information when they obtain it directly from the offering bank.

The data on charges has been compiled from banks' public statements of charges on their websites and in branches (publication is required under the banking regulations), and subsequently verified with the banks themselves. Banks appear to be increasingly engaging with the service, concerned not to allow incorrect information in the market. Think Business intends to update the data every three months.

Think Business hopes that the website will attract revenues from advertising from banks, and click-through fees from banks from customers who, after searching, click on a link to a given bank's online service. The USSD version will enable the provider to generate revenues (e.g., on a revenue share basis) from USSD charges paid by consumers to their MNOs for using the USSD-based service.

The CBK has taken an interest and appears to be generally supportive, but has not indicated any intention to regulate the service.

Think Business hopes to launch its website soon after the date of this Report, followed by launching a mobile app and later a USSD version, all before the end of 2017. The presentation of the website is not yet available, and so it is not possible to assess how user-friendly it will be, or the full scope of information that will be available for comparisons.

### 5.4.3 Market impact

If a substantial promotional investment is made in building up consumer awareness of the KBA costofcredit calculator and, when launched, the Think Business PCW, these have the potential to reduce search costs, eliminating the barrier arising from the customer having to apply and wait for approval before disclosure of the total cost of credit, and the effort to shop around for alternatives. The additional step the consumer must take to apply for and obtain the loan remains a limitation of PCWs. However, PCWs may evolve into websites that enable consumers to sign up for the chosen product, and the Inquiry considers that this and the improved market transparency are beneficial to the market.

It is yet to be seen when and whether the Think Business PCW will reach market or what form it will take, or what usage there will be of it and the KBA costofcredit service. Further, so long as the interest rate cap applies, it is also not clear how strong the commercial prospects for a PCW focused on comparing (as opposed to merely disclosing) the costs of credit can be. It is

also not yet clear whether either service will be as easy to use on mobile phones as on a computer screen. Much will depend on the design and ease of the functionalities.

However, the KBA costofcredit service and others that might emerge would likely be valuable components of a post-interest rate cap world, and the availability of PCWs might be one of the elements that would support the release of the cap.

The report discusses PCWs as a potential remedy for transparency and comparisons further in Section 7.3.

## 5.5 Switching

### 5.5.1 Types of switching

As noted previously, ease of switching is an important consideration in assessing the competitiveness of a market. If consumers are able to switch, they are empowered to exert competitive discipline on firms in the market. However, in many instances switching is constrained by the time and cost required. In this Section, we review switching in the Kenyan banking market and identify key barriers to effective switching.

Consumers may switch banking services providers for various reasons, including price, quality of service or service failure, customer care, convenience, reputation or response to advertising. In some cases, consumers may be compelled to switch (such as where the employer requires salary payments to be made into an account with the employer's bank). However, switching is generally not costless and existing customers incur what are termed "switching costs" when changing bank. Some may be technical, or transactional costs, and others may be informational costs:[250]

- *Transactional costs* are the costs of searching, the time taken to open a new account and transfer funds and close the existing account, as well as the psychological challenge of the process.
- *Informational costs* arise where the existing bank has better information on the financial profile and overall creditworthiness of the customer. These may give the existing bank the ability to extract 'rents' in the form of higher prices.

If the cost (whether financial or in terms of effort) to the customer of switching is higher than the benefit, switching may not occur. This affects the degree of price differential necessary for customers to switch.[251] Higher switching costs may effectively tie consumers and businesses to their banks, locking them into early choices. As a result, even in a multi-provider market, banks can have considerable *ex-post* market power. As a result, retail financial services are famed for "customer inertia."

Switching involves various steps in a customer's journey, as a customer needs to inquire about a product at a new bank, apply for and provide information necessary to open an account and to obtain the product, and receive authorisation.

[250] OECD (2006). Competition and Regulation in Retail Banking

[251] For instance, in a 2014 study carried out by the Netherlands Consumer and Markets Authority, one third of persons surveyed said they would not switch bank, and one third said they would only switch for a relatively high discount of 50 Euros. Netherlands Consumer and Markets Authority (2014), Barriers to entry into the Dutch retail banking sector, p.75.

In Kenya, there are various forms of account switching. For example, for savings or transaction accounts there may be the following types of switching:

- *Full switching with account closure:* The customer opens a new account, moves his or her money and transactions to a new account and closes the old account.
- *Partial switch with dormancy (becomes a full switch):* The customer opens a new account, moves his or her money and transactions to the new account but fails to close the old account. There is technically a period during which the customer is multibanked. After a period, the account becomes dormant and the switch is complete.
- *Partial switch with multibanking:* The customer opens a new account, moves most of his or her money and transactions to the new account but maintains a sum in the old account so that it does not go dormant.

The Inquiry's qualitative interviews and interviews with banks support the view that multibanking and allowing accounts to go dormant (rather than formally closing an account) was the most common method of switching. This was particularly evident in the Inquiry's focus groups with low- and middle-income customers. Consumers chose partial switching over full switching because they perceive the process of bank account closure as difficult (see discussion in Section 5.5.2).[252]

In the case of a loan, there are two chief types of switching:

- *Loan buyout:* A switch might occur during the course of the loan through a loan buyout.
- *Choosing a new bank for the next loan:* A customer might repay a loan with a bank but turn to another bank for the next loan.

The Inquiry was as interested in partial switching as full switching, considering that a tendency to partial switching was likely to help impose competitive pressure on banks. Indeed, full switching faces the barrier of having to close the old bank account, and a focus on this to the exclusion of partial switching might overestimate or otherwise misunderstand the barriers to competition.

We consider in Section 5.5.2 the practice of switching through multibanking and then loan buyouts in Section 5.5.3. We turn then to consider barriers to switching in Section 5.5.4.

### 5.5.2 Multibanking, dormancy and account closure

In interviews and submissions, banks acknowledged that multibanking is prevalent, [253] with [CONFIDENTIAL] estimating that its customers have on average 2-3 accounts at various banks. [254]

There may be a number of reasons for multibanking. For instance, when switching, a customer may wish to keep an old account open but move salary payments from it to the new account in order to demonstrate an income stream to borrow from the new bank. The switch might occur at the customer's initiative to obtain an account with better terms, or because the new bank is

[252]Inquiry's Consumer Research Phase I Report, Annex 10, slide 28.

[253] Meeting with Bank of Africa, 2 February 2017. Meeting with Cooperative Bank, 30 January 2017. Meeting with Family Bank, 31 January 2017. Meeting with Sidian, 1 February 2017. Meeting with NIC, 31 January 2017. Submission of Standard Chartered, 23 March 2017. Submission of Barclays, 28 February 2017.

[254] [CONFIDENTIAL]

linked to their employer, but they do so without closing the old accounts.[255] Similarly, when customers relocate, they often change banks as their old bank may not have branches in their new location. [256]

One reason for keeping the old account open when switching is that customers rarely formally close accounts even when they have no intention of ever using them again. [257] Rather, they tend to withdraw all of their funds and leave a zero balance. [258] Customers interviewed by the Inquiry perceived that the process to formally close an account was difficult, time-consuming and costly, if not impossible.[259]

Banks also appear to actively discourage formal account closure. In the mystery shopping exercise, customers that inquired about closing accounts were advised by bank staff to instead leave the account active with a small balance. [260] The qualitative interviews also showed that customers reported feeling "hassled" when they initiated the account closure process, with banks calling them to leave the accounts open.[261] The reason for this is not clear, though the practice appears to be common.

**Box 15. Customers multibank in part because account closure is perceived as difficult and banks advise against it**

*"[M]ost of the time [banks] will not allow you to switch[.] [I]f you tell them you want to switch due to some reasons they will tell you to just leave [the account] dormant [and that] you will come to use it again. So for me I just leave the account dormant."* [262]

*"I wanted to close my account but [the bank staff] told me not to close it because I may need it in the future."* [263]

***Interviewer**: "When you want close [an account] is the process easy or difficulty?"*
***R3**: "You can't just go [to the bank]and say you want to close [an account.] [Y]ou must write forms. . . [T]here is no need [to go through that process, instead,] let it remain dormant without depositing money. . ."*[264]

*"[T]here is something called book balance that is Ksh 500 [that must be in your] account. If it is not there you cannot close the account."* [265]

*"[I] am not aware [of the process for switching accounts] though I do not need to follow the process. I just withdraw all the money in my account and it becomes dormant."* [266]

***Interviewer**: "If you close your account today, do you think the process will be long, difficult or easy to do?"*
***R1:** "Difficult"*
***R4:** "It's a long process"*
***R5:** "It will be too difficult"*[267]

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[255] Meeting with Family Bank, 31 January 2017.

[256] Meeting with Bank of Africa, 2 February 2017. Meeting with Cooperative Bank, 30 January 2017.

[257] Inquiry's Consumer Research Phase I Report, pp. 59-60.

[258] Inquiry's Consumer Research Phase I Report, pp. 59-60.

[259] Inquiry's Consumer Research Phase I Report, pp. 59-60.

[260] Inquiry's Consumer Research Phase I Report, p. 60.

[261] Inquiry's Consumer Research Phase I Report, p. 60.

[262] Inquiry's Consumer Research Phase I Report, Annex 2.2.1, Switching Low Income – Naivasha, FGD, p. 22.

[263] Inquiry's Consumer Research Phase I Report, Annex 2.2.1, Switching Low Income – Naivasha, FGD, p. 27.

[264] Inquiry's Consumer Research Phase I Report, Annex 2.2.1, Switching Middle Income – Naivasha, FGD, pp. 33-34.

[265] Inquiry's Consumer Research Phase I Report, Annex 2.2.1, Switching Low Income – Naivasha, FGD, p.48

[266] Inquiry's Consumer Research Phase I Report, Annex 2.2.3, Switching Low Income – Nairobi, FGD, p. 18.

[267] Inquiry's Consumer Research Phase I Report, Annex 2.2.3, Switching Low Income – Nairobi, FGD, p. 25.

*"I do not think [closing an account] will be easy because when you are new they welcome you very nicely but when you want to move it will be a hassle."* [268]

*"[I]f you close an account in a certain bank they will deduct some amount from your account. There are those who ask for five hundred others one thousand to be deducted from your account for you to close and open another account elsewhere. So mostly it's not good to close account it's better to leave it dormant then you go to another bank and open another account."*[269]

*"The process [of closing an account] is a bit long because. . . they do not want to lose you so they spend time convincing you not to do so. . . It was difficult because when you tell them you want to close the account they portray another attitude."* [270]

*[To close an account, I would] have to write a letter telling [the bank] I want to close my account and do follow up to make sure its closed and may be request for an evidence to show that the account has been closed.* [271]

*"Sometimes you open an account for [y]our children so that they can benefit in terms of education or you open an account so that you can take a loan, so if you close one you will not get the benefit of that particular account. I prefer to use both or more accounts because of the benefits I get."*[272]

*"The first tier banks are in big cities alone so that is why I have an account with other [banks] which can be found in rural area too."* [273]

*"[I hold multiple bank accounts] to avoid risk. . . [T]here are few banks that collapse. One or two. . . one of my immediate family was a victim."* [274]

***Interviewer:*** *"When […] you want to switch, would you wish to close [the first account] completely or leave it dormant?"*
***R1****: "I will leave it dormant [and] in case I need it I will revive [it], but the problem [is the bank] will call and ask why you don't deposit[.] [T]hough I would [still] prefer to leave it because you never know what will happen tomorrow"*
***R2****: "Maybe one to remain dormant and I go on with one. . . In case I need I will revive it"*
***R3****: "[I] would wish to leave it dormant and I [would] open another one, so in case I need [the first account,] I will just go [to the bank] and say [']I had an [account] here['] and [there] won't be difficulty to continue."*[275]

***Interviewer:*** *"If you want to switch account providers, would you rather close the account, or leave it open with a small amount of money in it? Why?*
***R5:*** *"I would leave it with some small amount. . . so as not to have it closed."*
***R2:*** *"I would leave it with the bank fee to avoid it being closed."*
***R1:*** *"I would leave it with small amount to avoid it from becoming dormant."*
***R3:*** *"I would save in the both accounts."*
***R4:*** *"I would leave it with small amount because I would use it later."*[276]

A number of the practices described in the Box above (as described by focus group and interview participants as part of the qualitative interviews) appear to be non-compliant with current regulatory requirements. The Inquiry recommends that the CBK review these practices carefully.

[268] Inquiry's Consumer Research Phase I Report, Annex 2.2.1, Switching Low Income – Naivasha, FGD, p.49
[269] Inquiry's Consumer Research Phase I Report, Annex 2.2.2, Switching Middle Income – Kitui, FGD, p. 31.
[270] Inquiry's Consumer Research Phase I Report, Annex 2.2.3, Switching Middle Income – Nairobi, FGD, p. 17.
[271] Inquiry's Consumer Research Phase I Report, Annex 3.2, IDI – 4, p. 9.
[272] Inquiry's Consumer Research Phase I Report, Annex 2.2.2, Switching Middle Income – Kitui, FGD, p. 16.
[273] Inquiry's Consumer Research Phase I Report, Annex 2.2.3, Switching Middle Income – Nairobi, FGD, p. 11.
[274] Inquiry's Consumer Research Phase I Report, Annex 3.2, IDI – 4, pp. 2-3.
[275] Inquiry's Consumer Research Phase I Report, Annex 2.2.1, Switching Middle Income – Naivasha, FGD, pp. 33-34.
[276] Inquiry's Consumer Research Phase I Report, Annex 2.2.2, Switching Low Income – Kitui, FGD, p. 35.

The Inquiry's qualitative interviews and interviews with banks also indicated that customers multibank for strategic reasons. Sometimes they use different banks for different needs.[277] They may use one bank for depositing their salary, as it is linked to their employer, and another for business income at a bank that has more favourable commercial accounts.[278] Customers may try to capitalize on the specific benefits and services of various banks, including things like favourable rates on international transfers or currency exchange. [279]

Another strategic motivating factor is the wish to mitigate the risk of bank failure. [280] Customers fear having all of their savings in a single bank. With the high-profile failures of Chase Bank and Imperial Bank, two large banks, many customers opened new accounts at local banks which were perceived as more stable.[281] Also, there is a sense that if bank's stability is in question, money can easily be transferred out of the bank to an account at another bank. [282]

**Box 16. Strategic reasons for multibanking**

*"My reason [for having multiple savings accounts] is not putting all eggs in one basket so that if one goes down I still have the other."*[283]

*"I have three accounts at CFC Bank, Co-operative Bank and K-Rep bank. One is for business, another one is for future savings and another one is for daily use."*[284]

*"I have [multiple] accounts because [once] I was at home waiting for money to be deposited into my account but it was not deposited and I needed money for transport, it forced me to look for another source of money to use. . . I decided to open another account so that when the [one] account fails I can access money from the other account."*[285]

**Interviewer:** *"If you like [Co-operative Bank], why don't you close [your accounts at] KCB [and the] SACCO?"*
**R4:** *"I can't because there was a day I needed money, I went to KCB with my ATM and it got stuck inside. So you see what if I had no alternative I would have slept hungry."*[286]

*"I have two accounts. One is joint because my husband works abroad and that bank is available there but the other bank is not."*[287]

*"I have two accounts; Co-operative Bank is for saving while Family Bank is very helpful because I work as an M-Pesa agent and I usually bank with them because it's free."*[288]

### 5.5.3 Loan buyouts

As discussed in Section 3.1.2 above, loan buyouts were fairly common in the market before the interest rate cap. There have since been reductions in the level of loan buyouts and the extent to which banks can compete with each other on interest rates and prices offered. In such a

[277] Inquiry's Consumer Research Phase I Report, p. 56. Meeting with Family Bank, 31 January 2017. Meeting with NIC, 31 January 2017.

[278] Meeting with Bank of Africa, 2 February 2017.

[279] Inquiry's Consumer Research Phase I Report, p. 56.

[280] Meeting with Cooperative Bank, 30 January 2017.

[281] Meeting with Sidian, 1 February 2017.

[282] Meeting with Bank of Africa, 2 February 2017.

[283] Inquiry's Consumer Research Phase I Report, Annex 2.2.3, Switching Middle Income – Nairobi, FGD, p. 11.

[284] Inquiry's Consumer Research Phase I Report, Annex 2.2.1, Switching Low Income – Naivasha, FGD, p. 6.

[285] Inquiry's Consumer Research Phase I Report, Annex 2.2.1, Switching Low Income – Naivasha, FGD, p. 11.

[286] Inquiry's Consumer Research Phase I Report, Annex 2.2.1, Switching Middle Income – Naivasha, FGD, p. 15.

[287] Inquiry's Consumer Research Phase I Report, Annex 2.2.2, Switching Low Income – Kitui, FGD, p. 14.

[288] Inquiry's Consumer Research Phase I Report, Annex 2.2.2, Switching Low Income – Kitui, FGD, p. 14.

context, the benefits of switching are reduced and customers are less likely to make the effort to switch.

Switching accounts that are linked to an employer is subject to additional administrative barriers. The employer may not permit the switch, being unwilling to deposit salary payments into the new bank. The switch may also require burdensome paperwork between the employee, employer and the two banks to ensure that salary deposits are made into the new account. [289]

**Box 17. Loan buyout procedures**

**Barclays:** *The customer submits a written request to move their loan to another bank. The request is processed through the credit team who will then provide conditions under which the loan can move and pertinent information including the total amount outstanding to be cleared, the interest accruing and the rate of interest and if there is any security. If there is no security, then the loan will be repaid by the other bank. If there is security then release of the security and payment of the loan will be managed through the bank's lawyers and exchange of undertaking.*[290]

**Co-operative Bank:** *This being a buyout, the bank only receives funds from the bank from which the customer applied for the new loan. The funds received are then used to clear the outstanding loan and a clearance letter issued to the customer. For loans repayments that were being deducted at source (employer), a stop order is also issued to the employer to stop the deductions.*[291]

The mystery shopping exercise probed the ability of customers to obtain and execute loan buyouts from a competing bank. Ten mystery shoppers with existing personal loans at a bank (Bank A) visited a competing bank (Bank B) seeking an offer for a loan buyout. If the shopper received a buyout offer, the shopper visited a branch of Bank A and presented the buyout offer from Bank B. The shopper noted whether Bank A agreed to facilitate the buyout, refused to facilitate the buyout or attempted to retain the mystery shopper as a customer by making a counteroffer to Bank B's buyout offer.

**Figure 19: Design of mystery shopping loan buyout exercise**

Only 7 of the 10 mystery shoppers received a buyout offer from Bank B. In all but one case, the staff at each Bank A refused to facilitate the buyout. No shoppers received a counteroffer

[289] Meeting with Standard Chartered, 3 February 2017

[290] Submission of Barclays, 28 February 2017

[291] Submission of Co-operative Bank, 2 March 2017

from Bank A. The results of the exercise are summarized in Table 5 along with descriptions of the mystery shoppers' experiences quotes including some actual quotes from the shoppers.

**Table 5: Results of mystery shopping loan buyout exercise**

| No. | Bank B buyout offer? | Bank A will facilitate buyout? | Bank A makes counter offer? |
|---|---|---|---|
| 1 | Yes | **No.** *"They said I should first clear the loan before switching to [Bank B]. I should go take a loan at [Bank B] and then come clear [the existing loan] with [Bank A]. They seem not to like that issue of me switching."* | **No.** Bank staff stated that they cannot counteroffer because they offer the same rates as all other banks |
| 2 | Yes | Yes. | **No.** Bank A did not give a counteroffer because, according to the staff, it would be a bank policy violation. |
| 3 | Yes | **No.** *"[Bank staff] refused claiming that their terms on interest rates and bank commission are the same [as from Bank B]."* | **No.** Bank staff said they would only offer terms on a fresh loan. |
| 4 | Yes. | **No.** *"[Bank staff] insisted on their terms and said they were the best bank with the best terms."* | **No.** The staff said no counter offer could be given, as they could not go against the terms specified to them by the bank. |
| 5 | Yes | **No.** Bank staff were insistent on an internal resolution of the reasons behind the loan switch. | **No.** Despite insistence on resolution, no counteroffer was made. |
| 6 | No | | |
| 7 | No | | |
| 8 | Yes | **No.** Bank staff were surprised that they were approached with a buyout offer. They then stated that maintaining the existent good relationship was key in order for the shopper to obtain another loan in the future. In addition, they also stated that the shopper had already consented to the initial loan terms, and should therefore comply by them. | **No.** Same reason as refusal to facilitate buyout. |
| 9 | Yes | **No.** Bank staff displayed surprise at the request, and urged the shopper to reconsider. | **No.** No reason provided. |
| 10 | No | | |

*Source: Derived from Inquiry's Consumer Research Phase I Report, Annex 7, Loan Switchers Description*

This mystery shopping loan buyout exercise involved a small sample of borrowers and banks making it impossible to draw far-reaching conclusions. However, it does indicate that, despite the submissions of banks indicating that staff will facilitate buyouts of loans by competing banks, switching loan providers though a buyout process may be fraught obstacles if it is possible at all. With only one exception, bank staff at the various 'Bank A's were either unfamiliar with procedures necessary to facilitate buyouts or stubbornly obstructionist. None of the staff were willing to provide counteroffers.

### 5.5.4 Barriers to switching

The prevalence of multibanking and lack of difficulty of leaving an old account open until the bank closes it suggests that barriers to switching do not lie in a need to close an old account in order to switch to a new bank. However, the Inquiry identified several barriers to switching in the markets for traditional loans, and savings and transaction accounts, which we review here.

***Transparency and ability to compare products***

The ability to switch depends on the ability to identify a product that is preferable to an existing product (or one that the consumer has used previously, in the case of a loan that has been repaid). Here, the relevant concerns have previously been set out in relation to:

- how consumers make choices, including barriers to their information gathering, high distrust of banks, low financial literacy, challenging complexity of products, a tendency not to change, as well as the role of the employer influencing choice (discussed in Section 4);
- weak assessments by banks of consumers' needs and communication of product options to consumers (discussed in Section 5.1);
- weaknesses in the disclosure of pricing of loans (discussed in Section 5.2) and savings and transaction accounts (discussed in Section 5.3), including inadequate disclosure to enable understanding and comparison of pricing.

In short, the limitations on the consumer's ability to shop around that are detailed in the sections mentioned above are also barriers to the consumer's ability to switch.

We consider remedies to these particular concerns in Sections 7.2, 7.3 and 8.1.

***Establishing a creditworthy record with a lender***

The Inquiry's qualitative interviews showed that access to credit is a motivating factor for opening a savings or transaction account. In general, many respondents, particularly in the low- and middle-income groups, view savings accounts as a vehicle for establishing collateral that could be used to access credit.[292] Consumers may choose where they open their savings and transaction accounts as a pre-condition to applying for a loan or in anticipation of applying for a loan in the future.

Similarly, in the mystery shopping exercise, the most prevalent barrier encountered by shoppers to obtaining a loan from a traditional bank was the requirement that the customer have an ongoing prior relationship with the bank. In particular, banks offering unsecured loans (including check-off loans) typically require the customer to open and maintain a transaction account with them. This must show a transaction history over several months demonstrating the ability to repay the loan through arranging salary or other income payments into that new account.[293] These transaction histories are a key part of the bank's risk assessment, helping to ascertain whether the potential borrower has sufficient salary or other regular cash flow to cover loan repayments.

As a result, a preferred loan product with one bank may mean the consumer cannot hold their transaction accounts at another bank of their choice for such accounts. As [CONFIDENTIAL] expressed to this Inquiry, once a consumer takes out a loan, they may become locked into the same bank for their transaction account because they are required to have their salary deposited into a transaction account as a condition to receiving the loan.[294]

[292] Inquiry's Consumer Research Phase I Report, p. 34

[293] Inquiry's Consumer Research Phase I Report, pp. 20-21.

[294] [CONFIDENTIAL]

Several of the banks interviewed, including [CONFIDENTIAL], confirmed the rigid requirement of a pre-existing transaction account for personal loan eligibility. [295] However, some banks described more flexible and nuanced policies. [CONFIDENTIAL] and [CONFIDENTIAL] both indicated that they would accept printed copies of six months of transaction histories from other banks to satisfy this requirement.[296] [CONFIDENTIAL] indicated that it does not require a transaction history from customers, either from [CONFIDENTIAL] or another bank, but borrowers are required to open a transaction account as part of taking a loan.[297] [CONFIDENTIAL] indicated in its interview that it would typically require that a borrower open a transaction account, unless the borrower could provide 3 months of transaction history from another bank. [298] However, in its submission, [CONFIDENTIAL] provided documents showing that an unsecured personal loan requires 6 months of bank statements from non-[CONFIDENTIAL] customers.[299]

This Inquiry has subsequently learned that the policies of many banks on this requirement, including some of those interviewed, have been in flux since the time of the interviews, with the general trend that requirements are becoming more burdensome.[300] One expert has explained this trend as an adaptation to the interest rate cap.[301] With lower interest rates to cover risk, banks have made increasing demands on customers to demonstrate creditworthiness.

Transaction accounts thus generally operate as a sort of "gateway" function for loans and other services. Easing the ability of customers to move their transaction accounts elsewhere would ease their ability to borrow from an alternative provider.

This requirement of prior history emerged as a clear barrier to obtaining a loan in this Inquiry's mystery shopping exercise. Of the 39 shoppers who had banks discuss whether a prior relationship was required for requirements loan eligibility, only 2 were told that there was no such prior relationship requirement and 34 were told that the requirement was 6 months or more of prior history (see Figure 20).[302] The variety of approaches to this requirement that was described in bank interviews was largely absent from the mystery shopping results.[303] No shoppers were told they could supply transaction histories as a substitute to a prior relationship. Three shoppers were told that this requirement could be reduced to 1 month if they supplied 6 months of statements from another bank.[304]

[295] [CONFIDENTIAL]

[296] [CONFIDENTIAL]

[297] [CONFIDENTIAL]

[298] [CONFIDENTIAL]

[299] [CONFIDENTIAL]

[300] Email from Jack Odero, 17 May 2017.

[301] Email from Jack Odero, 17 May 2017.

[302] Inquiry's Consumer Research Phase I Report, p. 20.

[303] Inquiry's Consumer Research Phase I Report, p. 22.

[304] Emails from Busara, 15 May 2017 and 17 May 2017.

**Figure 20: Length of prior relationship required for loan eligibility**

| Minimum Time Requirement | Frequency |
|---|---|
| No time requirement | 2 |
| 3 months | 3 |
| 6 months | 27 |
| 9 months | 2 |
| 1 Year or More | 5 |

*Source: Inquiry's Consumer Research Phase I Report, p. 20.*

The mystery shopping did, however, confirm that banks would waive the prior relationship requirement when the borrower's employer agreed to directly and regularly pay a portion of the borrower's salary to the bank in repayment of the loan.[305] Four of the 39 mystery shoppers (10%) who discussed minimum time requirements were informed of this option.[306] This arrangement is commonly referred to as a check-off loan and requires a formalized and pre-existing relationship between the employer and the bank. Check-off loans assure the bank that so long as the borrower remains employed, regular loan repayments will continue. Interviews with several banks also confirmed that no prior relationship or proof of transactions were required for borrowers seeking check-off loans.[307]

However, even check-off loans are not always free from the prior history requirement. [CONFIDENTIAL] indicated that while the requirement to have a transaction account would be waived in the case of check-off loans, they still require the borrower to produce transaction histories from other banks. [308] In the months since these interviews and the mystery shopping exercise were conducted, we have learned that several other banks are also requiring some prior history even in the case of check-off loans. [309] Relatedly, we understand from one expert that Family Bank recently began requiring that check-off loan borrowers provide collateral.[310]

The effect of these requirements is to limit the options of a potential borrower when selecting a lending bank. The qualitative interviews show that borrowers generally seek loans on a "needs" basis, including for emergencies (see Section 4.2.1).[311] Waiting several months to satisfy a bank's prior history requirement is often not an option, locking people into the banks where they already have accounts and constraining the ability of a borrower to shop and compare loan terms.

As noted, some banks claimed in interviews to allow potential borrowers to supply transaction histories from other bank accounts. However, as the results of the mystery shopping show, this may not occur very frequently in practice. Furthermore, this requirement is itself burdensome

[305] Inquiry's Consumer Research Phase I Report, p. 20.

[306] Email from Busara, 31 May 2017.

[307] [CONFIDENTIAL]

[308] [CONFIDENTIAL]

[309] Emails from Jack Odero, 15 May 2017 and 17 May 2017.

[310] Email from Jack Odero, 17 May 2017.

[311] Inquiry's Consumer Research Phase I Report, p. 59.

as it creates a major hassle for loan shoppers. A potential borrower would need to obtain physical copies of transaction histories from their current bank, make multiple copies of these and carry them to each potential lender.

In some contexts, the requirement to acquire and use one product in order to acquire another that the customer does not need might be viewed as tying, and as an anticompetitive practice. However, in the case described, the transaction account has a clear purpose. The Inquiry does not wish to question commercial decisions of lenders as to how they satisfy themselves as to the creditworthiness of customers, whether through a short or long history of a transaction account with the lender, or relying on transaction history from another bank. Banks have an incentive to lend where it is profitable to do so, and to do so weighing the risk of the customer.

However, we do consider in Section 7.4 the issue of access to information about a customer's history. In particular, Section 7.4.1 considers whether easing the transfer of customer transaction data from an old bank to a new bank might reduce switching barriers. We also consider the importance of access to credit information through digital transaction data and credit reporting in Sections 7.4.2 and 7.4.3.

**Box 18. Requirements for prior history serve as a barrier to obtaining loans**

*"I think moving banks is quite difficult and the challenge around normally needing to have a banking record with a particular bank before they give you a loan means I am highly unlikely to move than to go to another bank and wait for another six months before they can give me a loan"*[312]

*"[W]hen you ask for a loan, they always want to know how you have been saving. You can save with them for three months or five months then they will know how you save and withdraw."*[313]

***Interviewer:*** *"How easy or difficult is it for you to compare different prices, rates and packages that different. . . loans providers offer to you?*
***R2:*** *"I see it difficult because you are not a customer of National Bank, Equity, Post Bank, Family Bank, you are not everywhere. Let's say you are in National and you want to go to get a loan from Equity it will be difficult. Because you should first start with savings and they will start asking if you have this and that, examples: do you have an account here? No, when you go to Family Bank they will still ask if you have an account with them so it will be difficulty."*
***R1:*** *"[I]t is difficult. [L]ike now I am in Family Bank, if I want to go to KCB, they will ask me if I have an account with them, I say no, I start by opening an account by the time I save to the amount they want it will take time."*
***R3:*** *"It is usually difficult. Like let's say you have gone to KCB and you have never been there, because you don't know where to request it will take time. It is hard because you don't have an account everywhere."*
***R5:*** *"It is difficult, maybe you go there and the person you inquire from notices that you don't have an account with them, he or she will be rude to you and he or she will be aiming to you opening an account with them so that they can explain. It will be easier if you have an account with them."*[314]

*"I once tried to apply for a loan over the phone and that is when they told me that to qualify for a loan, I must have saved with them for more than six months"*[315]

*"The requirements [for obtaining a loan] were that one was to save with the bank for 3 months consecutively."*[316]

[312] Inquiry's Consumer Research Phase I Report, Annex 3.2, IDI-6, p. 13.

[313] Inquiry's Consumer Research Phase I Report, Annex 2.2.1, Switching Low Income – Naivasha, FGD, p. 54.

[314] Inquiry's Consumer Research Phase I Report, Annex 2.2.1, Switching Low Income – Kitui, FGD, p. 23.

[315] Inquiry's Consumer Research Phase I Report, Annex 2.2.2, Transparency Low Income – Marang'a, FGD, p. 7.

[316] Inquiry's Consumer Research Phase I Report, Annex 2.2.3, Transparency Low Income – Nairobi, FGD, p. 17.

*"I just applied for a loan and my request was easily granted which I think was due to my numerous bank transactions."*[317]

**Box 19. Sought access to credit drives savings/transaction account choices**

*"[I choose to save at the bank] because my money is safe and as you keep saving you can get a loan from the bank."*[318]

***Interviewer:*** *"What may make you reluctant to move to another financial institution?"*
***R5:*** *"To get a good chance of getting a loan"*
***R4:*** *"To have a good chance of getting a loan."*
***R3:*** *"To build relationship with my bank and stand a chance of getting a loan."*

***R1:*** *"To build relationship with my bank and stand a chance of getting a loan."*[319]
*"[I have a savings account at Co-operative Bank because] they said if you are a client and ha[ve] savings with them you can be given a loan."*[320]

***Interviewer:*** *"[W]hen you switch from one bank to another what do you consider most?"*
***R5:*** *"I consider if the bank will help me in my time of need like if I want a loan."*
***R2:*** *"[Y]ou will have to go to a bank that will look after you. . . like giving you a loan if you get unemployed. It's not any other thing, the only thing is loans."*[321]

*I cannot [close one of my accounts] because there is this issue of loan[s.] [W]hen you need loan somewhere [the bank asks] 'where have you been saving?' . . . So I must stick in both.*[322]

*I [was] saving in National Bank but the bank I could get loan from is KCB so I found myself saving in KCB also.*[323]

*"[The bank staff] told me that the more I saved [the easier] it would be to access a loan."*[324]

*"I opened [the current account] because that was the bank we had an MOU with and I wanted a loan facility. So I did not have a choice to look at any other place. We just had to go to that bank because I knew I would get a loan facility."*[325]

# 6. Transparency, information asymmetries and customer data in digital savings, loans and mobile money

The Inquiry reviewed the adequacy of disclosures of prices and other terms and conditions in digital savings and loans provided over mobile platforms, as well as mobile money services.

After introducing the sector in Section 6.1, we review the disclosure practices in digital savings and loans in Section 6.2 and in mobile money services in Section 6.3. We find them to be wanting, both in terms of what is required to inform consumers in a manner enabling them to understand, compare and switch among products, as well as in terms of regulatory requirements.

[317] Inquiry's Consumer Research Phase I Report, Annex 2.2.3, Transparency Low Income – Nairobi, FGD, p. 18.
[318] Inquiry's Consumer Research Phase I Report, Annex 2.2.2, Switching Low Income – Kitui, FGD, p. 9.
[319] Inquiry's Consumer Research Phase I Report, Annex 2.2.3, Switching Low Income – Nairobi, FGD, p. 17.
[320] Inquiry's Consumer Research Phase I Report, Annex 2.2.1, Switching Low Income – Naivasha, FGD, p. 8.
[321] Inquiry's Consumer Research Phase I Report, Annex 2.2.1, Switching Low Income – Naivasha, FGD, pp. 8-9.
[322] Inquiry's Consumer Research Phase I Report, Annex 2.2.1, Switching Middle Income – Naivasha, FGD, pp. 15-16.
[323] Inquiry's Consumer Research Phase I Report, Annex 2.2.2, Switching Middle Income – Kitui, FGD, p. 10.
[324] Inquiry's Consumer Research Phase I Report, Annex 2.2.2, Transparency Low Income – Marang'a, FGD, p. 6.
[325] Inquiry's Consumer Research Phase I Report, Annex 3.2, IDI - 3, p. 9.

There appears to be significant non-compliance with the Prudential Guideline on Consumer Protection and the Competition Act.

The Inquiry also considered the importance of access to information about consumers. We assess in Section 6.4 the level and current practices around consumer control over transactional data, and how such data is sold and assessed by third parties. We consider also credit bureau reporting by digital credit providers in Section 6.5. We review differences in reporting obligations between regulated institutions on one hand and non-regulated institutions on the other hand. We assess whether such differences give non-bank digital lenders an anti-competitive advantage over bank lenders, and inhibits consumers' ability to take advantage of their own data for financial access.

## 6.1 Introduction

One of the unique characteristics of the Kenyan financial services market is its advanced experience with mobile money relative to other countries. The M-Pesa mobile money service has not only facilitated person to person money transfers and bill payments but has been used as a platform for the introduction of mobile savings and credit products, as discussed in Section 3.1.4.

While various products have been introduced in the market since 2011, the more widely used mobile savings and credit products are fairly recent. M-Shwari was only introduced in 2012 but has grown to over 9 million accounts, while KCB M-Pesa was introduced in 2015. Its predecessor, M-Benki, was introduced in 2013. In addition, there are a range of other mobile offers including several app-based models. For example, Co-operative Bank has released MCo-op Cash as a mobile wallet that offers savings and loans, and Branch provides small loans using information stored on an individual's smartphone, such as SMS, social media and M-Pesa usage.[326]Compared to mobile money, mobile savings and credit in Kenya are fairly new but are evolving and growing fast.

M-Shwari and other digital products are enabling people to access or save money, leading to increased financial sophistication. Studies suggest that savings are shifting from cash and M-Pesa to M-Shwari while loans are shifting from friends and informal moneylenders to M-Shwari. Various studies have been undertaken on M-Shwari's success and on the usage of M-Shwari.[327] Key factors that emerge include the following: [328]

- It is easily accessible and easy to use. It is separate from M-Pesa, which makes it feel safer and more private than M-Pesa, although certain studies raised concern over a perceived link with M-Pesa.

[326] Business Daily, "US Investor to offer loans on M-Pesa, Facebook Data." 18 October 2015, available at http://www.businessdailyafrica.com/Corporate-News/US-investor-to-offer-loans-on-M-Pesa--Facebook-data/-/539550/2919732/-/pgpxlp/-/index.html.

[327] Mirzoyants-McKnight, A and Attfield, W, 2015. Value-added Financial Services in Kenya: M-Shwari. Findings from the Nationally Representative. FII Tracker Survey in Kenya (Wave 1) and a Follow-up Telephone Survey with M-Shwari Users. Final Report, January 2015. Financial Inclusion Insights. Ndumba, HW and Muturi, W (2014) Factors Affecting Adoption of Mobile Banking in Kenya; Case Study of Kenya Commercial Bank Limuru. International Journal of Social Sciences Management and Entrepreneurship 1(3):92:112, November 2014.

[328] Cook, T. & McKay, C. (2015). How M-Shwari works: The story so far. Forum 10, Washington, D.C.: CGAP and FSD Kenya. Retrieved from http://www.cgap.org/sites/default/files/Forum-How-M-Shwari-Works-Apr-2015.pdf

- It is perceived as cheaper than most comparable sources of loans, despite the fact that the APR is approximately 90%.
- It allows customers to balance the need for short-term liquidity and emergency financing with future returns as their money is "working" for them by allowing them to access more credit in the future.

Disadvantages identified include the low loan limit, short repayment period, and concerns over the link between M-Shwari and M-Pesa (i.e., fear that repayment default affects the ability to use the related M-Pesa account for regular transfers and payments).

There is widespread perception that M-Shwari is cheap – despite its high effective interest rates. This discrepancy between perceived and actual costs may reflect the fact that borrowers may not fully understand interest rates and APRs or alternatively that there are other transaction costs (such as assembling paperwork, transport costs, time costs etc.) involved in alternative sources of loans that borrowers are considering. In addition to this, customer understanding is low in respect of terms and conditions, interest rates and prices and consequences of default.

**Box 20. A brief history of mobile deposit and loan products in Kenya[329]**

**M-Kesho** was introduced through an agreement between Equity Bank and Safaricom in 2011. It operates as a 'bolt-on' to M-Pesa, as a banking offering under Equity Bank's licence. The account can be opened at an Equity Bank or Safaricom agent. Charges are split between Safaricom and Equity Bank. The joint venture relationship between Safaricom and Equity Bank has broken down, however. Equity Bank claims to be the driver of M-Kesho as Equity had been looking to develop a mobile money solution since 2003, with a cash-in, cash-out functionality similar to M-Pesa.

**Equitel My Money**, also an MVNO service, was launched by Equity Bank in July 2015, and had reached 1.1 million mobile subscriptions by September 2015. This service is offered to Equity Bank account holders, though anyone may open an account using Equity Bank's *247# USSD code, via any mobile network. An Equity Bank account holder may collect a SIM card from an Equity Bank branch, activate the My Money account (effectively linking their bank account to their Equitel SIM card), and subsequently accesses their bank account via STK on the Equitel SIM.

**M-Shwari** was introduced by Safaricom in November 2012 through agreement with CBA, whose bank licence underpins the accounts. The service is provided through STK, and has grown very quickly. CBA is primarily a corporate bank along with high net worth individuals. Through M-Shwari its accounts have grown from around 1 million accounts at end 2012 (mainly high net worth individuals) to around 9.4 million accounts in 2014. Of these accounts, 7.1 million were active in September 2015, and 3.3 million were 30-day active. Deposit and loan sizes, however, are considerably smaller than those at other banks. A credit scoring system has been developed based on customers transfer behaviour which allows them to be appraised for the purposes of offering credit to them.

KCB's mobile banking products are **M-Benki**, launched in 2013, and **KCB M-Pesa** launched in March 2015. These services are delivered through USSD. KCB M-Pesa was made possible through a strategic partnership with Safaricom, which facilitates the opening of bank accounts and other transactions via its M-Pesa menu. Safaricom reported that there were 2.7 million active KCB M-Pesa customers in September 2015, and 1.3 million 30-day active customers.

**MCo-op Cash** was launched in Q3 2014 by Co-operative Bank, targeting 10 million co-operative members in Kenya. By December 2014, 1.42 million customers had registered for the service. The service offers a mobile wallet, including the ability to make payments and transfer funds across banks, micro-finance institutions and mobile networks. The service also offers a bank account, as well as the ability to apply for loans.

[329] Sources: CBK data, CA data, company annual and half-year results, and stakeholder interviews

## 6.2 Disclosures in digital savings and loans

While there has been substantial innovation and growth in digital loans and savings, the Inquiry identified key issues in the lack of transparency and compliance with disclosure requirements in relation to charges and other terms and conditions.

As in the case of traditional banking products, the nature and timing of disclosures on rates, fees and charges are critical to enable consumers to make comparisons among digital savings and loan products.

As mentioned in Section 2.2.2, the CAK has been reviewing disclosure practices in digital financial services. The CAK has found that digital loan providers were not disclosing "applicable transaction fees and charges, interest rates and roll over charges of the loan on the mobile interface before being asked to accept terms and conditions" and that "price information is conveyed only after the consumer enters into a binding loan agreement or has already completed a payment transaction."[330] As shown below, the CAK's findings are aligned with those of the Inquiry.

### 6.2.1 Digital savings

In its customer observation exercise, with the assistance of local consumer research firm Busara, the Inquiry reviewed the customer journey for making deposits, including by taking screenshots of the four digital savings platforms (see Annex 1 (Customer journeys))[331]:

- M-Shwari,
- KCB M-Pesa,
- Equitel, and
- MCo-op Cash

None of these four digital savings service providers provided any disclosure within the STK or USSD applications on fees or charges associated with the savings account. Rather, these screenshots only include the mechanical steps for selecting an account and making a deposit.

We understand that in the case of Equitel and MCo-op Cash, additional disclosure may take place at the branch when the customer asks for access to the digital product.[332] These disclosures would in any event be effectively unavailable to a customer making a savings deposit via USSD.

In the case of M-Shwari and KCB M-Pesa, before opening a savings account (or applying for a loan), a customer must first "activate" these services through the M-Pesa STK menu, as set out in Figure 21. Neither produces acceptable disclosure of terms and conditions:

- The English-language link provided in the case of M-Shwari is to a web page that has a link to a second web page named "Terms and Conditions" which has a further link to a 10-page, web-based pdf document containing terms and conditions for savings and loan accounts.
- The English-language link provided in the case of KCB M-Pesa is directly to a 16-page web-based pdf document containing terms and conditions for savings and loan accounts.

[330] Competition Authority of Kenya, *Digital Financial Services (DFS) in Kenya*.

[331] Inquiry's Consumer Research Phase I Report, Annex 5.

[332] Email from Busara, 1 June 2017.

These documents are not accessible via STK, the channel used by these two providers to operate their platforms, and we have therefore not included them in the description of the customer journey.

**Figure 21: Activation procedures for M-Shwari and KCB M-Pesa**

M-Shwari
- Go to the Safaricom menu Select "M-PESA" Select "Activate or Wezesha"
- The new M-PESA menu with Loans and Savings menu will be sent to your line.
- Then select M-Shwari
- A message will appear requesting you to read and accept the Terms & Conditions (English: Visit www.cbagroup.com/m-shwari www.safaricom.co.ke and Swahili: Tembelea www.cbagroup.com/m-shwari www.safaricom.co.ke)
- After accepting the terms; an SMS will be sent informing you that you are now activated on the M-Shwari service

KCB-MPESA
- Go to the Safaricom menu Select "M-PESA" Select "Activate or Wezesha";
- The new M-PESA menu with Loans and Savings menu will be sent to your line;
- Then select the KCB M-PESA menu;
- A message will appear requesting you to read and accept the Terms & Conditions (English: Visit http://www.safaricom.co.ke/KCB-MPESA-Account/Terms_and_Conditions.pdf and Swahili: Tembelea http://www.safaricom.co.ke/KCB-MPESAAccount/Terms_and_Conditions.pdf)
- After accepting the terms; an SMS will be sent informing you that you are now activated on the KCB M-PESA service.

*Source: Submission of Safaricom, 2 February 2017*

As a result, the four digital-savings journeys mapped by the Inquiry appear to be devoid of any disclosure of the terms and conditions of the savings accounts within the USSD- and STK-based platforms. This includes disclosure of interest rates or minimum balances required to accrue interest. Customers are required to obtain such disclosures at a branch or via the Internet, the latter being a feature only available via smartphone. This lack of disclosure within the platform is thus a barrier for customers to compare the terms of competing savings products.

Section 2.2 set out the regulatory disclosure requirements under the Prudential Guidelines and the Competition Act. These include bringing charges and fees to the attention of the consumer before they are imposed or the service is provided.[333] To the extent any fees or charges apply to these accounts, the failure to disclose these appears to be in non-compliance with sections

[333] The Competition Act contains disclosure requirements applicable to digital savings and loan products. Section 56(3) of the Competition Act states: "*A person shall not, in the provision of banking, micro-finance and insurance and other services, impose unilateral charges and fees, by whatever name called or described, if the charges and the fees in question had not been brought to the attention of the consumer prior to their imposition or prior to the provision of the service.*" This provision applies to the digital savings providers examined in the customer observation exercise (all of which were banks), and the digital credit providers that are banks as well. However, three of the digital credit providers examined in this exercise, Branch, Tala and Okoa Stima are non-banks. They may fall into the category of "micro-finance" or "other services," though this is unclear.

However, section 56(4) of the Competition Act is applicable to all of these services as it states: "*A consumer shall be entitled to be informed by a service provider of all charges and fees, by whatever name called or described, intended to be imposed for the provision of a service.*" The CBK's Guideline on Consumer Protection apply only to the digital products provided by banks. Section 3.2.3(b)(i) of the Guideline requires that once a customer has made such a choice but "*before the customer buys* the product or service" (emphasis added), a bank must "provide the consumer with general information or a summary of the main features of the product or service including the interest rate, charges, fees or other financial obligation relating to the product or service."

56(3) and 56(4) of the Competition Act and section 3.2.3(b)(i) of the Guideline. The Inquiry recommends that the CBK and the CAK both pursue appropriate investigative and compliance efforts in this regard.

### 6.2.2 Digital loan products

Two key features of digital loan products are the convenience and speed with which a customer can apply for and receive disbursement of loan funds. The Inquiry's qualitative interviews show that these features are valued by customers and they often use these loans for immediate and urgent demands. However, the speed of this process makes it difficult for customers to evaluate and compare products in a deliberative manner. This can be further complicated by a lack of transparency of loan costs and features.

***Disclosure of loan pricing and features***

This Inquiry found that that digital credit applications that were native to the MNO's platform (KCB M-Pesa, M-Shwari, Okoa Stima) provided minimal information and instructions on the platform's nature and use.[334]

As discussed above with respect to digital savings, M-Shwari and KCB M-Pesa provide an Internet link to customers upon activation of the STK menu that allows access to these services. This appears not to satisfy the requirements of section 56(4) of the Competition Act or section 3.2.3(b)(i) of the Prudential Guideline on Consumer Protection. This has been aggravated in some cases by advertising, which for example discloses an apparently attractive interest rate that is actually a monthly rate.

Digital credit services that were linked to traditional bank accounts, such as Equitel and MCo-op Cash, required a visit to the branch to link the mobile platform, creating additional opportunity for explanations.[335] Non-bank digital credit services, such as Branch and Tala, required more extensive information gathering from the customer to assess credit worthiness potentially affording the customer additional opportunities to understand what information was being collected and used for credit evaluation.[336]

The two traditional bank services that the Inquiry examined, Equitel and MCo-op Cash, provided customers with loan options that were not explained. Rather, the service left the burden on the customer to understand the nature of these services. MCo-op Cash offered "Flexi Salary Advance," Business Loan" "Secured Personal Loan" and "3 Months Flexi" with no explanation of the nature or costs of these options. [337] Equitel offered the branded products "Eazzy Loan" and "Eazzyplus loan" with no information on the meaning of these brands or what they represented terms of product features.[338] The opaque nature of these products may serve as a barrier to comparisons across providers.

The screen shots used and customer journey maps assembled as part of the Inquiry's customer observation exercise indicate that, of the seven providers examined in the customer observation exercise, only two (Branch and Tala) disclosed loan pricing information prior to execution of the loan.[339] The remaining five services only made these disclosures after the loan was executed

[334] Inquiry's Consumer Research Phase I Report, p. 65.

[335] Inquiry's Consumer Research Phase I Report, p. 65.

[336] Inquiry's Consumer Research Phase I Report, p. 65.

[337] Inquiry's Consumer Research Phase I Report, p. 65, Annex 5.1.4.

[338] Inquiry's Consumer Research Phase I Report, p. 65, Annex 5.1.2.

[339] Inquiry's Consumer Research Phase I Report, Annexes 5 and 6.

in confirmation to the customer. Table 6 sets out the disclosures made by each provider in Step 5 of the customer journey, i.e., before execution of the loan. The customer journeys and their various steps are set out in Annex 1 (Customer journeys).

**Table 6: Loan pricing disclosures**

| Lender | Bank/ Non-Bank | Loan Pricing Disclosures |
|---|---|---|
| KCB M-Pesa | Bank | In Step 5, KCB M-Pesa confirms the requested loan amount and period of the loan. Deduction of a 4.692% "facility fee" from the disbursed loan amount is not disclosed until the customer received a confirmation in Step 7. |
| M-Shwari | Bank | In Step 5, M-Shwari confirms the requested loan amount but did not disclose the total loan amount (which includes an additional 7.5% added onto the balance) until the customer received a confirmation in Step 7. |
| MCo-op Cash | Bank | MCo-op Cash omits Step 5 and does not confirm any information about the loan, omitting Step 5 entirely. The customer receives a confirmation in Step 7 that verifies only the loan amount and due date, without disclosure of any fees, charges or interest rate.[340] |
| Equitel | Bank | In Step 5, Equitel confirms the loan amount requested. Rather than making additional disclosures on interest rates or loan repayment periods, Equitel provides a link to terms and conditions and asks the customer to confirm that he or she has "read, understood and accepted" these. |
| Branch International | Non-Bank | In Step 5, Branch sets out the loan pricing. This includes, the loan amount, the amount of weekly payments, disclosure of the interest amount, and disclosure of the total payments to be made by the borrower (principal plus interest).[341] |
| Tala | Non-Bank | In Step 5, Tala sets out the loan pricing. This included options for different payment schedules. Each discloses the "fee" in percentage terms, the dates that payments are due and the amounts due at each date, and disclosure of the total payments to be made by the borrower (principal plus interest). |
| Okoa Stima | Non-Bank | In Step 5, Okoa Stima confirms he amount of the loan requested. However, it does not disclose the "service fee" of 10% until Step 7. The service fee is deducted from the loan amount resulting in a smaller amount that is disbursed. |

*Source: Derived from Inquiry's Consumer Research Phase I Report, Annex 5, Annex 6*

As with savings accounts, additional disclosures may be made by Equitel and MCo-op Cash at the branch when the customer asks for access to the digital product.[342] These disclosures were unavailable to a customer applying to a loan through a USSD platform. Also, M-Shwari and KCB M-Pesa provide links to web-based pdf documents containing terms and conditions prior to activation of these services (see Figure 21 in Section 6.2.1). These disclosures are also unavailable to a customer applying to a loan through an STK platform. No such disclosures, within or beyond the STK platform, appear to be made for loans through Okoa Stima.[343]

[340] As discussed below and shown in Figure 24, according to the screenshots submitted by MCo-OP Cash in March 2017, a new Step 5 screen has been added subsequent to the date the screenshots were captured for the customer observation exercise in December 2016 in which interest charges are disclosed prior to customer acceptance of the loan.

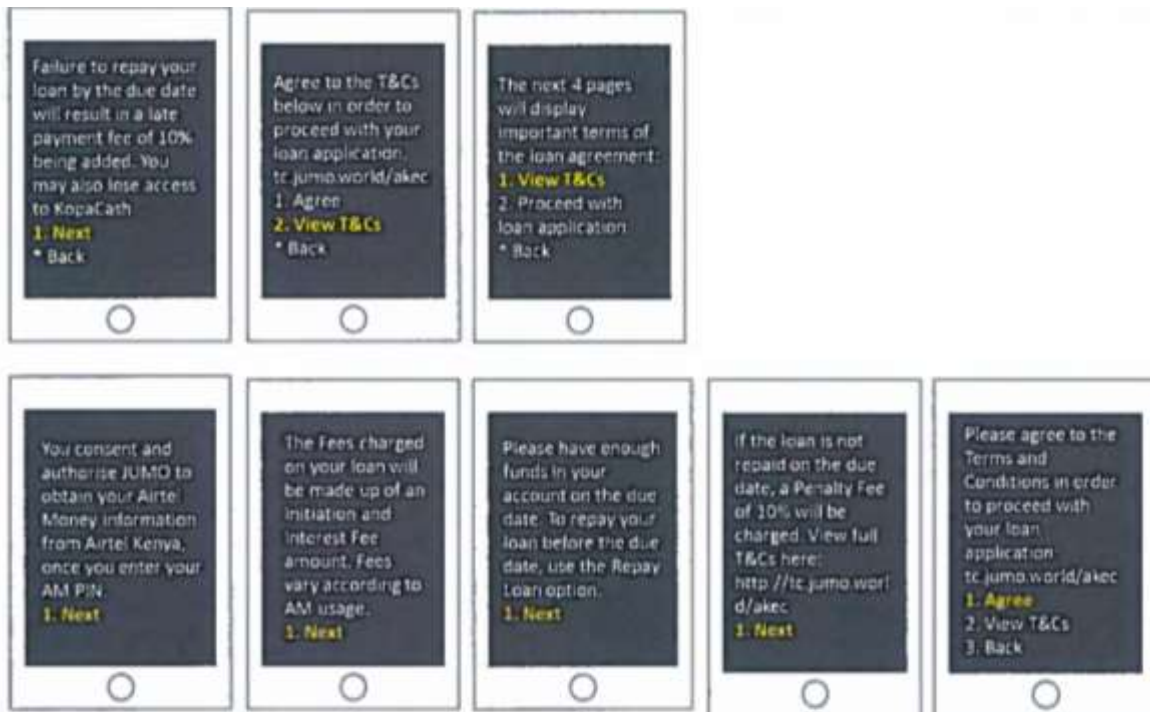
[341] The Inquiry has seen evidence that Branch has modified disclosure subsequent to the date the screenshots were captured for the customer observation exercise in December 2016 to include APR disclosure. However, this analysis is based on the screen shots collected as part of the customer observation exercise.

[342] Email from Busara, 1 June 2017.

[343] Submission of Safaricom, 2 February 2017.

STK and USSD platforms are constrained in communicating with consumers because of their screen size and volume of text they can communicate. However, this is not an insurmountable obstacle to disclosure of basic terms and conditions of loan accounts, as shown by Kopa Cash. Kopa Cash, a digital credit service offered by Jumo and linked to Airtel Money, operates over USSD. Kopa Cash was not one of the digital lenders examined in the customer observation exercise, but the disclosure approach it has taken is instructive. It requires customers to accept terms and conditions of before finalizing loans. As shown in Figure 22, Kopa Cash provides a basic summary of the terms and conditions that are readable on a USSD screen.

**Figure 22: Kopa Cash disclosure of terms and conditions**




*Source: Submission of Jumo, 26 January 2017*

The Inquiry's customer observation exercise showed that Equitel provided a link to its Terms & Conditions for Eazzy Loans prior to execution and asked that customers confirm that they have "read, understood and accepted." Such a link is accessible on a mobile phone that does not have internet browsing capabilities. When we visited this link, we found a two-page, text-heavy pdf document, that discloses interest and other charges. Page 1 of this document is included as Figure 23. Based on the CAK's interpretation of section 56(4), providing this link inside the USSD menu would not satisfy the requirements of Section 56(4) of the Competition Act. The Inquiry does not believe it reasonably satisfies the requirements of the section 3.2.3(b)(i) of the Guideline either.

**Figure 23: Eazzy Loan Terms & Conditions (Page 1 of 2)**

## EAZZY LOAN (One Month Loan)
## TERMS & CONDITIONS

1. **DEFINITIONS**

In these conditions;

1.1 "Account holder" means the person liable to the Bank for the settlement of the Eazzy Loan, interests and such other costs and expenses as are agreed to by the Parties hereto.

1.2 "Conditions" mean these terms and/or any other conditions that regulate or relate from time to time to the availing of Eazzy Loan by the Bank.

1.3 "Due Date" means one (1) month from the date of disbursement of the Eazzy Loan.

1.4 "Eazzy Loan" refers to the term loan given to the customer through the mobile phone or such other mode as shall from time to time be made available by the Bank and in such amounts as shall be determined by the Bank in its absolute discretion after an Account holder makes a formal application.

1.5 "The Bank" means Equity Bank (Kenya) Limited of P.O. Box 75104 - 00200 Nairobi which expression shall where the context so admits include its successors in title and assigns.

1.6 "Operative Account" means the account maintained by the Account holder with the Bank in connection with the Eazzy loan transactions.

1.7 The Bank and the Customer shall together be referred to as the "Parties" and where the context requires individually as a "Party".

1.8 The masculine gender includes the feminine and vice versa.

2. **CONDITIONS CONSTITUTING AGREEMENT**

2.1 These Conditions as varied from time to time constitute the Agreement between the Account holder and the Bank with regard to Eazzy Loan. These Conditions apply in addition to the General Terms and Conditions of operating an account with the Bank.

2.2 The Account holder by completing an Eazzy Loan application online shall be deemed to have read, understood and agreed to be bound by these Conditions upon acknowledging their receipt as availed in the Eazzy Loan application process.

2.3 The Account holder further confirms that he has considered the charges and interest levied by the Bank as specified in Condition 3 below and fully understands that failure to settle the Eazzy Loan on the due date shall result in the same being rolled over as a fresh Eazzy loan on the same terms as those on which the rolled over Eazzy Loan was availed. Such rollover shall persist until the total amount due under the Eazzy Loan and subsequent roll overs are fully settled.

3. **CHARGES & INTEREST**

3.1. The following charges shall apply and may from time to time be subject to change without notice within the full extent permitted or demanded by law:

| EAZZY LOAN Charge Description | | Charges |
|---|---|---|
| 3.1.1 | Interest Rate on loan amount | The Interest rate chargeable shall be as set out in the Banking Act comprising the Central Bank Rate ("CBR") plus a margin of 4%. The CBR currently being 10% per annum, the effective interest rate is thus 14% per annum. This rate is subject to change as stipulated by law. |
| 3.1.2 | Loan appraisal fee on fresh application | Maximum of 5% of the Loan amount recoverable upfront |
| 3.1.3 | Loan appraisal fee on loan rolled over | Maximum of 5% of the amount outstanding at the point of roll over. |
| 3.1.4 | Excise Duty as imposed under the Excise Duty Act. | 10% on the Loan Appraisal Fee recoverable upfront. |

4. **EAZZY LOAN REPAYMENT**

4.1 The Eazzy Loan is repayable on the Due Date.

4.2 Should the Eazzy Loan not be paid on the Due Date, the Bank shall, though not obligated, demand from the Account holder all monies, which may then or thereafter be due and owing under these Eazzy loan Conditions, including but not limited to:

4.2.1 All loan appraisal fees due, loan appraisal fees on loan rolled over Eazzy Loan, interest due on Eazzy Loan and rolled over loan and principal Eazzy Loan due;

4.2.2 All legal and other costs, charges and expenses which the Bank may pay or incur in connection with these Eazzy Loan Conditions or the recovery of any monies owing hereunder;

4.2.3 A fee to compensate the Bank for a reasonable estimate of any loss incurred by the Bank as a result of default to the full extent permitted by law; and

4.2.4 All monies due and computed from the due date until the settlement in full.

5. **INDEMNITY AND RECOVERY OF COSTS**

5.1. The Account holder undertakes to indemnify and keep the Bank indemnified at all times against all actions, claims, demands, liabilities, losses, damages, costs, charges and expenses of whatever nature inclusive of any legal costs and disbursements incurred by the Bank in obtaining payment of any monies due and owing to the Bank from the Account holder. The indemnity shall remain valid, subsisting and binding upon the Account holder notwithstanding withdrawal & termination of the contract.

5.2. Any legal costs and disbursements incurred by the Banks against the Account holder shall be deemed to include every sum which would be allowed to the Advocates of the Bank in taxation between the Advocate and clients to the intent that the Account holder shall afford to the Bank a complete entitlement and unqualified indemnity in respect thereof.

6. **VARIATION**

6.1. The Bank reserves the right to vary, amend or replace all or any of these Conditions at any time without prior notice. The Bank shall notify the Account holder of any changes made to these Conditions as soon as is practicable and by the most expedient means as determined by the Bank provided that failure to make such notification shall not invalidate the changes.

7. **BREACH OF CONDITIONS**

7.1 In the event of any breach by the Account holder of any of these Conditions the Bank may in circumstances where the Account holder fails to comply or procure compliance with the terms of a notice served by the Bank on the Account holder, require immediate repayment in full of the outstanding balance on the operative Account.

8. **EAZZY LOAN SUSPENSION**

8.1 The Bank may at any time and without notice cancel or suspend the right to utilize Eazzy Loan entirely or entirely withdraw Eazzy Loan as a product without affecting the Account holder's obligations under these Eazzy Loan Conditions.

9. **RIGHT OF SET OFF**

Upon the occurrence and during the continuance of default by the Account holder, the Bank is hereby authorized at any time and from time to time, without notice to Borrower and to the fullest extent permitted by law, to set-off and apply any and all deposits held in the Account holders other related accounts held with the Bank.

10. **TERMINATION**

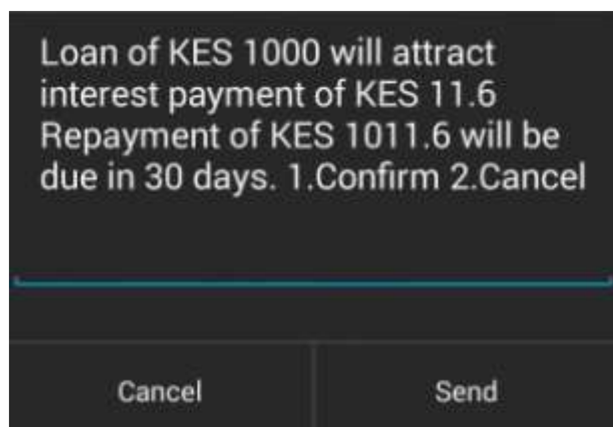
10.1. Either Party may terminate their obligations under these Conditions at any time on written notice to the other Party. On termination by the Account holder the termination notice should be accompanied

EAZZY LOAN Page 1

*Source: www.equitel.com/eazzy-loan.pdf*

MCo-op cash provided the least disclosure of pricing. The USSD interface did not disclose at any point the fees or interest, and the confirmation screen only included information on loan amounts and payment deadline. This does not satisfy the requirements of Section 56(4) of the Competition Act or section 3.2.3(b)(i) of the Guideline either. However, in its submission, Co-operative Bank supplied screenshots of a customer journey that differed from what was collected for the customer observation exercise in December 2016. These changes appear to be the result of the ongoing actions taken by the CAK. As shown in Figure 24, MCo-op Cash has added a new screen to Step 5 of the customer journey in which it discloses the interest payment prior to the customer approving the loan. However, our analysis in this report is based on the screenshots actually collected.

**Figure 24: MCo-op Cash new Step 5 screen**




*Source: Submission of Co-operative Bank, 2 March 2017*

The Inquiry has not found any display of the charges associated with a loan from Okoa Stima until the customer receives an SMS confirmation after committing to take the loan. Thus, it also appears not to satisfy section 56(4) of the Competition Act and section 3.2.3(b)(i) of the Guideline (if it were applicable).

**Table 7: Summary of digital loan disclosure compliance**

| | Banks | | | | Non-Banks | | |
|---|---|---|---|---|---|---|---|
| | **KCB M-Pesa** | **M-Shwari** | **MCo-op Cash** | **Equitel** | **Branch Int'l** | **Tala** | **Okoa Stima** |
| ***Competition Act*** | | | | | | | |
| **§56(3)** | No | No | No | No | Yes | Yes | No |
| **§56(4)** | No | No | No | No | Yes | Yes | No |
| ***Prudential Guidelines*** | | | | | | | |
| **Rates, fees, charges** | No | No | No | No | Yes | Yes | No |
| **TCC** | No | No | No | No | Yes | No[344] | No |
| ***Kenya Bankers Association*** | | | | | | | |
| **APR** | No | No | No | No | No | No | No |

*Source: Derived from Inquiry's Consumer Research Phase I Report, Annex 5, Annex 6*

### *Total cost of credit disclosure*

Section 3.4.5(i)(h) of the Guideline requires that banks disclose total cost of credit (TCC) for all interest-bearing loans prior to the customer entering into a loan agreement. TCC is defined in 3.4.5(ii) as "the total amount payable for credit, including all fees and other charges from the lender, after deducting the original loan amount."

Of the 7 digital credit providers examined in the customer observation exercise, only Branch disclosed TCC in compliance with this requirement, as it separately sets out, prior to the

[344] Tala does disclose (1) the principal amount of the loan and (2) the total amount the borrower will repay but does not separately break out the total of all charges added to principal, which is technically required in TCC disclosure.

customer executing the loan, the principal, interest and the combined total payments the customer will need to make to repay the loan.

Tala sets out, prior to the customer executing the loan, the principal, interest rate and the and the combined total payments the customer will need to make to repay the loan. However, it does not include a separate disclosure of the actual interest charges the customer will pay and therefore fails to meet the technical requirements of the Guideline. Neither Branch nor Tala are subject to compliance with the Guideline. None of the four bank providers disclosed TCC prior to the customer executing the loan, though some of them did break down principal versus interest or fees in the confirmation sent to the customer after the loan was executed.

***Kenya Bankers Association's APR disclosure***

As discussed in Section 2.2.4, the KBA developed a pricing mechanism framework to provide loan applicants with an "Annual Percentage Rate" (APR) that can be compared across banks. As of July 2014, all commercial banks in Kenya were bound to disclose APR for loans as part of its required disclosure of total cost of credit. [345] The non-bank digital credit providers are not bound to provide this disclosure as they are not members of the KBA. As indicated in Table 7, none of the digital credit providers examined in the customer observation exercise provided disclosure of APR on their platform. However, more recent disclosure screenshots for Branch provided by the CAK to this Inquiry as part of the ongoing audit and investigation into disclosure of digital financial services does show an additional screen including APR. We do not know if or when this new addition was implemented and have not taken it into account in Table 7.

### 6.2.3 Poor disclosure practices as a barrier to shopping around, choice and switching

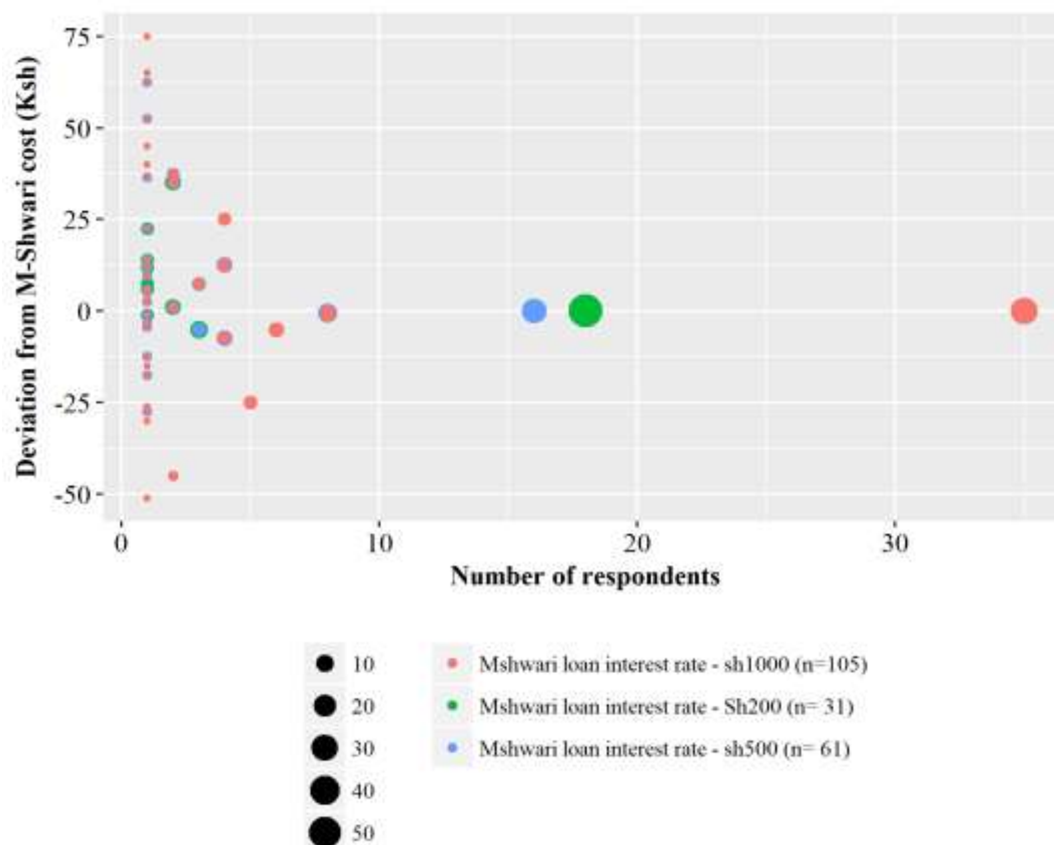
The lack of disclosure of costs by other providers prior to execution of a transaction is a barrier to the ability of customers to compare the rates between services. This is all the more so when recalling how consumers get their information and engage with pricing information (see Section 4) and in particular the relatively low level of consumer financial literacy in Kenya (see Section 4.1.2).

[CONFIDENTIAL] suggests, for example with M-Shwari loans (the largest provider of digital credit in Kenya, as discussed above in section 6.1), that many consumers do not know what they are paying for the loan.

Consumers reported their loan charges in Kenyan shillings, and these were compared to the actual loan charge applied by M-Shwari (reported below in Figure 25; in the Figure, bubble size indicates proportion of respondents that reported the deviation). While many consumers (58%) correctly reported the loan charge for small loans of Ksh 200, a substantially lower proportion of people reported the correct charge for loan sizes of Ksh 500 (26%) and Ksh 1,000 (33%).

[345] http://www.kba.co.ke/research-center/research-note/285-banks-adopt-annual-percentage-rate-calculation-method-for-consumer-loans

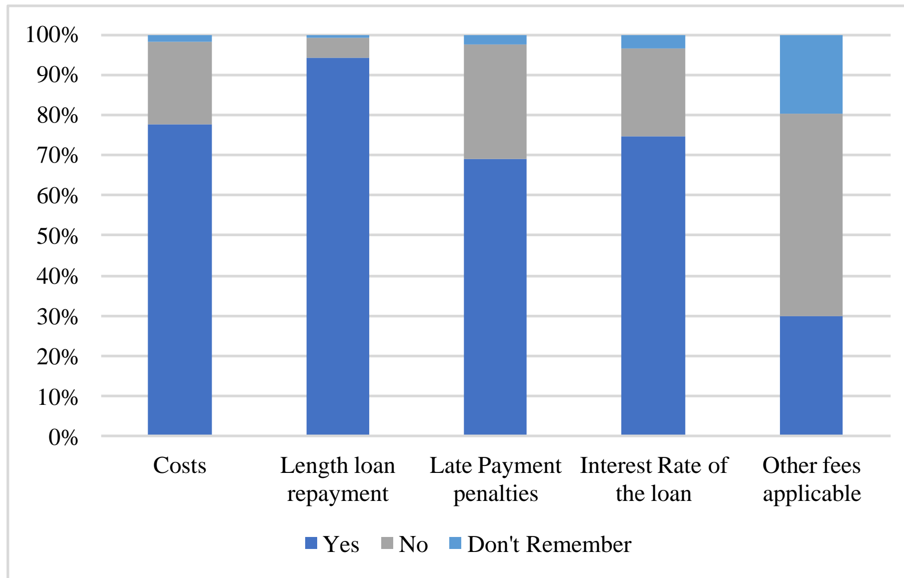
**Figure 25: M-Shwari loan charges reported by consumers**




*Source: The Inquiry's analysis of [CONFIDENTIAL]*

Despite their lack of price awareness in respect of digital credit, consumers largely report having received information on costs and the interest rate of the loan (see Figure 26). Between 70% and 80% of consumers report having received this information. Not only do they report receiving information, consumers report having read the information (93%) and having understood it very well (75%) or somewhat well (22%). In addition to this, 74% of respondents found that the information received was very helpful and a further 23% reported that the information was somewhat helpful. Thus consumers believe they are informed yet the evidence suggests they are not, which may only increase the lack of ability to make well informed decisions.

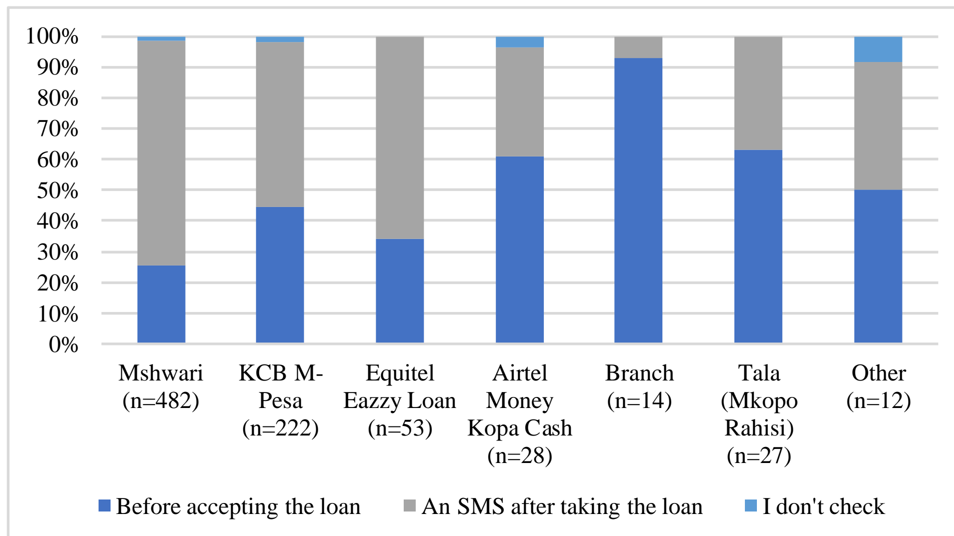
**Figure 26: If respondents received information on loans (n=595)**




*Source: The Inquiry's analysis of [CONFIDENTIAL]*

Even if consumers do receive information on interest rates, terms and loan penalties and understand the information, the timing with which they receive this information may result in poor choices (see Figure 27). Only a relatively small proportion of consumers using the large digital credit providers (M-Shwari, KCB M-Pesa and Equitel) report learning the cost of the loan prior to accepting it (see Figure 27). This means that a substantial proportion of consumers are not shopping around for the best available deal prior to taking out a digital loan.

**Figure 27: Point at which respondents learned cost of the loan**

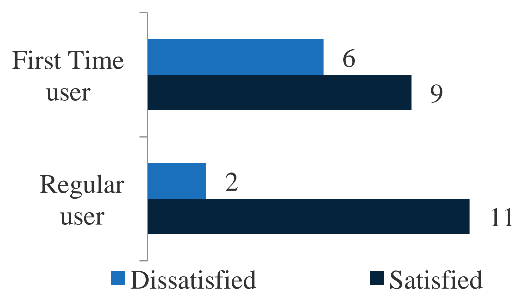



*Source: The Inquiry's analysis of [CONFIDENTIAL]*

These problems are borne out by customer dissatisfaction with the information provided to first time users. For instance, the Inquiry's customer observation exercise found that first time users of digital loan services were more likely than not to be dissatisfied with the amount of information provided by the service. Thus, at the time when they might shop around for a service, they are inadequately informed of terms necessary to do so.

By contrast, participants who had used these services in the past were generally satisfied, presumably because they were familiar with the pricing of the loan through prior use (see Figure 28).[346] However, satisfaction and familiarity with the terms gathered through use results in consumers understanding them only after they have become accustomed to them, but after they have made their choice of service.

**Figure 28: Customers satisfaction with level of information provided by digital loan providers**




*Source: Inquiry's Consumer Research Phase I Report, p.66*

In summary, consumers generally are not aware of the prices that are charged for digital credit, despite reporting that they receive and understand information on these charges. In addition to this, consumers are not receiving information at a time when the information might inform their choices, i.e., before taking up the product. This means that they are in a far weaker position to shop around for the best deal than if they received this information. This weakens the prospects for price-based competition in such services.

The CAK has been working with loan providers to bring their disclosures into compliance with section 56(4) of the Competition Act. This includes requiring that disclosure of charges and fees must be made on STK, USSD and app channels. [347] We understand from the CAK that, in general, digital loan providers and other digital financial service providers have been cooperating with the CAK to bring their disclosures into compliance. The implementation of these changes by these providers is ongoing and will continue after the conclusion of this Inquiry and its success is vital to improvements in disclosure practices. The Inquiry recommends also that the CBK examine disclosure practices for compliance with the Prudential Guideline on Consumer Protection.

## 6.3 Disclosures in mobile money

### 6.3.1 Disclosure practices and price awareness

The mobile money market is overwhelmingly dominated by Safaricom's M-Pesa service. This is despite the other mobile operators in Kenya providing their own mobile money services (including Airtel Money and, until recently closed down, Orange Money) and despite other financial services providers offering mobile money services, such as Equitel's My Money service and Mobikash's offering.

Mobile money providers in Kenya have typically not disclosed their charges in a user-friendly way. For example, in order for an M-Pesa customer to know how much a payment for goods and services will cost, the consumer must dial *234# and follow the prompts. Just as with

[346] Inquiry's Consumer Research Phase I Report, p. 66.

[347] Competition Authority of Kenya, *Digital Financial Services (DFS) in Kenya*.

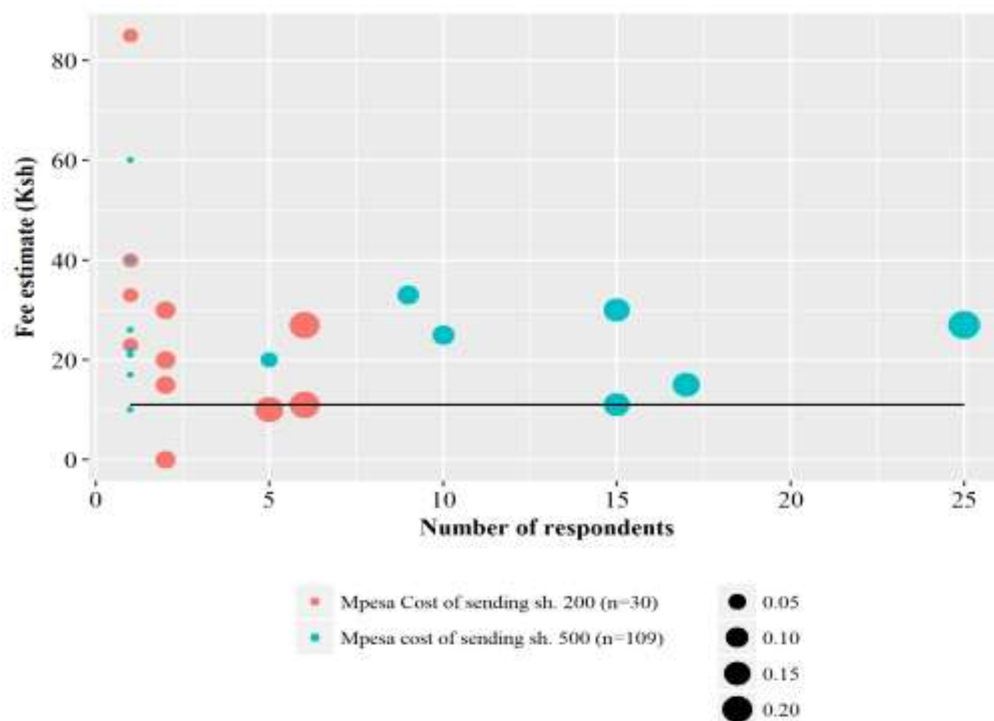
mobile savings and loans, while charges for transfers are disclosed on Safaricom and Airtel's website for their mobile money services, accessing a website and searching for the charges from a smartphone, even where the consumers have a smartphone (and many do not), is not user-friendly.

The impact of this on price awareness is significant. As discussed above, the [CONFIDENTIAL] studied 825 consumers in order to understand price awareness for various mobile money services. We draw on and analyse further its findings below in examining the disclosures of mobile money.

While the cost of sending Ksh 200 and Ksh 500 is Ksh 11 on the M-Pesa platform, M-Pesa users typically estimate significantly higher charges of between Ksh 15 and Ksh 40 (Figure 29; bubble size indicates the proportion of consumers responding to the question that estimate the fee presented on the graph).

Overall, 60.5% of survey respondents indicated they only learn about the fees for sending money after the transaction. Only 33.6% indicated that they learn about the fees before the transaction.

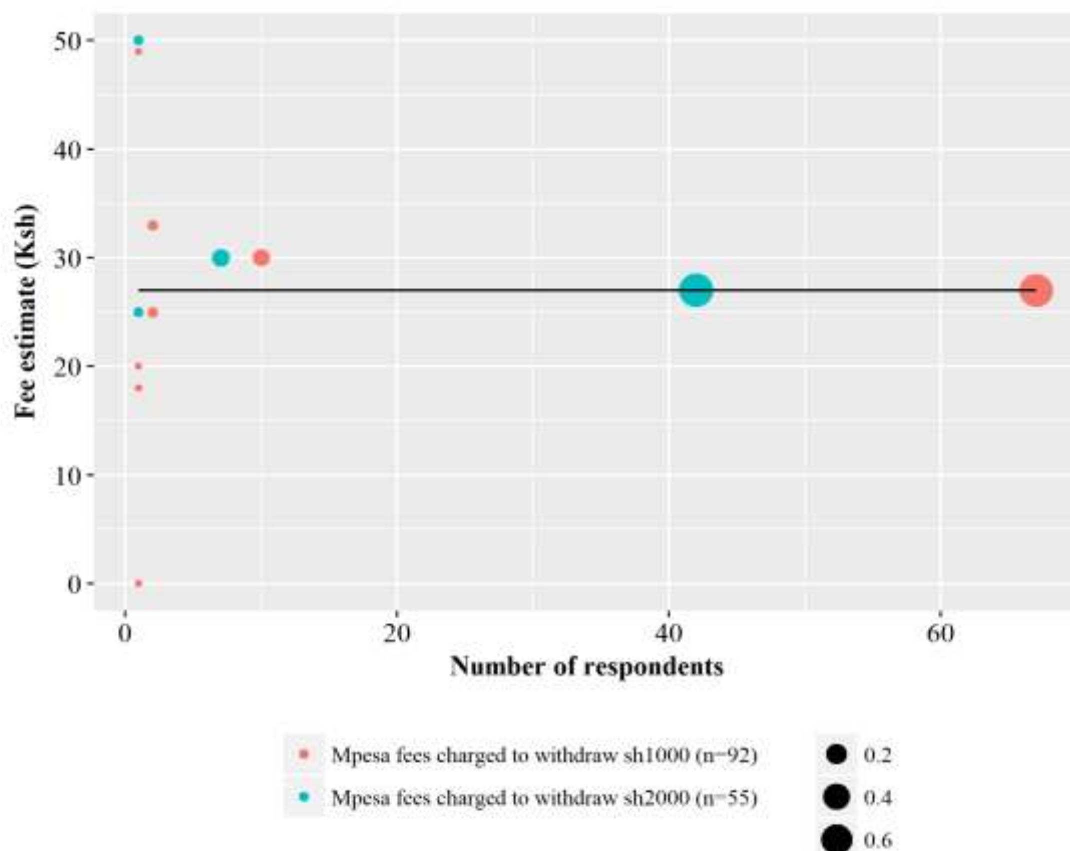
**Figure 29: M-Pesa send money fee awareness**




*Source: The Inquiry's analysis of [CONFIDENTIAL]*

A substantially greater proportion of users are aware of the correct charge for a withdrawal of Ksh 1,000 and Ksh 2,000, which is Ksh 27 on the M-Pesa platform (Figure 30). At the same time, a significant proportion (approximately 25%) either did not know or guessed the amount incorrectly.

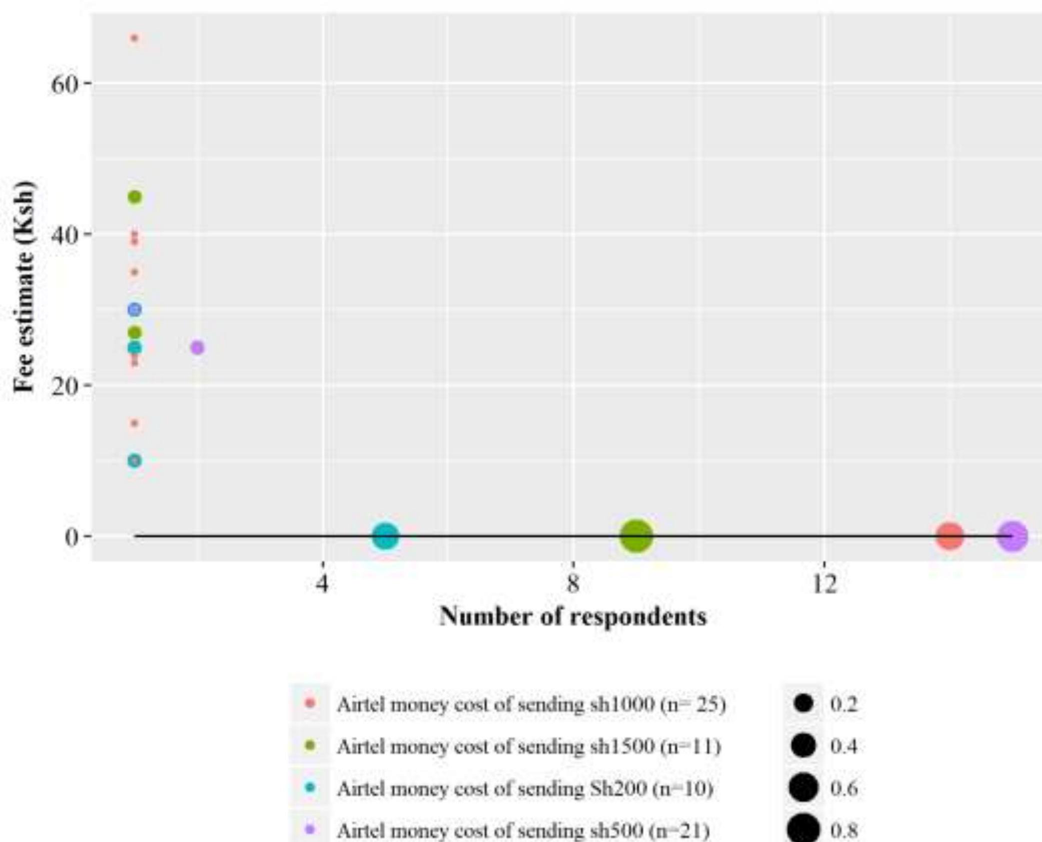
**Figure 30: M-Pesa withdrawal responses**




*Source: The Inquiry's analysis of [CONFIDENTIAL]*

Airtel does not charge users for sending money across its mobile money platform. While a substantial proportion of consumers do not seem to be aware of this and estimate higher fees or say they don't know what the fee is (between 30% and 50% of respondents answering this question), the bulk of consumers appear to be aware that sending money using Airtel Money is free (see Figure 31).

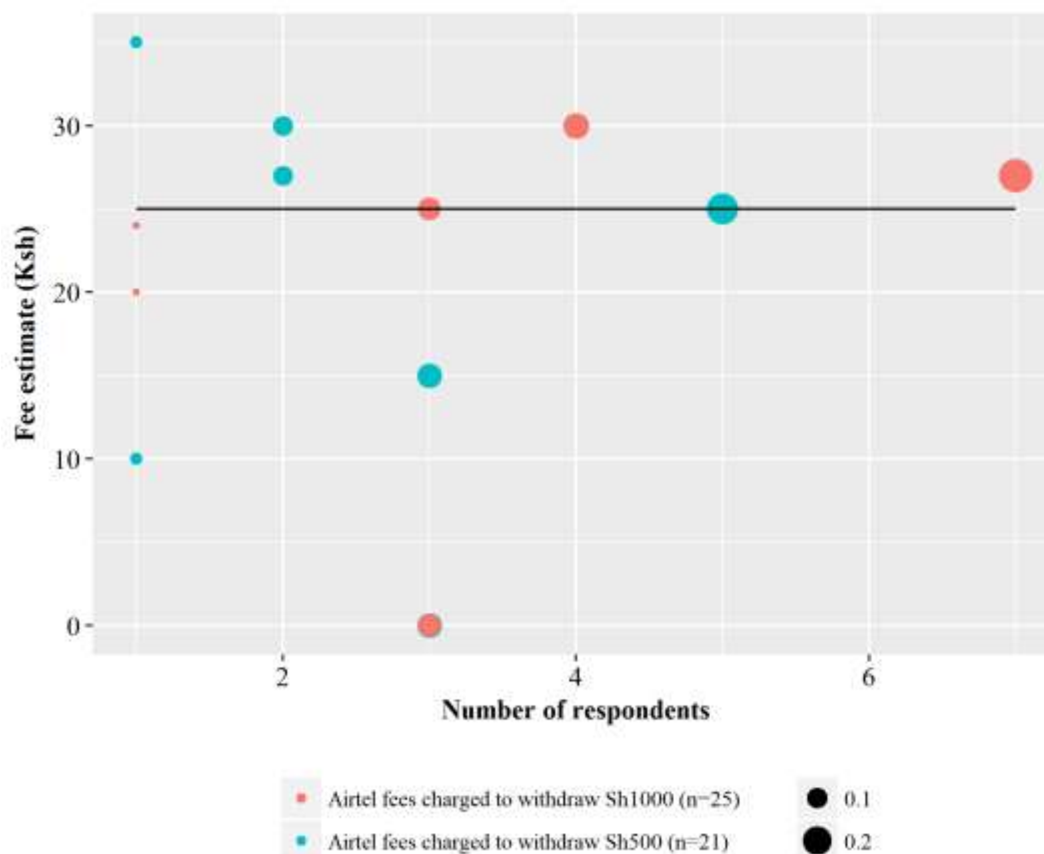
**Figure 31: Airtel send money responses**




*Source: The Inquiry's analysis of [CONFIDENTIAL]*

Similar to M-Pesa users, a significant proportion of Airtel Money users appear to be aware of the withdrawal charges they face of 25 Ksh for transaction values of Ksh 500 and Ksh 1000 (see Figure 32). However, while many consumers estimated fees close to the correct amount (in the region of Ksh 20 – Ksh 30), only between 12% and 25% reported precisely the correct amount.

**Figure 32: Airtel withdraw money responses**




*Source: The Inquiry's analysis of [CONFIDENTIAL]*

The Lipa na M-Pesa product offers consumers the ability to pay for goods and services using their cellphones. PayBill is a similar service, allowing consumers to pay for bills such as electricity and for subscription TV. Charges to consumers for the PayBill and Lipa na M-Pesa services vary, depending on the value of the transaction and the payment method selected by the merchant concerned.

However, a substantial proportion of survey respondents believe that, when using the pay for goods and services payment method, the fees are always the same (33.3%) or are zero (24%). Only 15% of survey respondents reported the correct response, that is being aware that fees sometimes or always differ. In the case of PayBill, only 30% of users reporting being aware of the charge before the transaction.

M-Pesa users are charged Ksh 1 for a balance check, while Airtel Money users are not charged. However, 34% of the 669 consumers who responded to the question said that they though that balance checks were free on M-Pesa. Only 55% reported the correct Ksh 1 charge. At the same time, 85% of the 101 respondents to the same question reported the correct (free) charge for Airtel Money.

In summary, consumers in general are not aware of the prices they pay for various kinds of mobile money transactions, including for money transfers, withdrawals, payments for goods & services, bills and balance enquiries. This means that consumers are not in a position to shop around based on price, which likely presents a barrier to switching between providers.

### 6.3.2 Lack of comparing and switching between mobile money providers

The lack of price-awareness among consumers where mobile money services is concerned feeds through to a lack of switching between mobile money providers. There are nonetheless several reasons for consumer inertia where choice of mobile money providers is concerned.

First, it is important to note that a significant number of consumers use a combination of two or more mobile money providers. This means that, rather than switching between mobile money providers, consumers use more than one mobile money provider. For example, 14% of the [CONFIDENTIAL] survey respondents said they use M-Pesa and Airtel Money, and a further 19% use both Equitel and M-Pesa (out of 458 respondents that answered the question on reasons for not switching). This compares to almost 60% of respondents who said they use M-Pesa exclusively.

The fact that consumers use more than one mobile money provider has similarities to the common practice of using more than one SIM card for mobile telephony in Kenya. While consumers may want to switch to another mobile provider, Safaricom is a 'must-have service.' This is primarily due to the access it provides to M-Pesa, and may also be due partly to Safaricom's market position in respect of mobile telephony, where it has a share of almost 70% of subscribers (and an even greater proportion of revenues) and practices of pricing calls to subscribers on the same network as opposed to other networks.[348] This means that a Safaricom subscription is necessary, even if subscribers want to primarily use another network, such as Airtel.[349]

In economic terms, this means that Safaricom benefits from 'network effects'. Evidence of this can be found in the [CONFIDENTIAL]. Even among Safaricom customers using the service as a secondary line, 40% used the service due to friends and family. This compares to secondary use among Airtel subscribers, for example, only 19% of who used the service due to friends and family.

Among exclusive and combination mobile money users, 93% of the full sample (825 respondents) said that they had not switched providers. Of the small proportion that did switch, 30% indicated that they did so to benefit from lower prices (this was the most important reason for switching). Therefore, if consumers were more aware of prices, more would make the switch. This is particularly so since most consumers appear to view switching as very easy (54%) or somewhat easy (23%).

Despite the ease of switching, consumers in Kenya rarely compare mobile money providers. A small proportion of survey respondents reported comparing mobile money providers very often (9%) or often (19%), while the majority reported never (39%) or rarely (33%) comparing providers. This is largely due to consumers being happy with their provider (33%), trust (15%), agent relationships (13%) and agent availability (11%) (see Figure 33).

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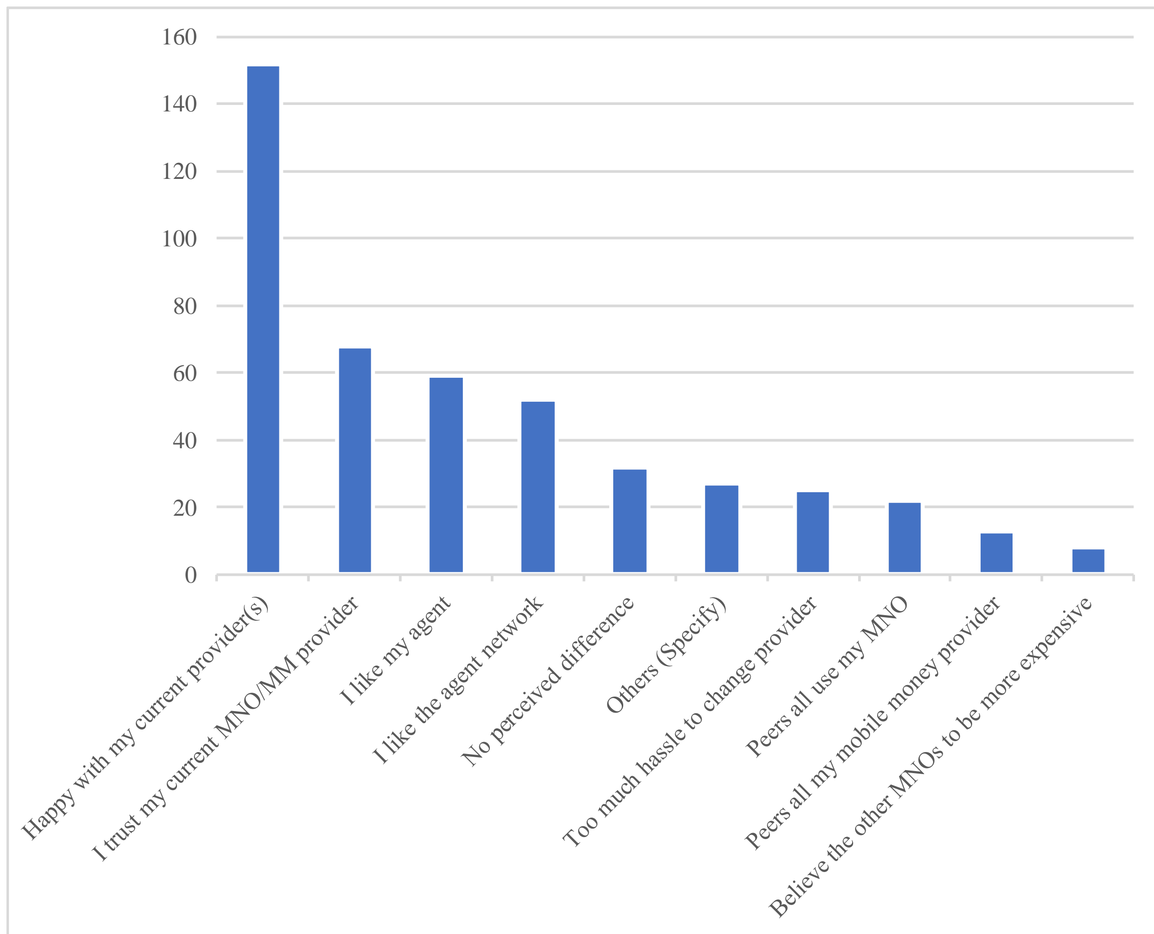
[348] [CONFIDENTIAL]

[349] [CONFIDENTIAL]

**Figure 33: Reasons for not considering alternative mobile money providers (n=458)**




*Source: The Inquiry's analysis of [CONFIDENTIAL]*

These reasons are echoed in what consumers report as playing an important role when deciding to stop using a mobile money service (105 consumers out of the sample of 825 did so, 13%). The main reasons for stopping using a service are the availability of agents (31%), network reliability (14%) and lack of trust (8%).

Therefore, consumers in Kenya are very reluctant to switch providers, and do not often compare mobile money providers. However, where they do switch, consumers do so at least in part to take advantage of lower prices. Greater transparency in pricing is therefore likely to facilitate greater switching, particularly since switching is perceived as being easy. At the same time, agent availability, network reliability and trust play important roles in consumer decision making on mobile money. While greater transparency has an important role to play, there are other factors that are likely drive customer inertia.

Just as with digital savings and loans, the CAK has been requiring mobile money providers to ensure that consumers are made aware of transaction charges before they undertake the transaction (see Section 2.2.2). [CONFIDENTIAL] and others, such as [CONFIDENTIAL], for example, have reported that they have already made the necessary changes. We understand that [CONFIDENTIAL] planned to make the changes by 15 June 2017.

The CAK's current activities in this area may have a significant impact on price awareness. Once implemented, we therefore do not suggest making any further changes in this area until the effects of these changes have been assessed by the CAK.

## 6.4 Customer transactional data

### 6.4.1 The role of transactional data in digital credit

One of the more innovative and transformative aspects of digital credit arises from the ability of lenders to leverage a variety of consumers' digital data without having to rely on formal credit histories. Digital credit providers typically use proprietary software algorithms to collect, sift through and apply appropriate weighting to this data in order to evaluate loan applications without any human review.

Providers rely on the output of these algorithms as a predictor of repayment that can be used to reliably evaluate loan applications and set appropriate credit limits. These algorithms, including which types of data are collected and how they are weighed, are often the "special sauce" of the digital credit provider and the details are closely guarded.

The nature and sources of the data that serve as inputs into these algorithms vary across credit products.

- For *mobile credit products provided by banks* that are linked or closely associated with existing traditional bank accounts, this data consists largely of prior banking transactions. Examples of these products include Equitel's Eazzy Loan and MCo-op Cash, both of which were examined in the Inquiry's customer observation exercise.
- For *Android app-based products provided by non-banks*, customers grant permission to allow the credit provider to access M-Pesa, SMS, call history, social media and other data on a user's smartphone. Examples of these products include Branch and Tala, both of which were also examined in the customer observation exercise.
- Finally, *products linked to mobile money accounts of MNOs* primarily use mobile money transactional data, as well as airtime and call activity. Examples of these products include M-Shwari and KCB M-Pesa, both of which are bank products that utilize M-Pesa and Safaricom data and were examined in the customer observation exercise, as well as Kopa Cash, a non-bank product which relies on Airtel Money data.

Due to the rapid rise and large scale of borrowing in the third of these, and because Safaricom's M-Pesa in particular is by far the most widely used mobile money service in Kenya, the Inquiry focused on the use of M-Pesa and other Safaricom data by digital credit providers and the ability of Safaricom subscriber to access this data. [350]

[350] This Inquiry's terms of reference include an assessment of current practices around customer control over their transactional data and the ability of customers to use their transactional data and to provide it to third parties. After discussions with the CAK, the focus of this Inquiry was focused on the practices around the provision of mobile money transaction data to digital credit providers and the ability of customers to access and utilize this data for their own purposes. Because Safaricom's M-Pesa is by far the most widely used mobile money service in Kenya, this Inquiry focused specifically on M-Pesa and other Safaricom transactional data.

### 6.4.2 Sharing of customer transactional data with digital credit partners

Safaricom collects information on its customers' usage of its services, including GSM services (including airtime purchases) and M-Pesa transactions.[351] It currently shares aggregated customer transactional data related to these services with three partners:

- KCB (in conjunction with KCB M-Pesa);
- CBA (in conjunction with M-Shwari); and
- M-KOPA Solar.[352]

According to Safaricom, of the information it shared with its lending partners, airtime purchases and M-Pesa activity were the most critical inputs to credit evaluation. [353]

In the case of KCB M-Pesa and M-Shwari, Safaricom's customers must "consent" to having their transactional data shared with these partners when they accept the terms and conditions prior to account activation for these two services (account activation procedures for KCB M-Pesa and M-Shwari are set out in Figure 21 in Section 6.2.1).[354] As discussed in Section 6.2 to activate an account for either service, customers are required to confirm via STK that they have read and accepted the Terms and Conditions of the respective service.

These Terms and Conditions are not actually delivered to customers, whether via STK or otherwise. Rather, customers are provided Internet links that would only be accessible to customers with smartphones. Safaricom estimates that approximately 55% of its subscribers use smartphones (although the Inquiry is not confident in this statistic as it may include SIM cards linked to tablets and other devices that constitute second lines).[355]

The M-Shwari link is to a web page that has a second link to another web page that contains a third link to a 10-page, web-based pdf document containing terms and conditions for savings and loan accounts.[356] The KCB M-Pesa link is directly to a 16-page web-based pdf document containing terms and conditions for savings and loan accounts.[357]

Section 4.3 (page 3 of 10) of the M-Shwari Terms and Conditions states:

> *[…] You also hereby agree and authorize the Bank to request Safaricom for information relating to your use of the M-PESA Service and M-PESA System as the Bank shall require for purposes of providing you the Services ("M-PESA Information"). You hereby consent to the disclosure of the […] M-PESA Information by Safaricom to the Bank and to the aforesaid use of the […] M-PESA Information by the Bank.*

Section 4.3 (page 4 of 16 (including 2 cover pages)) of the KCB M-Pesa Terms and Conditions has an almost identical consent.[358]

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[351] Submission of Safaricom, 2 February 2017.

[352] Submission of Safaricom, 2 February 2017.

[353] Submission of Safaricom, 2 February 2017.

[354] This Inquiry has focused on sharing of customer transactional data with digital lenders and has not examined sharing with other service providers, such as M-KOPA Solar.

[355] Meeting with Safaricom, 2 February 2017. This appears to be a large estimate of smartphone use, and its accuracy and relevance may depend on what is actually qualifies as a smartphone for these purposes.

[356] http://cbagroup.com/m-shwari/terms-and-conditions/

[357] www.safaricom.co.ke/KCB-MPESA-Account/Terms_and_Conditions.pdf

[358] It reads: "[…] You also hereby agree and authorize 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

Safaricom's sharing of transactional data with CBA and KCB, respectively, is carried out as part of the revenue sharing agreements that Safaricom has with each of these banks. Because Safaricom provides this data as part of the basis for receiving a portion of revenue from M-Shwari and KCB M-Pesa, we consider this data to have been "sold" by Safaricom to these banks.

As discussed in Section 2.3, this Inquiry has interpreted section 15(2) of The Kenya Information and Communications (Consumer Protection) Regulations, 2010 as requiring MNOs to provide conspicuous notice to customers that transactional data may be sold to third parties. The consents described above are not, in the view of the Inquiry, "conspicuous notice" of such sales provided to Safaricom customers. The Inquiry is not aware of any other notice given to customers that would be viewed as conspicuous.

As also discussed in Section 2.3, the Inquiry understands the privacy rights set out in section 3(1)(d) and section 15(3) of the same Consumer Protection Regulations to impose an affirmative obligation on telecommunications licensees to obtain prior customer consent before selling transactional data to, or sharing it with, third parties.

In addition, as discussed in Section 2.3, as a payment service provider in the provision of M-Pesa, Safaricom is subject to the National Payment System Regulations, 2014. Section 42(1) requires that information with respect to services be kept confidential and Section 42(2) provides limited circumstances where such disclosure is allowed. Because none of the other circumstances apply, written authorisation by the customer is required for disclosure to a third party such as CBA or KCB.

As described above, Safaricom considers the requirement that customers to "accept" the Terms and Conditions for M-Shwari and KCB M-Pesa as consent or authorisation to such information sharing. However, the Inquiry is sceptical that such acceptance reflects any meaningful consent or written authorisation or any "conspicuous notice." Customers are unlikely to be able to access these Terms and Conditions through their mobile device. In the case of M-Shwari, it requires navigation through two web pages before a link to a pdf is available. In addition, not all smartphones or computers have pdf readers installed.

Even if consumers are able to access this document, the use of a pdf document for viewing is particularly customer-unfriendly and visually difficult to follow. Furthermore, disclosure of transactional data sharing is buried in a long, legal disclosure document written in complex legalese. It is not remotely realistic to expect customers to navigate to this document, display it on the small screens of their mobile devices, and find and comprehend the provisions on data sharing. Accordingly, the current disclosure and consent process appears not to meet the requirements of the applicable telecom or payment service provider regulations.

A more effective means of providing "conspicuous notice" and obtaining customer consent would be, for example, to include a description of such sharing in plain English directly in the STK template. This disclosure could even be made in the same STK screen that links to the Terms and Conditions of these services as part of the activation process. A simple additional sentence would suffice, such as:

Services ("M-PESA Information"). You hereby consent to the disclosure of the […] M-PESA Information by Safaricom to the Bank and to the aforesaid use of the […] M-PESA Information by the Bank."

> By accepting these Terms and Conditions, you consent to Safaricom sharing information about your use of M-Pesa and your mobile phone with [KCB/CBA] for purposes of credit evaluation.

This addition would ensure meaningful compliance with the consent requirement.

### 6.4.3 Ability of customers to access and use MNO transactional data

Safaricom customers are not able to access or review the actual aggregated transactional data that is shared with CBA and KCB.[359] The data that Safaricom shares is aggregated into a database using predefined criteria.[360] The specific criteria, or "data sets," that Safaricom shares with these partners to facilitate their credit assessments are considered proprietary information.[361]

However, customers are able to access their M-Pesa transaction histories. These can be accessed in two ways. A customer can visit a retail centre and obtain a printout of M-Pesa transaction history for approximately Ksh 20 per printed page.[362] Also, a customer can also request 6 months of transaction statements via a short code through the STK menu.[363] Statements are delivered in PDF format to the customer's email address.[364] Safaricom announced this new service in January 2016, stating that "every month an average of 30,000 customers visit our Retail Centres specifically seeking to receive printed M-PESA statements, as a prerequisite to accessing credit from financial institutions or for business reconciliation purposes."[365]

In the qualitative interviews carried out by the Inquiry, several customers confirmed that they had been able to access their M-Pesa transaction histories and that they found the process easy. Some explained that they acquired the data in order to present it to a lender to show creditworthiness. We understand that this approach is not uncommon,[366] and the Inquiry has identified at least one digital lender, GetBucks, that includes customer acquisition of these transaction histories as part of the loan application process.

Overall, the Inquiry finds that customers are able to access their M-Pesa and Safaricom transaction data without unreasonable effort. For example, their ability to provide this information to third party lenders is not meaningfully more difficult than it is to share other similar data, such as bank statements.

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[359] Submission of Safaricom, 2 February 2017.

[360] Submission of CBA, 27 January 2017.

[361] Meeting with Safaricom, 2 February 2017.

[362] Meeting with Safaricom, 2 February 2017.

[363] Meeting with Safaricom, 2 February 2017.

[364] Safaricom website, FAQ, https://www.safaricom.co.ke/faqs/faq/271.

[365] Mazer R. & McKee, Kate. (2016). "Co-Ownership" of Mobile Money Data: Building a Kenyan credit bureau for the digital age," CIS Kenya Blogs, Ondieki's blog, available here.

[366] Meeting with CIS Kenya, 3 February 2017.

**Figure 34: GetBucks requires loan applicants to obtain and supply M-Pesa transaction summaries**

New customers

**What do I need to apply for a loan?**

GetBucks is an online lender and therefore you are required to register an account via our website (www.getbucks.com/ke), complete all necessary steps and website will determine how much bucks is available. We need you to provide us with the following details ID number, cellphone number, email address, employer info, address and banking details.

We require the following documents to process your loan:.

+ Copy of your national ID
+ 2 months bank statement with a net pay of 15,000/= and above
+ Copy of your ATM card
+ Current payslip
+ Mpesa transaction summary reflecting the last six months. To obtain it kindly click on the link and register selfcare.safaricom.co.ke

*Source: GetBucks website, https://ke.getbucks.com/answers*

**Box 21. Customer access to Safaricom and M-Pesa transactional data**

***Interviewer:*** *"Did you ever try to review or use your transaction history with a mobile provider (such as your M-Pesa history) to apply for credit? What was your experience?"*
***R1:*** *"Yes, I have, it is not hard because you just go to Safaricom they give you your statement of how you pay and withdraw and those pages you take them to where you want to take a loan."*
***Interviewer:*** *"Did they agree [to give you a loan]?"*
***R1:*** *"Yes"*[367]
***Interviewer:*** *"Have you ever used your M-Pesa history to. . . secure a loan somewhere?"*
***R5:*** *"[Yes,] there are some places you are told to bring your M-Pesa history. . . [T]here are banks that they look how you have been repaying the loan you took from your phone."*
***Interviewer:*** *"So was the experience good or bad?"*
***R5:*** *"It was good."*[368]

***Interviewer****: "Have you ever tried using your M-Pesa/Equitel statement or airtime to apply for a loan?"*
***R5:*** *"Yes, it was an easy process they just check if you have been a defaulter before."*
***R4:*** *"Yes, it's an easy process."*
***R3:*** *"Yes, I do that regularly."*
***R2:*** *"Yes."*
***R1:*** *"Yes, it was an easy process."*[369]

***Interviewer:*** *"Did you ever try to review or use your transaction history with a mobile provider such as your M-Pesa history or airtime purchases to apply for credit?"*
***R2:*** *"Yes, I have."*
***Interviewer:*** *"What was your experience?"*
***R2:*** *"They use to charge Ksh 25 per page."*[370]
***Interviewer:*** *"[H]ave you ever checked your M-Pesa history from the phone?"*
***R4:*** *"Yes, I have. . . it was easy."*[371]

[367] Inquiry's Consumer Research Phase I Report, Annex 2.2.2, Switching Low Income – Kitui, FGD, p.36.
[368] Inquiry's Consumer Research Phase I Report, Annex 2.2.2, Switching Middle Income – Kitui, FGD, pp. 44-45.
[369] Inquiry's Consumer Research Phase I Report, Annex 2.2.3, Switching Low Income – Nairobi, FGD, pp. 24-25.
[370] Inquiry's Consumer Research Phase I Report, Annex 2.2.3, Switching Middle Income – Nairobi, FGD, p. 32.
[371] Inquiry's Consumer Research Phase I Report, Annex 2.2.1, Switching Low Income – Naivasha, FGD, p. 53.

### 6.4.4 Impact of MNO transactional data on competition in digital lending

During the Inquiry's work, we encountered concerns that Safaricom's perceived "monopoly" on M-Pesa transactional data coupled with its commercial involvement with M-Shwari and KCB M-Pesa could negatively impact competition in digital lending. The theory of harm would be that Safaricom's control over critically important information might result in it impeding competitors who might pose a competitive threat if they had access to the data. In particular, it might maintain tight control on the number of providers its data enables in the digital credit market. Accordingly, we believe it is useful to set out some of our findings in that regard.

Although it did not study this issue in detail (this was beyond the Inquiry's terms of reference[372]), the Inquiry did not find a solid basis for this theory of harm. Safaricom is providing an upstream input (the data) to the downstream mobile credit services of M-Shwari and KCB M-Pesa. Safaricom shares in their revenues. Its incentives would appear to be to maximise its revenue from these downstream digital credit providers. It is reasonable to expect that Safaricom would benefit from greater use of its data by competing digital credit providers. Even if considered dominant in the market for mobile transactional and M-Pesa data, Safaricom's incentives would appear to be to exert its market power in the market in which it has this position (in this case, provision of data to digital lenders) and that it should support, rather than undermine, competition in the downstream market.

The information before the Inquiry was consistent with this. [CONFIDENTIAL][373] [CONFIDENTIAL][374] [CONFIDENTIAL] confirmed that they had discussions with Safaricom regarding partnership arrangements similar to the ones between Safaricom and KCB and CBA.[375]

In addition, we found that the digital lending space was quite vibrant in that it relies on a range of credit evaluation strategies. In particular, we encountered three business models in the digital lending space that did not require Safaricom's direct provision of M-Pesa transactional data to the lender as an input for credit evaluations:

- Digital banking products, such as MCo-op Cash and Equitel's Eazzy Loans, rely on data from existing bank transactions rather than M-Pesa transactional data.[376]
- App-based products, such as Branch and Tala, are able to extract data, including M-Pesa transactional data, directly from a customer's smartphone.
- Digital lenders like GetBucks instruct their customers to obtain transactional data from Safaricom and to provide this information in the loan application process. As set out above, the qualitative interviews confirmed that obtaining this data is not a difficult process for Safaricom customers.

Accordingly, although we caution that our conclusions are preliminary and that this was not a central focus of the Inquiry's work, we did not encounter evidence suggesting that Safaricom's

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[372] As mentioned above, this Inquiry's terms of reference focus on the effects of transactional data sharing on consumers and on the ability of consumers to utilize their transactional histories. This Inquiry was not tasked with assessing the impact of the current data sharing policies on competition in the digital lending market. However, it is appropriate to consider the concern raised in such an inquiry.

[373] Meeting with Safaricom, 2 February 2017.

[374] Meeting with Safaricom, 2 February 2017.

[375] [CONFIDENTIAL]

[376] Submission of Co-operative Bank, 2 March 2017.

control of M-Pesa transactional information of its customers and current partnership arrangements with CBA and KCB is inhibiting competition in the market for digital lending.

## 6.5 Credit reporting

The Inquiry considered how Kenya's credit reporting requirements and practices affect competition and consumer use of their data. The Inquiry reviewed compliance with reporting obligations by digital lenders and the effects of these disparate reporting obligations on competition and consumers' ability to use their own data for financial access.

Digital lending products are offered both by banks (and other regulated financial institutions) and by unregulated non-banks. Banks are the lenders behind products such as M-Shwari (CBA), KCB M-Pesa (KCB), Eazzy Loans (Equity Bank) and MCo-op Cash (Co-operative Bank) while non-banks are behind Branch, Tala and Kopa Cash (Jumo).

As explained in Section 2.4, bank lenders are required to comply with the Credit Reference Bureau Regulations, 2013 and report both positive and negative credit information on consumers to Kenya's three credit reference bureaus.[377] Unregulated non-banks have no such reporting obligation.

### 6.5.1 Compliance by bank digital lenders

During our initial field visit in March 2016, we were informed by CIS Kenya that KCB and Equity Bank had been reporting both positive and negative credit information with respect to loans from their KCB M-Pesa and Eazzy Loans services, respectively, while CBA had only been reporting negative information with respect to M-Shwari loans.[378]

CBA's reluctance to share positive information was due in part to a concern over what it considered to be potential "free riding" by other digital lenders.[379] The concern was that rather than make the investments in a credit evaluation algorithm and enter into a revenue sharing arrangement with Safaricom to obtain M-Pesa transactional data, competitors could use reported M-Shwari repayment as a proxy for a credit evaluation. A competitor could conclude that if a customer had successfully obtained an M-Shwari loan, then M-Shwari's data and algorithms resulted in a positive credit evaluation on which the competitor could rely instead of obtaining its own credit data. In its submission, CBA also blamed general lack of compliance with reporting requirements by digital lenders on the "misalignment" between the current credit reporting framework and the "unique nature" of digital credit products. [380] We discuss these latter concerns in Section 6.5.2.

The Inquiry's stakeholder interviews in January-February 2017 did not give rise to concerns that there is significant non-compliance generally by banks with reporting of positive and negative credit information.[381] The Inquiry also confirmed that CBA had begun reporting both positive and negative credit information of M-Shwari loans, which previously went

[377] §18

[378] Meeting with CIS Kenya, 3 March 2016.

[379] Meeting with CIS Kenya, 3 March 2016. Meeting with CBA, 31 January 2017.

[380] Submission of CBA, 27 January 2017.

[381] E.g., meeting with [CONFIDENTIAL], 30 January 2017. Submission of [CONFIDENTIAL], 2 March 2017.

unreported.[382] However, as discussed in Section 6.5.2., the process for reporting of M-Shwari loans appears not to meet the requirements of the Credit Reference Bureau Regulations, 2013.

With the exception of the deficiencies in the M-Shwari reporting, the Inquiry did not receive evidence of significant ongoing compliance issues around reporting obligations of banks for digital loans.

### 6.5.2 Nature and timing of reporting obligations

Although there do not appear to be significant ongoing compliance problems with credit reporting by digital lenders, the nature and timing of current reporting obligations has raised concerns. As CBA aptly stated in its submission, the credit reporting framework is "based on conventional banking before the advent of digital micro-saving and lending" and "the frequency and depth of reporting are not suitable for digital and micro-banking hence customer do not benefit from the intended value add of the [credit reporting] framework."[383]

Section 33(5) of the Credit Reference Bureau Regulations, 2013 requires that:

> *An institution that furnishes customer information to a Bureau shall, on a monthly basis or within such earlier time as an update is necessary, ensure that the customer information furnished is constantly updated.*

Accordingly, while reporting must take place no less frequently than monthly, circumstances may require more frequent reporting. In practice, however, monthly reporting is still the norm. The short duration of some digital loans, with loan terms as short as a week and some customers in practice repaying loans within even shorter periods, would suggest that monthly reporting may be inadequate.

This is particularly the case with the monthly reporting framework adopted by CBA.[384] On the monthly reporting date, CBA provides negative reporting on loans that are in default as of that date and positive information on loans that are currently outstanding and not in default.[385] As a result, the information reported does not include a record of loans taken out and repaid between reporting dates. For example, a customer may take out a 30-day M-Shwari loan on the first of the month and repay it on the 15$^{th}$ of the month. When M-Shwari reports on outstanding loans at the end of the month, this reporting will not include positive information on the customer's repaid loan because the loan is no longer outstanding.

Although the Inquiry understands that the CBK is allowing this method of reporting,[386] it appears not to be aligned with Section 33(5) of the Credit Reference Bureau Regulations, 2013, which requires that credit reference information be provided "on a monthly basis or within such earlier time as an update is necessary" and that banks "ensure that the customer information furnished is constantly updated." More regular reporting is clearly required in order to cover loans that otherwise remain unreported, or at the least monthly reports should cover all loans that have been granted during the period and not merely those outstanding on the reporting date. Without this, there is significant positive information about M-Shwari loans that is available to CBA but not to other lenders accessing the credit reference bureaus.

[382] Submission of CBA, 27 January 2017. Meeting with CIS Kenya, 3 February 2017. Meeting with CBA, 31 January 2017.

[383] Submission of CBA, 27 January 2017.

[384] Meeting with CBA, 31 January 2017.

[385] Meeting with CBA, 31 January 2017.

[386] Meeting with CIS Kenya, 3 February 2017.

According to CIS Kenya, other lenders, such as Equity Bank and KCB, provide more comprehensive positive reporting on loans on their digital lending that includes information on all the loans outstanding and repaid during that month, not just those that are outstanding on the reporting date.[387] The Inquiry did not receive information on the format of reporting by Co-operative Bank.

Another problem is that the credit reporting process has built-in lag time. If a lender has an obligation to report credit information to credit reporting bureaus at the end of the month, that information does not have to be received by the bureaus until 10 days into the following month.[388] The bureaus then have an additional 5 days to review the information before reporting to the CBK.[389] Putting aside the fact that under monthly reporting the information will not be refreshed for another month, when credit reporting information is first available to prospective lenders it is already potentially 15 days out of date. In a market where 7-day loan terms are common, this appears to be a major lag.

Clearly, the current reporting system was not designed to deal with the short terms and high turnover of digital credit. The Inquiry understands that the CBK is moving toward requiring daily reporting for digital loans, although this was not confirmed directly by the CBK.[390]

### 6.5.3 Disparity in reporting obligations of banks and non-banks

The Inquiry considered the effects of the difference in reporting obligations between banks and non-banks on competition in digital lending and consumers' ability to use their credit histories for financial access.

Whether extending loans traditionally or over digital channels, banks (and other regulated institutions) have more onerous reporting obligations than non-banks. Banks are subject to a substantial, complex regulatory regime developed over time that covers a range of prudential, competition and consumer protection issues relating to a wide variety of financial activities. Non-bank digital lenders are newcomers to the financial market, have entered a specific market segment that was largely unaddressed, and are not subject to this wider regulatory system, including the reporting obligations. At issue is whether to extend the reporting obligations applicable to banks to the non-banks in respect of their digital lending.

***Competitive impact***

Three reasons were given to the Inquiry in support of the concern that the lack of reporting obligations of non-banks' digital lending results in a distortion of competition between lenders.

The first was that compliance with reporting obligations involves costs borne by banks that are not borne by non-banks, thus placing banks at a competitive disadvantage. These include the costs of designing, implementing, operating and monitoring the necessary reporting systems as well as complying with consumers' rights to access, challenge and correct inaccuracies in their histories. The concern is that because non-bank digital lenders do not have to incur these charges, they enjoy an unfair advantage over bank digital lenders.

However, it is not clear that the costs borne by the banks are substantial enough to create a significant disadvantage vis-à-vis the non-banks. All of the bank digital lenders the Inquiry reviewed in interviews and the customer observation exercise (M-Shwari, KCB M-Pesa, Eazzy

[387] Meeting with CIS Kenya, 3 February 2017.

[388] Meeting with CIS Kenya, 3 February 2017.

[389] Meeting with CIS Kenya, 3 February 2017.

[390] Meeting with CIS Kenya, 3 February 2017.

Loans, MCo-op Cash) were provided by large, established commercial banks that already had technical, administrative and legal procedures in place for complying with credit reporting for traditional loans. The incremental costs of complying with reporting on digital lending was not cited as significant for these institutions. In the submissions of and meetings with the banks behind these digital lending programmes, none cited these costs as a source of concern to the Inquiry.

In contrast, Kenya's non-bank digital lenders (including those that the Inquiry interviewed or reviewed as part of the customer observation exercise, Branch, Tala and Jumo) are all entrepreneurial start-ups. Introducing mandatory reporting may disproportionately affect these entities, whether in terms of costs or the technical and administrative effort to incorporate reporting into their business.

The Inquiry did not conduct an accounting of reporting costs and cannot reach a sure conclusion on the comparative impact of costs on banks and non-banks. However, no party submitted to the Inquiry any quantitative, qualitative or even anecdotal evidence that current costs of credit reporting imposed on bank digital lenders are creating an anti-competitive advantage of any substance for the non-bank digital lenders in the market.

The second argument posits that non-banks are able to "free-ride" on the positive reporting data of bank digital lenders, again placing banks at a competitive disadvantage. This argument is similar to the one made by CBA in relation to sharing positive credit information (see Section 6.5.1).

However, the Inquiry found that neither bank nor non-bank digital lenders are currently relying significantly on borrowers' credit histories in making lending decisions. In the case of bank digital lenders, [CONFIDENTIAL] stated that for [CONFIDENTIAL] loans, it only uses "internal [CONFIDENTIAL] data to appraise a customer and determine the loan amount they qualify for."[391] For M-Shwari and KCB M-Pesa, we understand that the two most significant factors in initial credit assessment are M-Pesa and Safaricom airtime transactional data.[392]

Also, non-bank mobile lenders do not currently rely significantly on credit bureau data in their credit evaluations. According to [CONFIDENTIAL] the non-bank lender [CONFIDENTIAL], it does not check credit bureau histories of its customers in credit evaluations at all, primarily because it does not believe that a significant number of its customers have credit histories.[393] When we spoke to [CONFIDENTIAL] in 2016, it also was not checking credit histories of its customers, though it was considering adding this as part of its credit evaluation process.[394] In addition, no information was provided to the Inquiry suggesting that non-banks are making profitable loans to customers which the banks would make but cannot because non-banks are not reporting credit data.

Altogether, the Inquiry did not receive evidence that the disparity in reporting obligations currently affords non-bank digital lenders an unfair competitive advantage in the market for digital lending. Concerns about competitive advantage appear at this time to be more a matter of principle than based on an actual or threatened substantial adverse economic impact on the bank digital lenders.

[391] [CONFIDENTIAL]

[392] Submission of Safaricom, 2 February 2017.

[393] [CONFIDENTIAL]

[394] [CONFIDENTIAL]

A third concern is that a lack of credit-reporting by non-banks prevents consumers from easily switching between digital lenders, since they are unable to take their credit history with them. Digital credit providers typically approve borrowers for only very small amounts initially and gradually raise the available credit limit over time as borrowers evidence a history of successful repayment. Because these repayment histories are not shared across lenders, a lack of credit reporting serves as a disincentive to switch providers, as borrowers would have to again start out borrowing small amounts from the new provider. However, as described above, digital credit providers are not making significant use of borrowers' credit histories at this time. Accordingly, it is not clear that requiring digital non-bank lenders to report will remedy this switching barrier. The Inquiry did not have enough information showing that such a requirement would solve competition issues to recommend introducing a new regulatory obligation.

Positive reporting by digital lenders (as currently required of banks and as done voluntarily by some non-banks) is in its infancy. Furthermore, some non-banks, such as [CONFIDENTIAL], voluntarily provide negative credit information to the credit reference bureaus,[395] and some are even voluntarily providing positive information.[396] Non-bank digital lenders may therefore already participate in the credit reporting system to a greater degree over time absent regulatory intervention.

It is possible that as the problems with the monthly timing of reporting, the built-in lag time and other deficiencies are addressed and as this pool of data becomes richer, it will become more useful to digital lenders, prompting them to incorporate it into their credit assessments, and more beneficial to consumers. At that time, the question whether there is a competitive disadvantage that requires to be addressed could be revisited.

***Financial access***

Credit reporting also has a financial inclusion dimension. One of the potential benefits of credit reporting by digital lenders is the prospect of bringing large numbers of otherwise excluded consumers into the larger financial system, particularly banking. Credit reporting of digital loans could enable consumers to create credit histories from successful repayment of digital loans that can be leveraged for larger loans from traditional lenders. Similarly, a history of late payments or defaults on digital loans could alert traditional lenders that a borrower is high risk. This should help extend traditional credit to new borrowers, while providing information that can also lower overall borrowing costs for traditional lenders. A further concern is that, without sharing negative loan information, consumers may become over-indebted.

However, the Inquiry did not find compelling evidence that the lack of reporting by non-bank digital lenders is currently hampering growth in financial access, or that this is resulting in over-indebtedness.

As explained above, digital lenders do not appear to rely significantly on credit bureau histories when assessing borrowers. They rely heavily on other sources of customer data, such as banking, mobile and mobile money transactional histories and, in the case of Branch and Tala, SMS and social media activity.

Traditional bank lenders generally appear not to rely on digital lending credit histories in their credit evaluations for traditional lending. Such data may not be particularly valuable for their

[395] [CONFIDENTIAL]

[396] Input from CGAP, 28 June 2017.

purposes. [CONFIDENTIAL] the non-bank lender [CONFIDENTIAL] observed that the loans it offers are small and short-term and that traditional banks and other formal credit providers would not benefit from reviewing credit information on such loans because this information would not be "indicative of the customers' behaviour with the loan value and terms offered by banks and other formal credit providers."[397]

The Inquiry is also concerned that adding reporting obligations at this time could become a barrier to entry and growth in a young innovative market that could itself hinder new access to financial services, and so potentially even be counterproductive.

Altogether, in the absence of compelling evidence that requiring reporting by non-banks would have a significant positive impact on financial access or in reducing over-indebtedness, the Inquiry does not recommend legislation to introduce a new reporting obligation to this still-young segment of the market.

Nevertheless, as the market for digital loans evolves, it would be wise to review this. Reporting methodologies can be expected to improve and credit history data for digital lending should become richer. As this develops, the information may become more useful to digital lenders. Additionally, as the loan amounts in digital lending increase and terms are extended, credit histories for digital lending may become more relevant to credit assessments in traditional lending. The Inquiry considers that a review within two years would be appropriate.

# 7. Remedies

## 7.1 Approaching remedies

This Section 7.1 provides an introduction to the remedies discussed in the rest of Section 7. It outlines the objectives of the remedies and describes support gathered both from theories of consumer behaviour and from behavioural consumer research carried out in Kenya under the auspices of this Inquiry. In light of this, Sections 7.2 through 8.3 discuss the potential remedies that could be introduced.

Of the seven remedies considered, the Inquiry recommends pursuing the first four:

- improving price transparency,
- encouraging price comparison tools,
- improving access to customer information, and
- centralised KYC.

The Inquiry does not recommend at this time mandating the last three remedies discussed:

- publishing quality of service indicators,
- account number portability, and
- a switching facility.

[397] [CONFIDENTIAL]

### 7.1.1 Objectives of the remedies

This Inquiry has focused on improving competition in retail banking for the benefit of personal and small and medium business customers by addressing the competition problems it found in Sections 5 and 6.

Price-based competition appears to be weak in Kenya in part due to consumers' focus on access to credit rather than price. Consumers are often uncertain whether and when they will be granted credit, and regard their loans as urgent. If they believe the bank they are dealing with is likely to provide access to credit, they are less likely to shop around.

However, Kenyan consumers are not indifferent to price: far from it. The Inquiry found that the lack of engagement with pricing is largely a result of the difficulty consumers face in understanding the costs involved, in comparing costs and products across alternative providers, and barriers to switching to such alternative providers. This stems from a lack of access to salient information, as well as a lack of accessibility of the information that is made available.

For example, although banks do publish headline interest rates and charges, consumers find it difficult to identify the best priced loan for their borrowing needs due to the complexity of calculation. Furthermore, making price comparisons where product specifications and pricing structures vary significantly across lenders is difficult. The annual percentage rate is of limited usefulness in such contexts in facilitating a meaningful comparison, particularly when comparing loans of different durations.

There are areas where consumer behaviour leads to suboptimal outcomes. Fees and charges for late repayment are an area where consumers are particularly price-insensitive. Such fees and charges are sometimes less prominently and clearly explained than the headline interest rate. Consumers will typically focus less on such fees and charges when choosing a lender, sometimes due to over-confidence about their ability to repay the loan when due, but also because these charges are often not prominently displayed or mentioned in promotional materials or disclosures.

The lack of price-based competition among banks may result in higher prices than consumers would pay if competition were effective, although it is difficult to tell over this last year what price-based competition there could have been in the presence of regulated interest rates. Weaker price-based competition may also have led to less innovation in pricing than there would otherwise have been. More flexible pricing models and risk-based pricing could emerge in a market where pricing was more a factor of competition.

In lending, the interest rate cap will have mitigated some of the harm to consumers arising from high prices and may have set in motion efforts to improve efficiency through reducing costs. However, the interest rate cap is not a desirable solution for the medium- and long-term. Not only may it have an adverse impact on lending (as several commentators have observed), but it may create expectations for pricing and become a benchmark for interest rates.

Cost reductions may be achieved from new technologies, increased operating efficiency, and participation in credit bureau reporting (the last of which should lead to better risk assessment, and so to reductions in non-performing loans and loan impairment costs). Price competition is essential to create an incentive for banks to pass these cost reductions through to customers. Thus, even with the interest rate cap, there is harm to consumers from the lack of competition, and it is likely to continue to be significant unless competition problems are addressed.

Because the lack of consumer engagement, and particularly the barriers to searching and switching, are so significant a part of the Inquiry's diagnosis of competition problems, the potential remedies focus on enabling consumers to choose and determine outcomes. There is no single cause of the lack of consumer engagement, and no single solution can be expected to produce a significant improvement in competition. The Inquiry thus considered a number of potential remedies that could form a package.

The remedies discussed in this Section 7 consist of different layers of intervention:

- The first layer is to reinforce the pricing disclosure regime by ***better enforcement of existing regulation*** to ensure the transparency that is already provided is reinforced.
- The second layer involves measures to increase ***consumer engagement***, particularly with pricing. These build on existing regulation and advocate additional measures intended to sensitise consumers to the possibility of obtaining products at better prices from alternative providers, in short to encourage shopping around.
- The third layer is to ***reduce barriers to switching*** so that consumers not only become aware of the possibility of acquiring better priced products from alternative providers but face fewer barriers in acting on it, thereby crossing the threshold and making the switch.

These layers are woven through the various remedies discussed in this section, and are interrelated. For instance, pricing disclosure practices may be required by existing regulation, may be pertinent to consumer engagement with pricing, and may also present a switching barrier.

Underlying these layers and the individual remedies discussed is the Inquiry's primary concern, which is to empower consumers of banking products to pursue their needs from the banking sector more effectively. A common thread in the research carried out was that consumers are disempowered through weakened countervailing bargaining power when dealing with banks due to a stark information asymmetry. The perception of hidden charges and distrust of banks, and lack of proactive engagement to find lower priced products, all point to a market in which the demand side accepts what is presented to it (albeit sometimes with resentment).

The remedies recommended can be expected to increase competitive pressure on prices, increase innovation and improve products and services. If the interventions are introduced, they should lead to greater competition, both among existing providers and even potentially new entrants as Kenya's banking sector opens up to new licensees in due course.

We are very conscious that the remedies involve adding regulatory obligations to lenders. This is the basis for rejecting some remedies as inappropriate in the Kenyan context. For others, considering the proportionately greater burden that regulation places on smaller market participants, the Inquiry finds that it is reasonable to exclude the application of remedies to smaller banks. The Inquiry proposes that a *de minimis* threshold apply, based either on a bank's revenues or assets, or its number of customers, calculated in terms of number of active retail transaction accounts or loan accounts, as determined by the CBK. The proposed remedies apply to retail banking only, and not to private and corporate banking.

### 7.1.2 Relevance of consumer behaviour research

The remedies have been devised with the benefit of insights from "behavioural economics," including the design and testing of interventions in a few cases where this was possible to assess their likely effectiveness. In considering the remedies, the Inquiry took account of their likely effectiveness in advancing the objectives of competition in the retail banking sector, including

the feasibility of implementation over time. It has also considered the proportionality of remedies, including ensuring that they are not more onerous than is necessary or than alternative remedies to achieve their objectives.

Several behavioural and psychological factors underlie the financial decisions people make.[398] Some of these include:

- the perception that losses, however small, are larger than comparable gains made when using financial products;
- the inclination towards overconsumption in the present and procrastination over investment decisions;
- the tendency to consider financial decisions within a narrow frame of understanding;
- the power of default/status quo options to induce inertia;
- the problem of choice overload and cognitive limitations in processing and assimilating information about alternative products; and
- the diverging incentives of agents providing financial advice.

These psychological factors enable banks to profit from consumer behaviour, at times because consumers make mistakes.

Consumers' cognitive processes may be subject to bounded rationality, i.e., failure to make a self-interested decision in the face of complexity. This may result from the provision of inadequate information, but it may also reflect the inaccessibility of available information, reducing consumers' ability to act rationally. This effect is exacerbated by the tendency of individuals to rely on heuristics or 'rules of thumb' when facing complex decisions, or where salient information is obscured in some way. Their implementation of (or failure to implement) optimal outcomes may also be limited by bounded willpower or procrastination, e.g., failure to follow through on a self-interested decision, or by *status quo* effects which keep consumers wed to their existing product/service provider even when a switch might be in their best interest. Consumers may also lack confidence or be excessively confident.

Several countries, most notably the UK, but also others such as the Netherlands, have begun looking at why consumers make decisions that are sub-optimal when selecting financial service providers and their products. A fundamental policy goal is to determine how to help consumers discipline markets more effectively. This can have an impact in a range of markets. In the UK, the field of behavioural economics is already being employed to improve competition in cash savings, general insurance and retirement income markets.

Suggested policy implications for these kinds of behavioural factors include presenting choices regarding financial decisions in a form easily understood by different groups of people. For instance, in one study, framing the amount of repayments in cash amounts rather than interest rates, resulted in a significant drop in repeat borrowing.[399]

Understanding consumer biases and other psychological barriers and their impact on consumer choice (see Figure 35) is key to unlocking how regulatory interventions might best improve outcomes for consumers. It is therefore critical to determine the decision points at which individuals in the target population might be making choices that result in undesirable outcomes.

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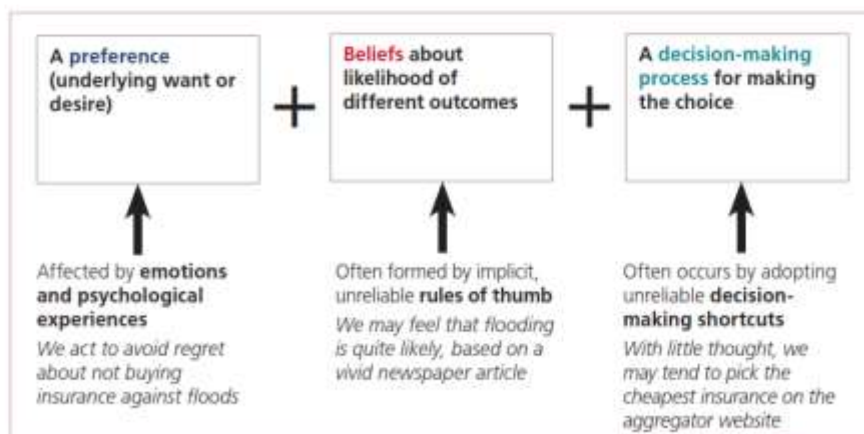
[398] These are outlined in a dedicated chapter to the topic in World Bank (2015): World Development Report.

[399] See Bertrand and Morse. (2011). 'Information Disclosure, Cognitive Biases, and Payday Borrowing.' *Journal of Finance* 66 (6): 1865–93.

One example is the failure of consumers to switch to more competitive banks with comparable but better priced products. To understand consumer behaviour and consumer choices, and to design interventions to change such behaviour, the Inquiry carried out 'behavioural mapping' through a detailed, iterative process of stakeholder interviews, careful data collection, surveys and focus groups that sought to determine relevant 'behavioural pressure points' in the context of a particular problem, by carefully drilling down into the sub-behaviours that constitute the chain of decisions and actions that determine eventual outcomes.

**Figure 35. Biases as distortions of choice.**




*Source: UK Financial Conduct Authority*

The Inquiry sought to understand the competition problems in the market, including reasons for lack of consumer engagement to put banks under competitive pressure, and to assess the effectiveness of potential remedies. In this Inquiry, in those instances where research revealed that consumers are not sensitive to the benefits of switching, it has proposed remedies focusing on availability and transparency of pricing information. Where the Inquiry's research found that consumers are aware of the benefits of switching but nevertheless fail to switch, it has devised remedies designed to address decision pressure points further down the decision chain.

### 7.1.3 Research and testing carried out by the Inquiry

The Inquiry worked with the Busara Centre for Behavioural Economics (Busara) to design a range of focused interviews, mystery shopping exercise, experiments and analysis of existing data to collect evidence. This allowed the Inquiry to determine the critical steps in the customer journey, and to understand the psychological barriers that may be responsible for the failure to switch. This enabled the Inquiry to suggest and recommend appropriate policy interventions, and insofar as was possible, evaluate their impact.

The results from Phase I of the Inquiry suggested a few key behavioural pressure points that might act to constrain the ability of consumers to exert demand-side pressure on banks to be more competitive. These include:

1. consumers lack salient information about the monetary benefits of switching;
2. the cost of search significantly reduces the propensity to search, with the result that consumers make sub-optimal choices;
3. improving price transparency and ensuring early disclosure of pricing information would reduce search costs and improve the ability of consumers to make optimal choices; and

4. reducing barriers to switching will increase switching behaviour.

Busara designed three experiments to test whether these identified barriers really do affect consumer choice, and whether interventions designed to alleviate/remove these barriers significantly improve consumer choice. The advantage of economic experiments is that they allow for the controlled study of markets, as well as the impact that changes in the market environment might have on the behaviour of consumers. They illuminate how individuals will respond to proposed changes in the institutional environment. This is especially important when it is not possible to test ideas or theories in the naturally occurring economy without causing major disruptions, requiring long time delays and significant research expenditures. Simply put, economic experiments allow policy makers to test and fine tune potential policy interventions before incurring the risk and expense of real-world application.

Three different experiments were designed and implemented to test specific hypotheses. The detailed designs and results are available from the CAK. We summarise them below.

***Experiment 1 – prompts***

Experiment 1 was a field-based experiment designed to assess the effect of different messages on switching behaviours in the digital credit market. Specifically, the Inquiry sought to understand whether making consumers aware of the potential savings from shopping around prior to committing to a service provider for a digital loan would encourage customers to switch from their current digital lender to an alternative digital lender.

Individuals were recruited from the University of Nairobi, as well as the low-income areas of Kawangware and Kibera. All participants were pre-screened to ensure that they were current Safaricom users and had taken out a digital loan within the past month. After recruitment, users were randomized into one of two treatment groups or a third control group. The two treatment groups received three targeted SMS messages over a three-week period, sharing information on the availability of cheaper credit products in the market, and the potential savings of said products (either in % terms or absolute Ksh amount).

Overall, SMS messages that encouraged switching did not have a *statistically significant* effect on switching behaviour, although there was some evidence that individuals who received messages were more likely to try an alternative provider. In other words, the messages were not overwhelmingly effective in getting people to report using new products, to use their primary account less frequently, or to signal a higher intention to switch to a new digital lender. In fact, switching rates across all groups were exceptionally low with only a quarter of participants switching digital lenders during the experiment, and just under 20% switching to a new primary digital lender. In addition, the Inquiry found no evidence that being in one of the two treatment groups and receiving SMS messages in any way helped individuals pick cheaper credit options as compared to the control group. As such, Experiment 1 did not yield strong evidence to suggest that SMS messaging will prompt consumers to actively search for cheaper credit providers or switch primary digital lenders.

***Experiment 2 – searching behaviour***

Experiment 2 was a lab-based experiment designed to assess the effect of several interventions on searching behaviour. A loan acquisition process was simulated in the lab, and this enabled us to identify how various price disclosure frames impact an individual's ability to identify the cheapest loan options, as well as the extent to which the timing of price disclosure affects an individual's propensity to engage in search behaviour.

The experiment first addressed the form of disclosure. Specifically, the experiment tested the hypothesis that if costs were displayed in a simple manner (including information about total cost of credit and monthly payments), consumers could more easily identify the cheapest loan than if they were shown the information in a complex manner (with individual costs given but not added up).

The experiment next addressed timing of disclosure. Specifically, the experiment tested the hypothesis that if people were given information about banks after completing only a minimal amount of effort (simulating 'early disclosure' in an application process), they would be likely to search more than if they had to complete a larger amount of effort before getting information about pricing (simulating 'late disclosure' in an application process).

Participants who were exposed to simple information frames as well as early disclosure treatments were significantly more likely to search across more banks. The Inquiry found clear evidence that participants that were given information in a simple manner (e.g., given the total cost of credit as opposed to having to calculate it themselves) were significantly more likely to search and correctly identify the least expensive bank.

Moreover, these individuals spent less time on average on any given search, suggesting that simple presentation of information allows individuals to search more efficiently. These effects were particularly pronounced for individuals who are young, male, wealthy, and financially literate. In contrast, early disclosure of pricing terms (i.e., having access to pricing information from banks after performing only a small amount of effort) increased the willingness of individuals to search but did not significantly improve individuals' ability to pick the least expensive bank. In other words, the key driver of helping consumers pick the least expensive product appears to be the presentation of information in simple terms as opposed to complex formats. The key contribution of early disclosure is to facilitate greater search by consumers.

This suggests that information presented in a complex format and that is difficult to obtain (in terms of effort required) is likely to result in reluctance of individuals to search. Moreover, participants in the treatment groups spent less time viewing bank information. This, coupled with the improvements in product selection among the treatment group, suggests that product viewing time is not a significant factor in optimal product selection, and that there may even be diminishing returns to viewing complex products. Rather, the focus should remain on simplifying and standardizing information, and ensuring early disclosure of terms.

***Experiment 3 – comparing prices and ability to choose***

Experiment 3 was a lab-based experiment designed to test whether displaying cost information in a consistent way made it easier for people to compare prices across alternative providers and choose the cheapest option. The Inquiry's diagnosis during Phase 1 generally indicated that the decision to switch is currently made in an environment where cost and benefit comparison is difficult because competing pricing information is not presented in a standardized format. In addition, in this experiment, we measured consumers' willingness to switch to the cheaper product under different conditions relating to waiting time, physical distance, mental complexity and waiting for pay-out under a variety of financial incentive schemes.

Participants were first asked to identify the least expensive of two loan options. Participants in the control group were shown information about a new bank in a format that was different from the one used to provide information about banks in Experiment 2 (i.e., 'unmatched'). Participants in the treatment group received information about a new bank presented in the same format provided during Experiment 2 (i.e., 'matched'). Participants were then asked to

determine which was the least expensive of the two banks, the one previously selected at the end of Experiment 2 or the new bank introduced at the start of Experiment 3.

Having completed this stage of the task, participants were then asked to indicate whether they would choose to switch to the less expensive option in the face of different barriers that would impose some cost on the individual. To assess consumers' sensitivities to waiting time, physical distance, mental complexity and waiting time for pay-out under different incentive schemes, participants were divided into one control and two treatment groups, each with different financial incentives given to switch. Those in the control group were offered Ksh 100 to switch to the new bank, those in the first treatment group were offered Ksh 200 Ksh and those in the second treatment group were offered Ksh 300 to switch. Participants then reviewed four multiple price lists for each type of barrier (waiting time, physical distance, mental complexity and waiting time for pay-out), where the individual's choice to switch would bring with it an associated cost.

The results from Experiment 3 provide clear evidence that being shown pricing information about two banks in a consistent format makes consumers significantly more likely to correctly identify the cheapest of two loan options. Less than half of the participants in the control group selected the cheaper option, while the matched treatment increased this probability by nearly one-third. Overall, presenting information about alternative products in a standardized and consistent format shows a strong, significant, and universal effect on a consumer's ability to select the cheapest option.

With regards to switching costs, the Inquiry found that consumers are quite willing to endure switching costs (e.g., more waiting time) to receive a monetary bonus. Put differently, once individuals are able to correctly identify the cheapest product, they exhibit remarkable willingness to endure switching costs (the most common response is always to switch), which suggests that it may not be the costs of switching that matter, but rather the inability on the part of consumers to definitively identify a cheaper alternative that is the binding constraint on switching.

Furthermore, the Inquiry found that consumers were more willing to face switching barriers when they were offered Ksh 200, than if they were offered Ksh 100 to switch. Surprisingly, those participant in the Ksh 200 treatment group were also more willing to face barriers than those in the Ksh 300 treatment group. Taken together, these finding suggests that consumers' willingness to endure switching costs are high, and have a non-linear relationship with monetary incentives.

Although the exact drivers of this behaviour are not clear, these findings may suggest that larger bonuses crowd out intrinsic motivation for enduring costs. What may act as a simple gift exchange at lower levels of bonus, may change, at higher levels to be internalized as a wage, leaving individuals to become more conscious of a cost-benefit trade-off. Although this effect is small, this result is worth further investigation to understand if there is, in fact an inflection point for this relationship.

The results of this Experiment 3 suggest that further policy on standardization of how cost information is displayed could benefit the consumer in making optimum loan choices. Simply offering larger monetary incentives to switch might not make consumers more likely to do so when facing barriers such as waiting time, physical distance, mental complexity and waiting time for pay-out. This suggests that final loan selection might not be purely driven by cost, such that the decision does not correspond solely and entirely to the maximum amount of money that

can be saved. As such, further work to reduce barriers could benefit the consumer and improve people's willingness and tendency to switch to cheaper loan options.

In sum then, across the three experiments, a number of key insights emerge that suggest particular remedies relating to presentation of pricing information to consumers, which we discuss next in Section 7.2.

## 7.2 Improving pricing transparency

As discussed in Section 4.1, based on the qualitative interviews and prior research, the Inquiry has found that there is widespread distrust among Kenyan consumers of banks with respect to traditional bank products. This distrust often emanates from a perception that banks apply "hidden costs" to these products, i.e., fees and charges about which consumers believe they were not effectively informed when they decided to subscribe to a particular product.

In the case of loans, these hidden costs often manifest as "appraisal" and other similar fees that are subtracted from the amount of a loan disbursed, giving the customer the appearance that he or she is receiving less than was promised. In savings and transaction accounts, they are often in the form of unexpected ledger, transaction, withdrawal and ATM fees. While a significant lack of financial literacy is doubtlessly a contributing factor (see Section 4.1), the findings of this Inquiry on deficiencies in disclosure of pricing and other important product features help to explain and, in part, validate this customer perception (see Sections 5.2, 5.3, 6.2 and 6.3).

In the case of savings accounts, a significant proportion of shoppers who were offered products in the mystery shopping exercise were not informed of how interest and fees accrue on the account, the annual percentage rate, the minimum balance necessary to accrue interest and the frequency of permitted withdrawals. For transaction accounts, a significant proportion of shoppers who were offered products were not informed of the account opening fee or charges for each transaction. In both cases, over two-thirds of such shoppers did not receive any supplementary written materials that set out account features. [CONFIDENTIAL] also independently found that over a quarter of its customers who opened accounts in September 2016 who were later contacted were unaware of the fees and costs associated with their accounts.[400]

In the case of loans, prior studies showed that over 40% of shoppers were not informed of the loan amount, duration of loan, total cost of capital and additional fees and in particular, interest rates, the repayment amount and repayment period were not sufficiently explained.[401] This Inquiry's mystery shopping exercise found that when interest rates and payment duration were disclosed they were rarely explained. Also, cost of borrowing disclosure (which banks are required to disclose as total cost of credit (TCC)) was often deficient from both a regulatory compliance standpoint and also as a means of enabling meaningful comparison between loan products. These deficiencies arise as a result of the format of the TCC disclosure, which omits key information, as well as the timing, coming too late in the customer journey to serve as a meaningful means of comparison between banks.

These deficiencies in disclosure are compounded by a failure of banks to assess the needs of their customers. These needs assessments are necessary to enable banks to recommend products

[400] [CONFIDENTIAL]
[401] [CONFIDENTIAL]

that are suitable to a customers' particular financial circumstances. Across product types, the mystery shopping exercise found that between one-third and a half of shoppers did not receive any form of needs assessment from bank staff, with lower income shoppers far less likely to receive such assessments (see Section 4.1.1). Those customers that received assessments mostly reported that they were light and not in-depth. Meaningful needs assessments are essential to guide customers to appropriate products which can then be compared across banks. They also are likely to engender trust in bank staff and their recommendations.

The distrust of banks and often opaque nature of pricing and other product features presents an important barrier to searching and switching. A consumer will be considerably less inclined to search for alternative products when he or she does not understand the product or trust the descriptions given.

This general lack of trust is magnified by the seemingly contradictory finding from the qualitative interviews that customers tend to trust information provided by their own banks. Customers tend to get comfortable over time with the banks they utilize, presumably because they learn to understand the features of their products, including fees and charges. However, they remain distrustful of other banks. This effect magnifies the barrier to searching and switching among banks as customers are inclined to stick with the banks they have grown to trust for what they perceive as untrustworthy alternatives.

In digital credit and savings products, the principle barrier to making meaningful comparisons is a lack of disclosure of costs and product features within the digital channel. In digital products, the amounts involved – particularly accessed over mobile phones – are typically significantly less than in traditional banking.[402] Furthermore, consumers report digital financial services to be more easily understandable than traditional banking,[403] so the problems may appear less acute. Nevertheless, the immediacy of digital financial services – accessible over remote electronic connection – creates risks of consumers becoming over-indebted, the credit market becoming saturated, and of consumers taking on debt that they did not necessarily intend.

In digital savings and lending, the Inquiry found by reviewing screenshots taken as part of the customer observation exercise that digital savings and loan products often do not disclose basic terms and conditions of the products. None of the savings products reviewed disclosed any of the features of the accounts, including interest rates and charges within their USSD- and STK-based platforms. In digital loans, most of the products reviewed did not disclose interest or fees that are imposed on loan amounts prior to a customer agreeing to take the loan.

In both traditional banking and digital credit and savings, there appears to be ample opportunity for banks to improve their perception and consumers' trust in them through increased transparency and customer engagement. The Inquiry recommends several regulatory interventions which would require banks to take action to put consumers in a position whereby they are aware of their costs, and facilitate comparisons with alternative providers.

In its recommendations on improving pricing transparency that follow in this Section 7.2, the Inquiry has recommended several actions to be taken by the CBK and the CAK, sometimes in

[402] A recent CGAP study found that digital credit loan amounts are typically small (i.e., significantly less than the local equivalent of USD 100). Hwang, B. & Tellez, C. (2016). The proliferation of digital credit deployments. CGAP Brief, Washington, D.C.: CGAP. Retrieved from http://www.cgap.org/sites/default/files/Brief-Proliferation-of-Digital-Credit-Deployments-Mar-2016_1.pdf

[403] See, e.g., Mazer, R. & Fiorillo, A. (2015): Digital Credit: Consumer Protection for M-Shwari and M-Pawa Users, CGAP 21 April 2015.

combination. The lapses in compliance by banks with their disclosure obligations noted by the Inquiry in Sections 5 and 6 make clear that a more robust approach to enforcement of pricing disclosure is required.

### 7.2.1 Traditional loans, savings and transactions

***More vigorous enforcement of existing disclosure and suitability requirements***

As discussed in Sections 5 and 6, prior research and the Inquiry's mystery shopping exercise, qualitative interviews and customer journey research all suggest a failure of banks to comply with existing disclosure and suitability rules. As a starting point, vigorous enforcement of existing regulatory requirements for traditional banking products would ensure that consumers are receiving mandated disclosures and needs assessments.

Applicable pricing disclosures are required under the Competition Act and the Banking Act, enforced by the CAK and the CBK, respectively. However, the CBK may be better placed to lead in such enforcement as its Prudential Guideline on Consumer on Protection (the Guideline) contains highly detailed required disclosure that is specific to the banking sector and its products. This includes required detailed disclosures on the nature of interest rates, repayment and fees and charges. The Guideline also sets out suitability requirements that necessitate a needs assessment. Also, as the regulator of banks on a number of matters beyond just consumer protection, the CBK is likely to be able to exert pressure on banks that are found to be out of compliance with these requirements.

The disclosure of TCC is particularly important. There is evidence from the Kenyan market that making the cost of borrowing more salient by separating the repayment of principal from the cost of financing makes consumers more sensitive to the amounts involved, leading to lower default rates.[404] Hence the Guideline requires disclosure of the total payments to be made to the lender less the amount borrowed.

Yet as discussed in Section 5.2, the Inquiry found significant non-compliance with the disclosure requirement under section 3.4.5 of the Guideline to disclose the sum total cost of credit, rather than merely listing individual costs. The KBA's widely used Total Cost of Credit template, which banks adapt with their brand names and logos, does not provide a sum total of the cost of credit, merely the component parts of the costs as required by the Guideline. The Inquiry did find high-end banks such as NIC that do disclose the sum total of the cost of credit in the application form, but was not supplied any evidence that this is the prevalent practice. In addition, the template omits disclosure of annual percentage rate (APR). The KBA requires its members to disclose APR of loans as part of TCC disclosure. APR is another metric that consumers can use to easily compare the costs of borrowing across loan products.

The Inquiry found through experimental research that consumers are better able to compare the terms of financial products if they are simple and harmonised (see Section 7.1). This is all the more important where financial literacy is limited (see Section 4.1). In this context, the absence of the sum total cost of credit and APR in the Total Cost of Credit template and banks' TCC forms in the marketplace is particularly significant. This sum total is necessary for a consumer to compare the costs of loan products across alternative providers and failure to provide it places the unnecessary burden of potentially complicated arithmetic on consumers.

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[404] See Mazer, R., Vancel, J. and Keyman, A. (2016), Finding "Win-Win" in Digitally-Delivered Consumer Credit, CGAP, 13 January 2016.

The Inquiry considers that vigorous enforcement of the TCC requirement in section 3.4.5 of the Guideline should be a priority. The CBK should work with the KBA to design a TCC disclosure template available to all banks that complies with the current TCC disclosure requirements and the KBA's required APR disclosure.

**Recommendation 1.** The Inquiry recommends more vigorous enforcement of disclosure obligations under the Prudential Guideline of Consumer Protection by the CBK. In lending, enforcement of total cost of credit (TCC) disclosure by banks should be made a priority and the CBK should work with the KBA to ensure that banks are provided with templates that comport with the mandated disclosure requirements.

***Improvements to current required cost of borrowing disclosure***

In the case of loans, the Inquiry finds that current disclosure requirements around costs of borrowing are insufficient. Even when banks are in technical compliance with section 3.4.5 of the Guideline and the KBA's APR disclosure requirements, the content and timing of the disclosures are often not adequate to foster useful comparisons between bank products.

*Content of TCC disclosure*

The Inquiry has found that the current information provided in the TCC disclosure required under section 3.4.5 of the Guideline is insufficient to meaningfully inform consumers of the costs of borrowing and to enable easy comparisons among loan products.

First, TCC disclosures required under section 3.4.5 of the Guideline should be supplemented so that APR is a required component of TCC disclosure. While all commercial banks have already obligated themselves to comply with this requirement by virtue of their membership in the KBA, inclusion in the Guideline would allow the CBK the power to enforce this requirement on banks.

Second, TCC disclosures required under section 3.4.5 of the Guideline should be supplemented so that the amounts of the periodic repayments under the loan are also disclosed as part of TCC. The Inquiry's qualitative interviews indicate that presentation of a monthly payment amount is extremely important to many consumers who have difficulty understanding rates and overall borrowing costs. A periodic repayment amount is a tangible number to which they can relate their monthly domestic or small business budget and cash flow management. It is also a useful means of comparing loan products. The Inquiry also recommends that all such disclosures be made in a standardised format across service providers (discussed below).

*Timing of TCC disclosure*

The Inquiry has found that the *timing* of the disclosure, i.e., the stage in the customer journey at which the key terms and conditions, including TCC, are disclosed is also vital. Consumers often do not receive the TCC until after they have inquired about, applied for and obtained authorisation (sometimes weeks later) for the loan. Thus, disclosure of TCC is often made too late in the process for customers to engage in shopping around because they are already too invested in a process with a given bank.

This creates a substantial searching cost in terms of time (potentially measured in weeks) and is thus an important searching barrier. A search for alternative products would involve going through the process of applying for and obtaining authorisation from an alternative provider. It is not realistic to expect consumers to submit multiple applications for credit to multiple institutions in order to learn the comparative pricing.

The experiments carried out by the Inquiry described in Section 7.1 found that searching improves product selection by consumers, and that early disclosure of product features leads to higher search effort. Earlier disclosure improves searching and, in turn, cost savings in product selection. Barriers to searching will result in consumers not choosing the optimal product. Consumers who receive the terms of a product earlier in a selection process are more likely to search for alternatives. Late information may lead the consumer to feel more obligated to the provider, or more exhausted from the process, whereas having the information readily available leads to more competitive product selection.

Taking these findings into account in considering the lending process of Kenyan banks, the Inquiry finds it important to ensure that banks disclose TCC (including the enhancements of the content that this Inquiry recommends above) to the customer prior to submission of an application for a loan. This would comport with the existing requirements of the Guideline to provide pricing information while the customer is "choosing" among products. In order to ensure this step is included in the process at this stage, loan applications could include an acknowledgement by the consumer that he or she has received a statement of the TCC prior to submission of the loan application.

The Inquiry considers that a requirement that these disclosures be made before application for a loan be added to section 3.4.5 of the Guideline. A further amendment to the Banking Act would also be appropriate, which was amended in 2016 to provide that banks must "before granting a loan to a borrower disclose all the charges and terms relating to the loan."[405] This would be supplemented to provide that banks must, "before accepting an application for a loan from a borrower, disclose all the charges and other costs and periodic repayment amounts relating to the proposed loan in a format to be prescribed by the CBK except where it is unfeasible to do so."[406]

Such disclosure by a given bank would not constitute a representation that the loan will be made available to the consumer, as the credit review will occur after the application. In addition, third party costs may be estimates at this stage, so that the final TCC may not be fully certain. Indeed, one bank that does disclose TCC correctly at the time of application includes an explicit acknowledgement in its application form that the TCC information provided is based on information provided by the customer, is not binding on the bank and may be modified if the information provided changes:

> *The outlined costs contained in the attached Total Cost of Credit Template in respect to the facility are based on the information that you have provided to the bank and the related estimated third party providers' costs and are therefore subject to change depending on various factors affecting the facility and in the event there is a variation to the validity of the information that you have provided to the bank. Any change on the outlined costs shall be communicated to you. The outlined costs contained in the attached Total Cost of Credit Template are not legally binding to the Bank and shall not constitute any liability on the part of the Bank.*[407]

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[405] Section 31A of the Banking Act, as amended by the Banking (Amendment) Act, 2016.

[406] The European Consumer Credit Directive 2008/48/EC requires in Article 5, "In good time before the consumer is bound by any credit agreement or offer, the creditor and, where applicable, the credit intermediary shall, on the basis of the credit terms and conditions offered by the creditor and, if applicable, the preferences expressed and information supplied by the consumer, provide the consumer with the information needed to compare different offers in order to take an informed decision on whether to conclude a credit agreement." The Directive goes on to specify a number of key elements that must be disclosed.

[407] [CONFIDENTIAL] on file with the Inquiry.

While subsequent modifications may occur, the terms of the loan for which the consumer is applying should be made clear, subject only to changes to third party charges from the time of application. Any such modifications must also be disclosed in writing before signing. The ability to modify the terms between application and signing in this manner should not, however be used as part of a systematic practice of presenting favourable terms at time of application only to modify them significantly and adversely at the time of approval and signing.

**Recommendation 2.** The Inquiry recommends that section 3.4.5 of the Prudential Guideline on Consumer Protection (the Guideline) be amended to require total cost of credit (TCC) disclosure to include disclosure of annual percentage rate (APR) (as is currently required by the Kenya Bankers' Association) and periodic repayment amounts. The Inquiry further recommends that section 3.4.5 of the Guideline be amended to require disclosure of TCC to the customer prior to submission of an application for a loan.

In addition, the Inquiry recommends a corresponding amendment of section 31A of the Banking Act to require that banks must, "before accepting an application for a loan from a borrower, disclose all the charges and other costs and periodic repayment amounts relating to the proposed loan in a format to be prescribed by the CBK except where it is unfeasible to do so."

***Required disclosures should be made in writing and in a standardized format***

As described in Section 2.2, the Guideline (section 3.2.3) currently requires disclosures to be given to consumers "choosing" a product or service and (after having chosen) before the consumer buys the product or service.' The Inquiry considers it appropriate to specify further that such information should be in writing, specify particular pricing information that should be included and provide a standardized template for such information that enables easy comparisons across products.

Such information would frame the oral presentations given by bank staff, which should lead to fuller explanations and permit customers to present staff with similar disclosures from competitor banks. It would also sensitise consumers to the costs, which in itself may lead consumers to consider whether they could obtain a better deal from an alternative provider. This should in turn incentivise providers to compete on the basis of their charges.

The Inquiry thus considers that any customers inquiring about a loan should be given a simple written statement setting out basic costs, charges and features of the loan, including,

- TCC (as enhanced by our recommendations above);
- description of how interest rates are calculated, including whether they are fixed or variable;
- repayment schedule, indicating principal repayments and interest charged;
- any late payment or prepayment fees or fees for inquiries; and
- any other charges that the customer may incur during the course of the lending relationship.

Customers inquiring about transaction or savings account should be given a simple written statement of the basic charges, including:

- account opening charges;
- periodic service charges;
- charges for balance inquiries, and statement requests and other inquiries;
- deposit and withdrawal charges;

- charges for payment services (including top-ups of air-time and mobile money accounts, funds transfers, and bill and merchant payments);
- minimum balance requirements;
- charges and interest rates for arranged and unarranged overdrafts; and
- any other material charges.

Additional information that should be disclosed to the consumer in the case of savings accounts:

- minimum period associated with a savings product;
- the date on which a preferential interest rate will terminate; and
- any other material terms.

In all cases the format of the written statements should be standardized and easy to follow to allow customers to easily make comparisons among products. The formats of the statements should be tested on users to ensure they are understandable and useful and before they are implemented across the sector.

**Recommendation 3.** The Inquiry recommends that section 3.4.5 of the Prudential Guideline on Consumer Protection be amended to require banks to provide customers with a simple, standardized, written statement setting out basic costs, charges and features of bank products.

***Electronic messages to supplement written and oral cost disclosure***

Other markets have found that timely electronic alerts, in contrast for example with regular generic information (such as annual reports on charges), can have a significant impact on consumers' engagement in their financial decision-making and cost reductions.[408] Such alerts have the significant benefit of being automatic and not requiring the consumer to invest additional effort to acquire the information.

The Inquiry considers that there would be significant benefit to customers receiving an electronic message summarising key information about a product for which they are interested in applying. This could occur during a visit to a branch to inquire about the product, or shortly after leaving the branch. This could be used for a wide variety of products, including loans, and savings and transaction accounts. Here we focus on the case of loans, but prompts would be relevant when inquiring about savings and transactions products as well.

In the case of a loan, the objective would be to ensure that the customer not only receives the written TCC disclosure (as supplemented by our recommendations above) while in the process of inquiring about it, but also in the form of an electronic message on his or her own device. This should strengthen the consumer's confidence in the information and increase the likelihood that he or she will enter a branch of another bank and compare prices.

The mobile telephone is the obvious device to use for this purpose. It is commonplace now for customers to provide contact information including cell phone numbers to banks when seeking financial products. In many cases, existing banks have these on record. Banks can be required to collect mobile telephone numbers during the application process and require customer consent to receive a message providing the TCC disclosure for the loan for which they wish to

[408] For instance, consumers receiving text alerts or mobile banking app messages about unarranged overdrafts would reduce their unarranged overdraft charges by 6% and 8% in the UK, and 24% where both services were used. Hunt, S., Kelly, D. and Garavito, F. (2015): Message received? The impact of annual summaries, text alerts and mobile apps on consumer banking behaviour, FCA Occasional Paper No. 10.

apply. The use of the number for messaging would be restricted to this purpose except to the extent to which the bank is already entitled to use the number for other messaging purposes.

Given that a substantial portion of the Kenyan population does not use a smartphone,[409] messages should be sent by SMS by default. If a customer is invited to and expressly agrees to receive a message by alternative means, that could be used instead. Possible means could include messaging services within the capability of the bank (such as WhatsApp), email or mobile banking app push alerts over an app already installed on the customer's device. A simple version of such a message could be as follows:

> You have inquired about borrowing Ksh AAA from [name of bank] over a period of BBB months. If such a loan were approved, you would pay the bank Ksh CCC (the total cost of credit) in addition to repaying the amount borrowed. Your monthly repayment amount would be Ksh DDD. Your APR would be EEE%.

Such messages could be used for loans, and adapted to provide the basic terms of savings and transaction accounts.

Electronic messaging could also alert consumers that they have incurred or are about to incur a charge, which would increase their sensitivity to pricing. In the case of savings accounts, electronic alerts could also be used to inform a customer when the balance dips below (or is close to dipping below) the level required to obtain a particular interest rate, or if the period applicable to a given preferential interest rate expires. In each case, the message would be most effective if accompanied by a relevant call for action, such as to top-up a savings account where the balance has fallen below a level entitling the consumer to a particular interest rate. For example:

> Your savings account balance of Ksh AAA is less than the minimum required Ksh BBB to benefit from the CCC% interest rate. Increase your balance by Ksh DDD in order to return to that rate. Until then, the interest rate of EEE% will apply.

and:

> Your savings account balance is Ksh AAA. The minimum balance required to benefit from the BBB% interest rate is Ksh CCC. Increase your balance in order to ensure that your balance does not dip below the required level.

The consumer would thereby be informed of the costs at the time relevant to an actual or potential financial decision. Not only will the consumer be better placed to make an informed decision, the awareness of pricing may increase the likelihood of considering alternative providers.

Furthermore, such messages could include supplementary Internet links or short codes that could provide consumers with additional educational content on understanding bank product costs and charges. While banks might innovate in their selection of language for such messages, the Kenya Bankers Association might also play a useful role in developing such content which would be available to all banks and consumers.

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[409] Safaricom estimates that 45% of its subscribers do not utilize a smartphone. Meeting with Safaricom, 2 February 2017.

This Inquiry did not carry out extensive testing to enable it to recommend a specific form or language for such messages. Indeed, the Inquiry does not consider it appropriate at this time to prescribe specific language for all such electronic alerts. Banks may operate different systems, depending on the availability of mobile banking apps, the complexity of types of alert systems messaging services to be arranged with the mobile telephone companies, and their style of communication. A prescribed format and language at this time might produce a lowest common denominator result with banks merely adopting the prescribed form and text. Instead, the Inquiry considers that there is merit to allowing banks to devise the most effective means of communicating, not least as there is likely space for banks to differentiate their communication services and compete through innovation.

While we consider there to be benefits in allowing banks to innovate in the language they use, we also recommend that the CAK and/or CBK carry out pilot experiments using a variety of messages in order to understand better whether any particular formulation is significantly more effective than another. This will enable the CAK and/or CBK to offer guidance to banks on their messaging in due course, including to assess the degree to which harmonisation of the language to be used is needed.

In any case, all such messages should always be clear, not misleading, and consistent with the underlying contractual terms. And, where a financial decision is involved, such as to increase the balance to avoid or reduce overdraft charges in a transaction account or to benefit from a higher savings account interest rate, the message should be sent with sufficient time for the consumer to act up on it and benefit accordingly.

The Kenyan telecommunications services market already includes text services. The main costs to banks will include developing the required IT system, collecting and registering customers' telephone numbers in the database, training staff, and communicating with customers about the system. Banks have different alert systems at this time, and some will need longer than others to develop the required systems, including in some cases to develop the core alert functionality. The Inquiry considers that there may be benefits to some banks collaborating with others to share a common platform to reduce costs. Kenya has an active messaging aggregator market that may be able to provide such services to multiple banks, and so achieve such efficiencies.

In terms of timing, the Inquiry considers that a 12-month period from the implementation of this requirement for electronic alerts should suffice. Where particular circumstances make it impossible or unreasonable for a bank to introduce an alert service within this period, an extension could be sought.

Banks should also be required to report on the implementation of their alert systems, including information about the enrolment of customers into the alert system, alerts for which their customers are enrolled, volumes and frequencies of sending such alerts.

As with other disclosure requirements, this Inquiry recommends that these electronic messaging requirements be enforced by the CBK. As regulator of banks on a range of matters, the CBK has more regular contacts with banks and has more opportunities to exert leverage over their behaviour. In addition, these requirements could be easily added to the Guideline by the CBK. Currently, it is not clear that the CAK would have the authority under the Competition Act to mandate such electronic disclosure, and amendment of the Act is likely to be a lengthy and politically fraught process.

**Recommendation 4.** The Inquiry recommends that the Prudential Guideline on Consumer Protection (the Guideline) be amended to require banks to provide messages delivered to a

customer's mobile phone summarising key information about a product for which they are interested in applying. Electronic messaging could also alert consumers that they have incurred or are about to incur a charge, which would increase their sensitivity to pricing.

The Inquiry considers that a 12-month period from the implementation of this requirement for electronic alerts should suffice. Where particular circumstances make it impossible or unreasonable for a bank to introduce an alert service within this period, an extension could be sought. The Inquiry further recommends that Banks should be required to periodically report to the CBK on the implementation of their messaging systems.

The Inquiry recommends that the CAK and/or CBK carry out pilot experiments into the effectiveness of a variety of such message formulations with a view to understanding their relative effectiveness.

***Electronic messages to prompt shopping around***

The consumer research carried out by the Inquiry and by others suggests that bank customers are not aware of the degree to which they could save if they were to look to alternative providers. The Inquiry considers it important to alert customers not only to the cost of the product in question, but to the fact that prices vary in the market and that better deals may be found through shopping around.

In order to address the weak customer engagement, customers could receive messages at appropriate times to remind them that banks charge different prices, and to encourage them to shop around. Such 'prompts' could be sent at pertinent moments when the customer might be most open to them and likely to act on them. For instance, a customer who enquires about a loan in a bank branch or online could be sent a message informing them of the wide range of prices for a given product in the market, and reminding them that they may save money by shopping around.

As described in Section 7.1, the Inquiry carried out a small consumer behaviour experiment to explore the impact of messages alerting customers to the range of prices available in the market for digital credit and encouraging them to shop around. Although the experiment was too small to produce reliable statistical results, and the observable trends were limited, there was some evidence that such messages would increase a tendency to shop around.

In part, the lack of strong results in our consumer behaviour messaging experiment may reflect the limited duration of the experiment (only 3 weeks) and the relatively small sample size compared to other studies of this nature. In addition, the consumer behaviour experiment only considered the effect of messages sent at regular intervals and did not test the impact of messages timed for, and targeted at, an occasion when the consumer was looking for credit. The design and implementation of such an experiment would have required substantially longer time horizons and considerable disruption to existing market operations so as to make it infeasible. Nevertheless, the experiment results did not support widespread sending of generic messages to consumers, and the Inquiry has concluded that mass messaging, whether by banks, a regulatory authority or a consumer body, is not a priority at this time. Indeed, such messages may be perceived as spam, and may numb consumers to the message with the result that they do not think of the potential benefit of shopping around at all when they actually are looking for credit.

However, the Inquiry does wish to note that the timing of messages has been found elsewhere to make a significant difference to their impact, namely, where the messages are sent at the time

when a consumer stands to benefit from making a relevant financial decision.[410] The Inquiry considers that sending a prompt to a Kenyan consumer about the opportunity to obtain credit at a lower price at the very time when he or she is seeking credit can be expected to increase the likelihood of shopping around.

The Inquiry considered the ways in which this could be done, and found that only one is really practical. The Inquiry sees no benefit to involving a regulatory authority or consumer body in sending additional messages to a consumer at this stage. Rather, the simplest approach would be for the bank approached by the consumer to send a message as to the range of pricing and benefit of shopping around while the consumer is inquiring as to the availability of credit with that bank. After all, if the situation that makes the message relevant to the consumer's situation is that he or she is seeking credit, it is the bank that is approached by the consumer that becomes aware of this and has the information about the amount of credit sought. In turn, this should exert competitive pressure on banks. To be confident of not losing a potential client through the shopping around which the message would encourage, the bank in question has an incentive to ensure they offer the best terms in the market.

A statement as to the range of pricing in the market and benefit of shopping around could be included in the same recommended electronic message summarising the pricing of the product described above, or in a separate message, in any case sent shortly after the consumer has approached the bank to inquire about the product.

Again, using the example of a loan, one possibility would be for the statement to be generic, such as:

> You have inquired about a loan. Did you know, lenders charge different amounts? You could save a significant amount by shopping around.

However, international experience with prompts suggests that they have a considerably greater impact when they provide greater specificity to the relevant consumer and his or her situation. In particular, their impact is greater if they refer to specific amounts on which the consumer stands to lose out if they do not turn to an alternative provider compared to the one initially approached.[411] The greater the specificity to the consumer in question, the greater the impact on the consumer's propensity to shop around. Messages giving the actual difference in amount between the price being offered to the consumer by its current provider and the best price in the market have a larger impact on shopping around than messages giving only an estimate.

It might be ideal, then, for consumers seeking credit from a Kenyan bank to be informed of precisely how much more cheaply they could obtain such credit from the lowest priced lender in the market. However, the Inquiry does not at this time consider that the reasonably anticipated benefits of requiring disclosure of a precise comparison of one lender's pricing with

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[410] In the UK, consumers would take out savings accounts with high introductory interest rates but often not switch when the high rates ended despite initially intending to do so. In 2015, the FCA used random control testing to examine the impact of sending reminder letters to consumers encouraging them to switch accounts when the high introductory rates ended. These reminders increased the switching by 5.6 percentage points up to 7.9%. The timing was significant, with those reminded before the rate decrease took effect being more likely to switch to another provider, while those reminded after the rate decrease took effect being more likely to switch to a different product of the same provider. See Adams, P., Hunt, S., Vale, L. and Zaliauskas, R. (2015), 'Stimulating Interest: Reminding Savers to Act when Rates Decrease,' FCA Occasional Paper 7.

[411] Research in the UK's annuities market showed considerably greater shopping around where the consumer received a prompt comparing the pension provider quote against the best available quote in the market, personalised for the individual in question. Oxera (2016): Increasing consumer engagement in the annuities market: can prompts raise shopping around?

the lowest in the market would exceed the costs of such a requirement, or that it is even feasible at this time.

Providing a personalised comparison would depend on the availability of a comprehensive and reliable price comparison service, capable of calculating a comparison for the same loan duration among all lenders. While price comparison websites are now entering the Kenyan market, they are new and untried and untested, and may encounter teething problems common to such services. The need to encourage and support such services to develop in the Kenyan market is considered in Section 7.3, and only in due time when flourishing price comparison services exist should mandatory precise comparisons be considered.

Nevertheless, the Inquiry suggests that there is a middle ground between such high-impact personalised situation-specific cost-saving prompts and a weak generic message about the benefits of shopping around (such as shown above). In order to increase effectiveness, a message to the consumer could convey a benchmark indication of the scale of potential savings available generally from shopping around in a manner relevant to the consumer's situation.

For example, in the experiment conducted by the Inquiry, the messages referred to an example of a Ksh 1,000 loan and the wide range of charges from Ksh 34 to Ksh 200, a potential saving of Ksh 166 or 83%. Although not statistically robust, the experiment results suggested that quoting the saving in percentage terms (here, the 83%) rather than the monetary amount (the Ksh 166) will lead to greater appetite among Kenyan consumers for shopping around.

However formulated, a message of this nature can be set at a level to be relevant to the consumer, without requiring the full extent of a price comparison calculator. For instance, the CBK could establish, maintain and make available a regularly updated register of prices for a range of illustrative loan amounts, such as Ksh 1,000, Ksh 10,000, Ksh 100,000 and Ksh 1,000,000 over a variety of periods, say 3 months, 12 months and 36 months.

Banks could be provided electronic access to the CBK's database over APIs or other means, enabling them to set their systems to send messages to inquiring consumers using the loan amount and duration most relevant to the consumer in question. Their messages would give the price range and percentage difference for the amount nearest the amount of the loan and term the consumer is seeking.

Thus, a message could take the following form (whether SMS by default, or a messaging app, email or mobile banking app push alert):

> You have inquired about borrowing Ksh AAA from [name of bank] over a period of BBB months.
>
> We are required by the Central Bank to inform you that lenders charge different amounts for such loans.
>
> For example, for a CCC-month loan of Ksh DDD, some charge Ksh [highest amount on the market] and others Ksh [lowest amount in the market].
>
> A borrower could save as much as EEE% by shopping around depending on the amount and duration of the loan.

As mentioned above, this could be combined with the message providing the TCC, APR and periodic repayment amount discussed above.

The Inquiry also recommends that the CAK collaborate with the CBK to evaluate *ex post* the impact of such a message among consumers, including their tendency to shop around as a result of receiving it at the time when they are inquiring about the availability of a loan. This could be done using different formulations, including conveying the scale of the difference in prices between the highest and lowest in the market in percentage terms or the Kenyan shilling amount of the difference.[412]

The timing of electronic prompts in the case of transaction and savings accounts is less obvious. Transaction and savings accounts typically have no end date to their contracts. A consumer might hold an account for years without it occurring to them to shop around and change provider. The Inquiry considers that consumers are more likely to take such an initiative if prompted at appropriate occasions to review their current service and consider alternatives. These could be periodic, for example sent annually with their annual statements, or when monthly charges are applied.

As the market develops and banks build fuller data on their customers' behaviour, alerts could also be deployed to provide summaries of financial position and activities to consumers who have difficulties managing their finances (e.g., regular defaulters) along with options for improving financial management. Since the relative cost of messaging is quite low, in every instance, the potential benefits likely far exceed the burden of such messaging interventions.

**Recommendation 5.** The Inquiry recommends ensuring that consumers are alerted not only to the cost of the product in question, but to the fact that prices vary in the market and that better deals may be found through shopping around. The Inquiry recommends that in the case of loans banks be required by the CBK to receive electronic messages at appropriate times to remind them that banks charge different prices, and to encourage them to shop around.

The Inquiry also recommends that the CAK collaborate with the CBK to evaluate *ex post* the impact of such a message among consumers, including their tendency to shop around as a result of receiving it at the time when they are inquiring about the availability of a bank product. The Inquiry also recommends that the CAK carry out further research into the potential use of electronic alerts for broader purposes, such as for the pricing of transaction and savings accounts. The CAK should also examine the evolving use of technology, including mobile banking applications, and how consumers are interacting with them in order to understand what uses of the technology may have the largest impact on empowering consumers.

***Relationships between banks and their customers' employers***

Section 3.1.2 describes the use of check-off loans, which require a prior relationship between the customer's employer and a bank, as a barrier to shopping for loans. Similarly, barriers to shopping around in transaction accounts arising where consumers take up transaction accounts with their employers' banks, whether to facilitate faster receipt of salary payments or to access check-off credit (Section 4.1.5).

These schemes facilitate making credit available that might not otherwise be provided, and employers bring some bargaining leverage that helps drive competition among the banks. While these may impede consumers from leaving the transaction account providers, the Inquiry considers that there are consumer benefits from employers facilitating check-off loans. Before

[412] The Inquiry carried out limited consumer behaviour experimental research in this area but the scale of the experiments was too small to give reliable trends.

the interest rate cap, there were signs of banks encouraging consumers to switch to them, including through check-off loan buyouts.

The Inquiry is not inclined to intervene to weaken the link between the employee using the employer's bank, or to regulate the choice of products that bank staff present, or manner of oral presentation, viewing these as best left to the competitive dynamic.

### 7.2.2 Digital loans and savings

***More vigorous enforcement of existing disclosure requirements***

As discussed in Section 6.2, the Inquiry found significant non-compliance with disclosure requirements in digital lending and savings over mobile platforms. Some lenders were requiring borrowers to commit to loans prior to disclosing interest or other charges on the loan. Bank lenders failed to make required disclosures such as TCC and APR required by the Guideline and the KBA, respectively. Similarly, some banks allow customers to open savings accounts before disclosing basic information such as interest rates and minimum balances required to attract headline interest rates, as required by the Guideline.

As discussed in Section 6, these practices did not comply with the right of the consumer in section 56(4) of the Competition Act "to be informed by a service provider of all charges and fees, by whatever name called or described, intended to be imposed for the provision of a service." They also appear to have violated the prohibition in section 56(3) on imposing "unilateral charges and fees […if they] had not been brought to the attention of the consumer prior to their imposition or prior to the provision of the service" specifically in relation to banking, micro-finance, insurance and other services.

As discussed in Section 6, the CAK is aware of this non-compliance and during the course of the Inquiry was taking steps to address it. Among other things, the CAK found that "customers accessing loans via mobile applications or USSD codes are not informed of the interest rates and rollover charges of the loan on the mobile interface before being asked to accept the terms and conditions." The CAK wrote to [CONFIDENTIAL] mobile financial service providers ordering that each [CONFIDENTIAL][413] The CAK also required them to implement various steps to improve disclosures:

[CONFIDENTIAL]

The Inquiry considers that these enforcement steps by the CAK are well-judged, and if implemented will make a significant difference not only to consumer protection but to put consumers in a position where they can compare the pricing of products, and thus enable shopping around.

In particular, the requirement to disclose costs before a service is provided, and to do so 'inflight (during the transaction)' vitally meets the consumer's need, experience and practice: customers will use pricing information at the very time of making his or her financial decision. This is an important improvement over disclosure of fees posted on kiosks or websites for instance.

The Inquiry was informed by the CAK that implementation of these steps is underway, with some 24 digital financial service providers having implemented the required changes.

We understand that bank digital products must be approved by the CBK prior to their release in the market. Despite these approvals, this Inquiry found that required disclosures were absent. We therefore recommend vigorous enforcement by the CBK of the disclosure requirements of

[413] Letter, dated 17 May 2016, from the CAK to mobile payment and mobile credit providers.

the Guideline, which should be taken into account during the product approval process, and which the Inquiry considers to be crucial for the development of a competitive market in digital financial services.

**Recommendation 6.** The Inquiry recommends that the CAK continue its work on requiring digital financial services providers to comply with the pricing disclosure requirements of the Competition Act. The Inquiry further recommends that the CBK vigorously enforce the disclosure requirements of Prudential Guideline on Consumer Protection, which should be taken into account during the product approval process, and which the Inquiry considers to be crucial for the development of a competitive market in digital financial services.

***Presentation of charges***

The Inquiry considers that consumers would be better able to compare products and so shop around if there was greater harmonisation of charges. Section 7.1.2 describes the consumer behaviour experimental work of the Inquiry, that found that harmonisation of presentation significantly improves the ability of consumers to compare prices of different products.

Currently, the practices of disclosing prices vary – especially in digital credit, for example, where some charges are characterised as fees and others as interest rates. This has resulted in headline rates being advertised and displayed within the digital channel in an inconsistent manner, which can be confusing to the consumer. For example, within the digital channel

- KCB M-Pesa loans incur a “facility fee” that is deducted from the requested loan amount;[414]
- M-Shwari does not characterize the charges incurred but rather adds an amount to the requested loan amount;[415]
- Equitel’s Eazzy Loans add an interest charge to the requested loan amount, expressed as a monthly interest rate;[416]
- MCo-op Cash does not quantify or characterize the charges for its loans and only confirms the requested loan amount;[417]
- Branch sets out an interest amount that is added to the requested loan amount;[418] and
- Tala refers to a “fee” that is added to the requested loan amount.[419]

The Inquiry does not seek to impose a rigid approach to charges, particularly considering the potential for innovation in pricing to spur on competition. However, harmonisation of some fundamental pricing is necessary for comparative purposes. The Inquiry considers that in the case of digital credit provided by banks, the disclosures described above with respect to traditional credit – of the TCC, APR and periodic repayment amount – will achieve the desired harmonisation. The Inquiry has not recommended that these particular forms of price disclosures apply to non-bank lenders as they are not subject to the Guideline. However, they would remain subject to the requirements of the Competition Act.

[414] Inquiry’s Consumer Research Phase I Report, Annex 5.1.3.
[415] Inquiry’s Consumer Research Phase I Report, Annex 5.1.5.
[416] Inquiry’s Consumer Research Phase I Report, Annex 5.1.2.
[417] Inquiry’s Consumer Research Phase I Report, Annex 5.1.4.
[418] Inquiry’s Consumer Research Phase I Report, Annex 5.1.1.
[419] Inquiry’s Consumer Research Phase I Report, Annex 5.1.7.

In addition to requiring disclosure of these key data points, the Inquiry considers that consumers should be reminded to view the terms and conditions applying to digital credit before taking out the loan. Consumer behaviour research in Kenya has found that explicitly offering the consumer the choice to view the terms and conditions during the customer journey before proceeding to borrow increases the likelihood that the consumer will read the terms and conditions, and that this leads to lower default rates.[420] As described in Section 6.2.2, one digital credit product, Kopa Cash, has included a basic set of terms and conditions that is displayed within the USSD interface. This display was developed through user testing and behavioural research.[421] Other products, including both digital credit and savings, should be required to adopt this approach as well. The Inquiry recommends that the CAK should lead enforcement of such a requirement, which is consistent with section 56(4) of the Competition Act and applies to both bank and non-bank providers.

The Inquiry did not find significant other disclosure-related steps that should be taken in order to improve the ability of consumers to compare pricing among mobile savings and loan providers.

Consumers face challenges comparing between services provided over STK and USSD channels with those available online and via mobile banking app. For instance, a consumer accessing M-Shwari or KCB M-Pesa over STK (or other providers over USSD) cannot at the same time easily compare the pricing with other providers without closing out the session. And if he or she does so, it is necessary to restart the session, including incurring the network connection charges again. However, the Inquiry does not find that this challenge calls for particular disclosure requirements, but rather for availability of price comparison services (discussed in Section 7.3) which could be consulted separately.

The Inquiry also considered the desirable improvements in presentation that are available over smartphones. A number of practices and principles are increasingly well-understood to enable more effective communications over devices.[422] These generally aim to improve the customer's ease of understanding and interaction with apps through more 'human centred design.'[423] Greater focus on such practices and principles in the Kenyan market should improve the ability of consumers to compare among providers, and so increase competition.

The Inquiry considers that the CAK and the CBK should, when reviewing disclosure practices of digital financial service providers, draw their attention to the importance of effective communication using such practices and principles. They should also request reporting on compliance with the regulatory requirements that banks deal with consumers with fairness,

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[420] See Mazer, R., Vancel, J. and Keyman, A. (2016), Finding "Win-Win" in Digitally-Delivered Consumer Credit, CGAP, 13 January 2016.

[421] Input from CGAP, 28 June 2017.

[422] For example, CGAP recently proposed 21 principles for good design for mobile money services over smartphones: 1. Allow users to explore before using, 2. Help users find agents, 3. Simplify application registration, 4. Flatten menu hierarchy, 5. Focus menu choices on actions, 6. Reduce text and use visual cues, 7. Design icons relevant to local users, 8. Use simple and familiar menu terms, 9. Build on users' familiarity with smartphones, 10. Customize transaction choices, 11. Auto-fill from the address book and transaction history, 12. Auto-check to minimize human error, 13. Display information in digestible chunks, 14. Reassure with transaction confirmations, 15. Leave a clear trail of transaction histories, 16. Provide instructions when needed, 17. Handle errors by providing next-step solutions, 18. Customize and simplify keyboards, 19. Auto-calculate fees during transactions, 20. Provide full transaction details on one screen to finalize transactions, 21. Make account balance easy to see and hide. See Chen, G., Fiorillo, A., & Hanouch, M. (2016): Smartphones & Mobile Money: Principles for UI/UX Design (1.0)

[423] See for example, Rasmussen, Mikkel. 2014. "Go Digital. Don't Forget Banking's Human Factor." AmericanBanker.com. http://www.americanbanker.com/bankthink/go-digital-but-dont-forget-bankings-humanfactor-1071244-1.html.

reliability, transparency, equity and responsiveness, and "using simple and ordinary language which the consumer understands."[424]

While the Guideline applies to institutions regulated under the Banking Act, the CAK's consumer protection initiatives described above apply to all digital financial services providers. The Inquiry considers that each of these two regulatory bodies has an important role to play in pressing for enforcement of their respective regulatory frameworks. In order to avoid risk of contradictory standards, some basic coordination between them is essential. Furthermore, where the CAK's powers are essentially *ex post* (i.e., the CAK has the power to investigate after the conduct has occurred), the CBK has extensive statutory powers to regulate *ex ante* (i.e., the CBK has the power to set out rules in advance of conduct occurring), making its vigorous enforcement of standards all the more important to put consumers in a position to compare products and providers.

**Recommendation 7.** The Inquiry recommends that digital financial service providers be required to remind customers to review the terms and conditions applicable their product within the digital channel and to provide basic summaries of the terms and conditions within the channel. The Inquiry believes that the CAK is best placed to lead efforts to require such disclosure as its mandate extend to non-bank providers and such requirement is consistent with the Competition Act. The Inquiry further recommends ongoing coordination between the CAK and the CBK on disclosure requirements applicable to digital financial services.

## 7.3 Price comparison websites and similar services

### 7.3.1 The potential for price comparison websites

As discussed in Section 4, an important switching barrier arises in the difficulty customers have in understanding and comparing the pricing and related terms of financial products. These difficulties are compounded where they wish to consider trade-offs between different features, such as the duration of a loan.

Section 7.2 discussed ways to improve pricing information disclosures in a simple and harmonised manner in order to make it easier for consumers to compare products. However, the very process of gathering the information and holding it all in one place (physically, digitally or mentally) to carry out the comparison remains laborious and a challenge for consumers.

Tools that would reduce such difficulties and so help consumers shop around include price comparison websites (PCWs) and SMS or USSD search tools that make pricing information more easily comparable and salient. There is evidence from other countries that consumers that review products ranked by price make better price-based decisions.[425]

Effective PCWs would enable customers to identify the best-value product and the product with the most appropriate terms for their needs. Use of such facilities should lead to greater price competition among financial service providers and help customers find the products that best

[424] The CBK Prudential Guideline on Consumer Protection, section 3.2.3 and section 3 generally.

[425] See, for example, UK Financial Conduct Authority (2015): High-Cost Short-Term Credit Price Comparison Websites A behavioural study for the Financial Conduct Authority. The study found that while 26.7% of consumers tested would correctly identify the lowest price loan when listed semi-randomly, 67% did so when listed in ascending order of price. See also, UK Competition Markets Authority. (2015). Payday lending market investigation, Final Report.

meet their needs. They would also be an avenue for new entrants entering the market with competitive and innovative pricing models.

The immediate, and for our purposes, primary benefit of PCWs is that they focus on price transparency, which is a factor of competition that the Inquiry has found to be in need of addressing. However, PCWs also have the potential over time to become part of the distribution channel for financial services. This could be for opening transaction and deposit accounts or even taking out credit, in each case on a "click-through" basis, by clicking on a hyperlink to the preferred provider. They could over time develop quotation search tools enabling consumers to assess their eligibility for, and price of, loans before applying (with data protection to ensure that search does not affect credit file). Ultimately, they might even integrate transaction contracting into the search service, e.g., as booking.com does for hotels and ebookers does for flights.

Section 5.4 discussed initiatives underway in Kenya by the Kenyan Bankers Association, Think Business and CompareGuru for online price calculators and comparisons. If a significant effort is made to promote these sites and consumer usage grows, they can help reduce search costs significantly for internet users.

However, the KBA costofcredit service has only just been launched, and Section 5.4 provided a critique of the service, including what the Inquiry considers to be a flaw in the design of the price 'top 5 alternatives' comparison function. Neither of the other PCWs have yet been completed. The potential for PCWs is also limited by broadband penetration, which in Kenya is currently 27%.[426] There is likely to be a correlation between segments of the population who have access to financial services and who use the internet, so that much of the initially addressable market would have access to them. However, where they are only available through the internet, a substantial portion of the population would not be reached by PCWs, at least initially.

There is, then, no assurance at this stage that any of these will result in effective – and extensively used – services that have a significant impact on the market. We thus consider below how best to approach PCWs in general for banking services in Kenya and what regulatory policy position might be adopted towards them.

### 7.3.2 Regulatory policy issues

***Public and private models***

PCWs could be developed and provided in a variety of ways. Among other aspects, they could be:

- operated by the public sector, industry associations or commercial providers, or combinations of the foregoing;
- subject to heavy, light or no regulation, with this being partly a function of the degree to which consumer interests would be expected to be reflected in the service; or
- funded by the public sector, by development agencies, or by commercial investors.

There are trade-offs in these design elements. For instance, a public-led initiative might result in an 'official' PCW where its objectivity and impartiality is assured, thereby generating greater trust. This could be owned and operated by the government or licensed to a single trusted PCW

[426] See Communications Authority of Kenya. (2016). 'First quarter sector statistics report for the financial year 2016/2017 (July-September 2016).' Available here.

operator or operated as a public private partnership. However, a public-led initiative also carries a high risk that it is not sufficiently market-oriented to respond to the needs of consumers both in terms of content and promotional effort. There may also be insufficient incentives to ensure that content is regularly updated. A public-led initiative might also stymie potential competition in provision of PCW services.

Furthermore, a model dominated by the public sector would potentially have a substantial amount of power over lenders listing their products on it. It might even unintentionally result in an overbearing influence on the market by the manner in which it channels information as an information gateway for consumers.

An advantage of one or more private ventures would be the commercial incentive to pursue customer usage, which may make it more likely to innovate to meet customer needs. If necessary to achieve policy objectives, commercial PCWs could be required to operate under specified standards, i.e., on a regulated basis.

Needing continual updated pricing data from banks, any commercial venture would have to achieve a minimum scale of voluntary participation among banks to attract customers. Even the Think Business model, which gathered data from banks' public disclosures of tariffs, found it necessary to write to banks to verify the data. A strong advantage of the KBA costofcredit calculator is its ready access to its members' data. In the absence of full cooperation from banks, regulation may be required to ensure the viability of a PCW, e.g., proactively requiring banks to list their products and prices with PCWs. In turn, such strengthening of a PCWs' position, or public funding or otherwise, might suggest a need for heavier public oversight of the PCW itself.

In the long-term, a PCW may evolve to allow customers to enter directly into transactions with the banks listed on the terms displayed. This would incentivize banks to voluntarily update the pricing information displayed to ensure it is accurate.

***Choice of pricing and other data***

In addition to their potential benefits, PCWs present various risks. A PCW could simply list incorrect information due to human or machine error, with the consequence that consumers make bad choices. Or, striving to simplify information for consumers, a PCW might focus only on headline prices and omit or inadequately convey other material terms, resulting in consumers obtaining financial products that do not best suit their needs. For instance, a comparison might be made on the basis of an interest rate, annual percentage rate or monthly repayment amount, but late repayment fees and charges may not be compared, or even disclosed.

For PCWs to have the desired impact of increasing competitiveness in the market, they need to identify the primary information for comparison, and also supply other relevant information without overwhelming the consumer.

So, for instance, in the case of loans, a PCW could include a monthly repayment amount and the sum total cost of credit, as does the KBA's costofcredit service (unlike the TCC standard form, which currently does not). This would provide the customer with two important data pieces for the types of loans covered upon searching, rather than having to wait for the bank to provide the TCC form after application is made and the loan is approved.

When ranking loans, ideally, the terms for input would be amount, duration, instalment frequency, and whether or not it is secured. The primary ranking would ideally be the total cost

of credit (interest plus charges in accordance with prevailing Kenyan regulation), shown in the order of the lowest to highest amount payable.

In addition, consumers should be able to opt to view comparable monthly payment amounts in ascending order. In a number of cases (particularly as the interest rate cap loans and floor on deposits applies and for some time after it is removed in due course), products may have the same price. These should be shown in ascending order pursuant to a secondary ranking based on objective criteria.

In addition, key supplementary information should be shown for any given loan that might reasonably affect a consumer's choice, such as for instance early, late and non-payment charges.

It would be desirable for such services not to involve searching each bank one-by-one rather than simply searching for the best deal, which might leave customers vulnerable to default bias as they search only banks with which they are familiar.

***Objectivity and impartiality***

Where PCWs are funded by advertising, it will be important to ensure the integrity and impartiality of search results by preventing comparisons being affected by banking and other financial service providers who are also advertising to clients. Other countries have found that some PCWs will promote those participants that paid them commissions, distorting the rankings.[427]

There are unlikely to be enough PCWs in the market, and consumers are unlikely to be able to have enough information, for consumer 'trust' to be a strong enough competitive factor among PCWs themselves to guarantee the impartiality of comparison search results. Whether this argues for some regulatory oversight will depend on whether governance mechanisms can be set in place to ensure robust impartiality. Such mechanisms will likely be necessary to attract a significant number of banks to participate.

***Risk of PCWs adversely affecting competition***

Another risk is that PCWs may address relatively generic products and as a result omit those that do not fit the mould. There is a related risk that if one or a small number of PCWs become particularly powerful, the manner in which they organise and present comparative information may pre-structure product design in the market and hinder deviation that might otherwise be innovative. This could even have an exclusionary effect on those seeking to compete through innovation. In addition, where responsibility lies – between the PCW and participating banks – for omissions may be uncertain.

The effect of PCWs could also be to exclude other potential lenders that are sometimes viewed by consumers as alternatives to banks, for instance if SACCOs were not able to participate. By improving the ability to shop around with some lenders, they could raise barriers to competition for others. Ideally, PCWs would only exclude a financial institution from participating on the basis of its record of regulatory compliance, financial standing or willingness and ability to provide the pricing and other data to meet the PCW's requirements.

[427] This was the case in the UK energy market, for example. See House of Commons Energy and Climate Change Committee (2015): Protecting consumers: Making energy price comparison websites transparent, Seventh Report of Session 2014–15, HC 899 Published on 28 February 2015

There is a risk that a powerful PCW would have bargaining leverage over lenders when it comes to fees for participating, or for advertising. Where this occurs, the added cost to the lenders may actually increase the cost of lending, and so interest and charges on loans passed through to consumers.[428] Another potential result of a PCW gaining market power could be conditions imposed on those listing on it. For instance, a PCW might prohibit lenders from offering cheaper prices elsewhere, thereby removing incentives to cut prices.

There may be risks that some lenders that seek to be listed on a PCW are, without good reason, not listed. It will be important to consider how PCWs can be made open to as wide a group of lenders as possible, and to provide protections for lenders that are unreasonably excluded.

Finally, there is the risk that PCWs become a platform for collusion among the banks. This is because, while transparency in bank charges is desirable, transparency makes it easier for banks to reach and monitor horizontal (cartel) agreements.[429] This in turn reinforces the ability for a cartel to be formed, and to be maintained, over time. While this risk does not necessarily outweigh the benefits of greater transparency, it should nonetheless be borne in mind and mitigated as far as possible through vigilant enforcement of the prohibitions on horizontally restrictive practices in Kenya.

### 7.3.3 Regulatory policy approach

Notwithstanding that even with the best will in the world the sorts of problems described above are likely to arise, the Inquiry finds that encouragement of PCWs is desirable at the very least to generate price-based competition.

Furthermore, the risks outlined above should generally be addressable through a combination of governance and, if necessary, regulatory oversight and well-designed feedback enabling rapid adjustments to the system.

***Design and operating models***

The regulatory treatment of non-public PCWs would depend partly on their design and operating models. An ideal PCW might embed certain principles:

- A PCW should be generally open and competitively neutral as to the different types of participating institution whose products it lists.
- A PCW should rank products in a competitively neutral manner, i.e., showing financial products based on objective criteria pursuant to search functions based on key features of the product.
- At no time should any ranking or prominence given to any financial product or provider in a comparison be affected by the commercial interests of the PCW.
- Relatedly, there should be clear differentiation between advertising on the PCW and ranking of products in order to prevent customers becoming confused between what is an objective ranking result and what is promotional.
- The PCW should disclose the number and names of participating banks and other institutions so that consumers are aware of the limits of the comparison facility.

Such principles could be adopted with varying levels of formality. They might be adopted in a regulation or in guidelines by the CBK, or published in a paper on good practice by the CBK

[428] See Ronayne, D. (2015): Price Comparison Websites, University of Warwick, October 2015, revised February 2017

[429] See Motta, M. (2004). Cited above.

or the CAK. They might require prior review and approval of a regulator, or alternatively merely require compliance with the principles.

If any policy intervention is considered in the future, the Inquiry suggests that any requirements for search and ranking criteria not be overly prescriptive, so as to allow as much room as possible for innovation by any PCWs that emerge both in pursuit of consumer interests and to ensure the economic viability of the PCW funding model. Further details could be prescribed if considered necessary to ensure effective functioning of PCWs.

***Licensing, clearance and accreditation***

PCWs could be provided freely or subject to a licensing or other requirement. This in turn affects the regulatory institution that would supervise them. The CBK has greater *ex ante* supervisory powers than say the CAK, while the latter has an important *ex post* function in dealing with transparency in consumer charges for credit under section 56(3) and (4) of the Competition Act. At this time, there appear to be no plans to regulate the planned PCWs in Kenya. Some countries have required them to be accredited, while others not.

While price transparency can improve competition for the reasons described above, it can also harm competition, whether through facilitating coordination or excluding innovation, also as described above. For these reasons, the CAK should keep a close eye on the manner in which PCWs are designed and operated. Where they run a risk of resulting in horizontal constraints on trade, in particular through risk of pricing coordination, it may even be appropriate for PCWs coming onto the market to ask the CAK for clearance under its Exemption Guidelines for Horizontal Practices, 2012.

While licensing and clearance under the Exemption Guidelines involve a permission before a PCW may begin or continue business, a lighter regulatory touch is possible using a voluntary accreditation arrangement. This could be established by the CBK or the CAK under which it reviews the PCW scheme and accredits it if it complies with certain design principles (discussed in the next section). A PCW would not be obligated to obtain accreditation, but it would likely be an important element for it in developing industry and consumer trust. Annual reporting to the relevant agency as to ongoing compliance with the principles would appropriately accompany such accreditation.

The Inquiry does not suggest introducing an accreditation scheme at this time. Such a scheme would risk delays and create regulatory uncertainty for the existing initiatives when they are preparing for launch or shortly after they have launched. It would also introduce questions as to its scope, and which institutions it applies to.

Under any scenario, such regulatory intervention should be done delicately in order not to discourage investment in PCWs. Indeed, if carried out with consultation over a reasonable period of time, regulation may even establish a helpful publicly-known framework for operation, lending a legitimising force that may contribute to confidence of the PCW itself and trust among participating institutions and consumers.

The Inquiry also recommends that, other than ensuring that rankings are not affected by commercial interests and the separation of rankings from advertising, there should be no regulation at this time of the funding models, whether through advertising, click-through referrals to the financial institutions or otherwise. At this time, although there is a risk of one or more PCWs becoming dominant over time, they do not yet even exist. There is not yet any indication that any PCW will have or be able to exploit unequal bargaining power with participating financial institutions and so regulating the financial model is premature. Indeed,

in the early period, the first PCWs will have much to prove and may be in a significantly weaker bargaining position.

***Mandatory participation***

A strong regulatory intervention to boost PCWs could be to require banks by regulation to publish prices of certain products on a PCW site before offering them to the public online. Such an intervention would need to consider carefully any dampening impact it might have on online lending and indeed lending generally, and the Inquiry does not recommend it at this time. In addition, it would need to address the risk that banks only post "best-case scenario" product information which does not correlate with products actually available to consumers.[430]

Financial service providers could also (or alternatively) be required to provide a link on their websites to one or more PCWs in order to increase awareness of their existence and encourage consumers to consider alternatives. The Inquiry considers it premature to require such a link where PCWs have not yet been established and proven the quality and reliability of their services, whether through commercial practice or official accreditation or licensing.

The Inquiry does not consider there to be sufficient certainty at this time as to the need for such regulation, or as to the likely impact of PCWs, for it to recommend requiring all banks to list their main products on a PCW or provide links to it.

***Supporting development of PCWs***

The Inquiry considers there to be merit in first supporting the development of the PCW initiatives currently underway and assessing their impact after a reasonable period of time (e.g., 2 years). Only if obligating lenders to list their prices and products would be reasonably expected to have a significantly greater impact than voluntary participation should this be considered at that time. Even then, it should only be introduced after a cost benefit analysis finds that the measure is proportionate to the anticipated beneficial impact and the regulatory burden.

The Inquiry considers that, particularly given signs of potential concerns about the KBA costofcredit service discussed in Section 5.4.1, it would be valuable to initiate a public discussion of the benefits and risks of PCWs. This should not necessarily be with a view to regulating their conduct, but rather to identifying relevant issues and how they should be approached. This could be done through preparing a study and holding a workshop with the banking sector and existing and potential PCWs.

### 7.3.4 USSD and SMS based price comparison services

A substantial portion of the population accesses digital financial products over feature phones through USSD and STK channels. These are less likely to go online to compare prices, as this undermines the speed and simplicity of accessing such products – particularly digital credit – from the phone.

The Inquiry has considered the prospects for price comparison services being provided over USSD and SMS channels, and finds no reason why they could not be. There are numerous examples of market information services provided over USSD and SMS, including in Africa, and including services offering pricing information – particularly in the agricultural sector.

[430] Gine X. & Mazer, R. (2016). Financial (Dis-)Information, Evidence from a Multi-Country Audit Study, Policy Research Working Paper 7750, World Bank Group, Development Research Group, Finance and Private Sector Development Team.

The inputs required for a PCW to generate a comparative total cost of credit or monthly repayment amount are limited, possibly even only to the loan type (secured, unsecured), amount and duration. The outputs can be limited also to a sum total cost of credit and monthly repayment amount, with the user being able to choose between these. While other channels should be considered, it ought to be feasible to provide over a USSD connection.

While the same data and back-end data processing could be used as for a PCW, the customer-facing interface would obviously differ. The business model for a commercial price comparison service over USSD would also likely differ significantly from a PCW. Where a PCW may generate revenue from advertising and click-through referrals, a USSD-based service would likely have to find alternative sources of funding, such as fees from participating institutions or consumers. The cost-base would also differ, in that USSD usage by consumers would have to be paid either by consumers or by the service provider. The ability to generate revenue would likely determine whether the service provider could absorb the USSD charges to allow the connectivity to be zero rated for the consumer.

An alternative would be for a PCW provider to fund the USSD service from the broader revenue from its PCW service, regarding the USSD service as a means of attracting usage and building trust and brand name. In any case, it is likely that the bodies that are already preparing PCWs would be the best candidates to establish a USSD service, leveraging the data and infrastructure already to be used for the PCW.

If a credible USSD price comparison service were to be established, digital financial service providers using USSD and STK for distribution of their services (such as M-Shwari and KCB M-Pesa) could be required by CBK regulation to include a notice in their menus indicating that alternative financial service providers exist and offer different prices, and providing the USSD codes for such price comparison services. For example, a message could appear along the following lines before the customer commits to take out a loan:

> Other lenders may offer better rates. You can compare the price of the amount you want to borrow by dialling *12345#

The Inquiry therefore considers that there is merit in encouraging those bodies that are already developing PCWs in Kenya to examine how they might add to these a USSD interface for comparison of simple products. The CBK and the CAK should engage with these to explore what could be done in this area, as well as seeking support from multilateral agencies to examine the technical and financial dimensions of such a service.

**Recommendation 8.** The Inquiry recommends that policy makers encourage a small number of commercial PCWs to develop, and ideally two or three to impose competitive pressure on one another.

In particular, the Inquiry considers there to be benefits from applying some public guidance as to their governance and operation, and suggests that this take the form of a 'best practices' paper of the CBK or the CAK after holding a workshop and carrying out a study involving the banks, the KBA and aspiring PCWs. This would seek to establish key design and operating principles for PCWs, but without being overly prescriptive. These principles would relate to (1) competitive neutrality, (2) openness to different types of financial provider, (3) protection of content from the PCW's commercial interests, (4) differentiation between advertising and ranking, and (5) disclosure of participating institutions.

We also recommend that any PCW brought to market be tested with consumers in order to verify its effectiveness and lack of distortions from the manner in which information is presented.

We do not recommend at this time introducing a licensing, clearance or accreditation scheme at this time, or requiring banks to participate. These options should be considered after the operation of PCWs has been reviewed over a period of 2 years.

The Inquiry also recommends that the CAK and the CBK engage with those organisations that are already preparing PCWs and multilateral agencies to examine how USSD and other customer interfaces might be added to PCW initiatives, including examining the types of products that could be compared with simplicity, and potential business models.

## 7.4 Use of, access to and reporting of customer information

### 7.4.1 Access to a customer's historical bank account transaction data

The report discusses below in Sections 8.2 and 8.3 potentially powerful remedies of introducing account number portability or a switching facility. While, as discussed there, the Inquiry does not consider competition concerns to justify imposing these at this time, the Inquiry also considered whether lighter targeted interventions might enable greater customer switching.

Consumers face a switching barrier where approaching a new bank for a service (typically a loan) that requires them to provide transaction data from their existing and potentially prior banks. As discussed in this Section, the Inquiry considers that some steps could be taken to simplify, accelerate and extend the process.

***Transaction history from existing banks***

At this time, a customer seeking a service from a new bank that requires transaction data from the customer's existing bank must approach the existing bank, request transaction data (often six months of bank statements), wait to receive these, pay a charge for them, and deliver them to the new bank. This involves time and cost that, if reduced significantly, should ease the process of switching.

The process essentially concerns communication of a limited amount of information held by one bank to another. Currently, the customer acts as an intermediary, obtaining the information and delivering it to the new bank.

One option to simplify this would be to require customers' existing banks to provide a customer-friendly mechanism for requesting provision of bank statements. For instance, the request mechanism could be integrated into a mobile application for customers using internet banking, or a USSD service. This could operate similarly to Safaricom's provision of six months of M-Pesa transaction histories to customers, as described in Section 6.4.3. However, this mechanism would allocate to the bank which the customer is leaving the effort of simplifying that switch away from it. The Inquiry is not minded at this time to impose an obligation on banks to provide an additional service to their customers beyond the existing service to provide customer transaction data in the form of bank statements upon request.

The Inquiry considers that one alternative would be to establish a multilateral arrangement whereby banks transfer the information under a common system of requests and protocols, and

another would be to rely on bilateral communication between the requesting and providing bank.

The Inquiry considers that the simplest mechanism is likely the latter. To enable it to function, the Inquiry considers that banks should be required by regulation to provide customer transaction histories in electronic form to another licensed bank requesting such data under authorisation of the customer, and to do so within a prescribed period of time. The means of communication can follow other secure means by which banks already communicate with one another, such as in connection with interbank transfers.

The initiating party in such cases would be the new bank requiring the transaction history in order to offer the service to the customer, which has the incentive to do so. The new bank, when approached by the customer for a loan or other service can secure authorisation from the customer to retrieve the required transaction data from the customer's existing bank. A request from the new bank to the existing bank would include a representation that the new bank has duly obtained the valid authorisation of the customer to make the request.

It would be important to establish a disincentive against abuse of the system. By analogy to the telecommunications industry, the practice whereby a telecommunications operator causes a customer's switch to it without permission under a number portability system is referred to as 'slamming,' and it is typically unlawful. Similar rules could be applied to protect against such abuse in the banking sector. For instance, a bank misrepresenting that the customer has authorised the request when he or she has not done so would be subject to serious penalties.

There may be scope for banks to innovate in obtaining such initial authorisation from the customer. Use of paper forms in the branch would be one approach, but others could include obtaining the authorisation over a USSD service or a mobile banking application or online banking. The Inquiry suggests at this time that banks should be left flexibility as to the means by which they obtain such authorisation, so long as the means they select have legal effect.

The Inquiry also considers that the provision of such information should be at no cost to the customer. It is inclined also not to provide for an interbank charge payable by the new bank to the existing bank, as such a charge may simply be passed through to the customer under the new loan or other service. It is preferable for the cost to be borne by the existing bank as a service that is provided to customers. It should not matter that the customer wishes the information to be provided directly to the new bank instead of to himself or herself.

It may be important to avoid 'fishing expeditions' by new banks seeking customer data at the cost of existing banks. To do so, the Inquiry considers it reasonable to provide that a new bank may only obtain the customer's authorisation and initiate a request from the existing bank in connection with an actual application by the customer for the loan or other service in question. One means of implementing this, which has been explored in the context of digital credit scoring,[431] is to require customer confirmation via SMS before information sharing is executed.

The new bank should also only request the information necessary for the process at hand, for instance if it requires six months of transaction history in order to assess a customer's creditworthiness then it should not request (or obtain customer authorisation for) more than this unless there is an industry consensus on a standard period of time for such data (e.g., up to 5 years).

[431] Mazer R., Carta J. & Kaffenberger, M. (2014). Informed Consent, How Do We Make It Work for Mobile Credit Scoring?, CGAP Working Paper.

The significance of customer data for making lending decisions may give rise to the question which entities should have a right to obtain the customer's authorisation and request transaction history from an existing bank. For instance, should only licensed banks have the right to request such data, or should unlicensed online lenders as well? While the latter would promote competition, the Inquiry is concerned not to overburden banks with excessive numbers of requests from unregulated entities. At this time, as such a regulatory intervention is introduced, the Inquiry considers it reasonable to establish a secure system among the banks only. However, it would also be worthwhile to investigate the feasibility of including non-bank lenders into the system on a reciprocity basis, i.e., where they can request transaction histories if they undertake to provide the same. If including non-bank lenders is not feasible at its inception, then perhaps as the system matures the issue can be revisited and studied further.

***Transaction history on and after closing of accounts***

A customer may also be required to provide a transaction history to a new bank after he or she has closed an account with a prior bank. In order to ensure that the customer has ready access to such data, we consider it reasonable and appropriate for a customer actively closing an account (as opposed to it going dormant and it later being closed with passage of time) to receive bank statements at the time of closure.

As some customers may not wish to receive these, this need not be an automatic requirement that imposes needless cost on banks, and so the Inquiry proposes that banks' account closure procedures provide for delivery to the customer of the records, subject to an opt-out by the customer. Delivery could be made in paper or electronic form at the customer's option.

Customers may also require transaction history not only from an existing bank when approaching a new bank, but possibly also from a bank after they have terminated their relationship with it. For instance, a customer's prior bank may have years of transaction history that are relevant to the customer's ability to obtain a loan or other service from another bank. A customer leaving a bank (i.e., completing a full switch to close an account) may, then, have a concern about access to historical transaction data from that bank when dealing with other banks in the future.

The Inquiry considers that customers would be more empowered to select the banks of their choice knowing that leaving a bank will not result in lack of access to transaction history, and that this may also facilitate switching. Effective availability of customer data for any service the customer seeks with the bank of its choice would depend on prior banks retaining records and making them available upon request to the customer or another bank requiring them.

The Inquiry considers that it is in principle reasonable to require such retention and provision of transaction data after customers have closed accounts. The relevant period and extent of the requirement should be determined by the CBK after further consultation with the banking industry in light of the existing and potential practices of data retention and use of transaction history when considering providing services such as loans. For instance, some Kenyan banks retain data for several years.[432]

This sort of initiative has implications for wider legal and policy issues regarding data protection, retention and privacy in Kenya. Kenya has not yet adopted comprehensive legislation in this field since consideration of the Data Protection Bill 2013. For these reasons, the Inquiry considers it vital that any move to introduce requirements for banks to retain and

[432] Standard Chartered's policy, for instance, is to retain data for no more than 7 years. https://www.online-banking.standardchartered.com/scb/newGUI/DataProtection_KE.htm

provide data take into account and be coordinated with the wider policy and law being developed. This includes any data retention, protection and privacy law that may be enacted, the context of Kenya's Access to Information Act 2016 (which applies to public bodies and private entities involved in public sector work or possessing information of significant public interest), as well as Kenya's right to privacy enshrined in Article 31 of the Constitution.

In the Inquiry's view, the cost of providing such data if requested should not necessarily fall on the original bank, and the Inquiry also recommends that the CBK consult as to how the costs of data retention and provision should be allocated. The Inquiry's preliminary view, subject to such consultation, is that customers who have been provided with the option on closing an account to receive transaction history (whether or not they exercised the option) should bear the cost of later obtaining such historical data if they subsequently request it.

**Recommendation 9.** The Inquiry recommends that the CBK and the CAK review this option if it is shown that customers continue to show reluctance to switch and such reluctance is primarily due to the administrative effort of doing so. Any such consideration of switching facility must take into account the potentially large costs of its establishment and operation and proportionality to the market failure it would be intended to remedy.

### 7.4.2 Third party use and customer access to mobile money transactional data

As discussed in Section 6.4, digital credit products rely heavily on customers' digital data to provide quick, often instantaneous credit assessments of potential borrowers. Some digital credit providers already have access to such data, as they may also provide traditional banking services to the customer and some obtain this data directly from the customer. Others receive this data from third parties. In Section 6.4.4, the Inquiry noted the vibrancy of the digital credit market.

Mobile phone airtime and mobile money transactional history is one form of customer digital data has proven to be a particularly useful input for the credit evaluation algorithms utilized by digital credit providers. The Inquiry looked specifically at use of Safaricom and M-Pesa transactional data by those digital credit providers (M-Shwari and KCB M-Pesa) that receive this information directly from Safaricom, rather than directly from the customer (Branch, Tala, Get Bucks). The Inquiry also assessed Safaricom customer's ability to access their M-Pesa transactional histories and to use these to apply for credit from other providers.

***Improved mechanisms for obtaining customer consent for sharing data***

As set out in Section 6.4.2, the Inquiry found that the current mechanisms used by Safaricom to obtain consent to share Safaricom and M-Pesa transactional data with CBA and KCB (its partners in the M-Shwari and KCB M-Pesa products, respectively) are insufficient. Currently when customers "activate" their M-Shawari and KCB M-Pesa accounts (see Figure 21 in Section 6.2.1) they are asked to accept terms and conditions for these accounts. The terms and conditions are not accessible within the STK channel. Rather, customers are provided an Internet link to a lengthy, formal pdf document that sets out terms and conditions for the savings and credit products. The consent to permit Safaricom to share M-Pesa transactional data with these banks is buried deep in these complicated documents.

The Inquiry does not believe that these mechanisms allow for any meaningful informed consent by the customers to such sharing. Many customers would not be able to access the documents through their mobile devices. Even if they can view them on their small mobile screens, it is not realistic to expect them to find and understand the consent provisions relating to information sharing.

For these reasons, with respect to mobile transactional data, such as airtime balance history, the current practices appear not to meet the customer privacy obligations of MNOs found in the Kenya Information and Communications (Consumer Protection) Regulations, 2010. The Inquiry recommends that the Communications Authority of Kenya assess whether current practice complies with these Regulations.

In addition, the Inquiry believes that the current practices around sharing of M-Pesa transactional data are likely not to meet the confidentiality provisions of the National Payment Systems Regulations, 2014. Section 42 of these Regulations require that payment service providers, such as M-Pesa, to obtain written authorisation from a customer prior to sharing customer information with a third party such as CBA or KCB. The Inquiry encourages the CBK to assess whether current sharing of M-Pesa data meets these standards.

The Inquiry found that a more effective and compliant means of obtaining customer consent would be to include a description of such sharing in plain English directly in the STK template. This disclosure could even be made in the same STK screen that links to the terms and conditions of these services as part of the activation process. A simple additional sentence would suffice, such as:

> By accepting these Terms and Conditions, you consent to Safaricom sharing information about your use of M-Pesa and your mobile phone with [KCB/CBA] for purposes of credit evaluation.

This addition would alert the customer to the information sharing and comply with the regulatory consent requirement.

***Ability of customers to access and use their M-Pesa transactional data***

The Inquiry also assessed the ability of M-Pesa users to access their M-Pesa transaction histories and to utilize these to access credit from providers other than M-Shwari and KCB M-Pesa. The Inquiry concluded such histories are easily available to M-Pesa customers through user-friendly mechanisms made available by Safaricom.

The qualitative interviews confirmed that customers are aware of and frequently utilize these mechanisms to access their transaction histories. Participants also reported that these mechanisms convenient and easy to navigate. Some participants further reported obtaining and then using these histories to as part of a credit application. The Inquiry also separately identified at least one digital lender, Get Bucks, that expressly requires its loan applicants to obtain their M-Pesa transaction history from Safaricom and then submit it as part of a loan application.

However, borrowers using feature phones may not be able to easily access electronic versions of transaction histories sent as PDF files to an email address. These customers must either use a computer to access the file or go to a retail centre to print out the transaction history. However, the current mechanism does allow users to have their transaction histories delivered directly to an email address of their choice, which could include a potential third-party lender. Such third-party lenders can give the customer an appropriate email to which they can request the data be sent.

Accordingly, the Inquiry did not find strong reasons for additional regulatory interventions at this time.

**Recommendation 10.** The Inquiry recommends that mobile money platforms be required to include a simple, plain English consent to use of customer transaction data for credit evaluation

(and any other purposes for which such data is used). It also recommends including a short description of such sharing be included in the STK screen for customers to read prior to indicating consent. The Inquiry also recommends that the Communications Authority of Kenya and the CBK review the practice of MNOs in using such data with a view to assessing compliance with the privacy provisions of the Kenya Information and Communications (Consumer Protection) Regulations, 2010 and the confidentiality provisions of the National Payment System Regulations, 2014, respectively.

### 7.4.3 Credit reporting by digital lenders

The Inquiry also assessed credit reporting by digital lenders. It looked at compliance with current reporting requirements by digital lenders and considered whether the current reporting methodologies are appropriate for digital lending. It also assessed whether the disparity in reporting obligations between banks and non-banks were harming competition in the market for digital credit or the ability of consumers to gain financial access.

***Compliance by bank digital lenders***

Credit reporting is currently only required for banks and similarly regulated entities, leaving unregulated, non-bank digital lenders, such as Branch, Jumo and Tala, under no obligation to report positive or negative information. As discussed in Section 6.5.1, the Inquiry did not find significant compliance problems with credit reporting by digital lenders.

However, the current methodology employed by M-Shwari still omits reporting on any loans that are not open on the reporting date each month but were successfully repaid. This does not appear to be aligned with the requirements of Section 33(5) of the Credit Reference Bureau Regulations, 2013.

***Nature and timing of reporting obligations***

The nature and timing of current reporting obligations raised concerns. As explained in Section 6.5.2, current reporting obligations were not designed to accommodate short-term loans. Reporting is often made on a monthly basis and there is significant lag time (relative to the short terms of the loans) before this information is available to other lenders. According to CIS Kenya, the CBK is in the process of updating its reporting obligations for these lenders to address these deficiencies. Proposed changes include daily reporting obligations for digital loans.[433] The Inquiry considers that such an initiative would be a significant improvement.

***Disparity in reporting obligations of banks and non-banks***

The Inquiry considered whether the disparity in reporting obligations between banks and non-banks creates a significant advantage for bank lenders that harms competition. The Inquiry did not find there to be a significant advantage with respect to the banks' reporting burden or the lack of availability of credit histories from those non-bank lenders that do not voluntarily report. The Inquiry also did not find compelling evidence that the lack of reporting by non-bank digital lenders is currently hampering growth in financial access or resulting in over-indebtedness. However, the Inquiry considers that a review of the disparity of reporting obligations within two years would be appropriate.

[433] Meeting with CIS Kenya, 3 February 2017.

**Recommendation 11.** The Inquiry recommends that the CBK review the reporting regime employed for M-Shwari loans and require compliance with the Credit Reference Bureau Regulations, 2013.

In order to ensure that reporting on digital loans is appropriately tailored to the short-term nature of these loans, the Inquiry supports any efforts to require daily reporting.

The Inquiry does not recommend adding a new reporting obligation for non-bank digital lenders at this time. However, the Inquiry does recommend that this issue be monitored and revisited as the market develops, review it within two years.

## 7.5 Centralised or coordinated KYC

### 7.5.1 The potential of centralised or coordinated KYC

***Purpose and function***

Differences in KYC standards among Kenyan banks were voiced to the Inquiry as resulting in duplicative KYC procedures that are both inefficient and a barrier to switching. The additional costs of banks are passed through (albeit indirectly) as costs to consumers in charges and interest. It also provides a disincentive to consumers who have to go through the inconvenience and effort to provide KYC information to a new bank to which they wish to switch. While consumers did not complain strongly about KYC processes specifically, they did express perceptions that opening new accounts was administratively burdensome.

Focusing on the latter point, the Inquiry considered whether some form of common KYC standards, operated in a streamlined coordinated or centralised manner, might increase the speed of account opening and reduce actual or perceived switching barriers. The opportunity for banks to reduce costs could present an incentive for participation.

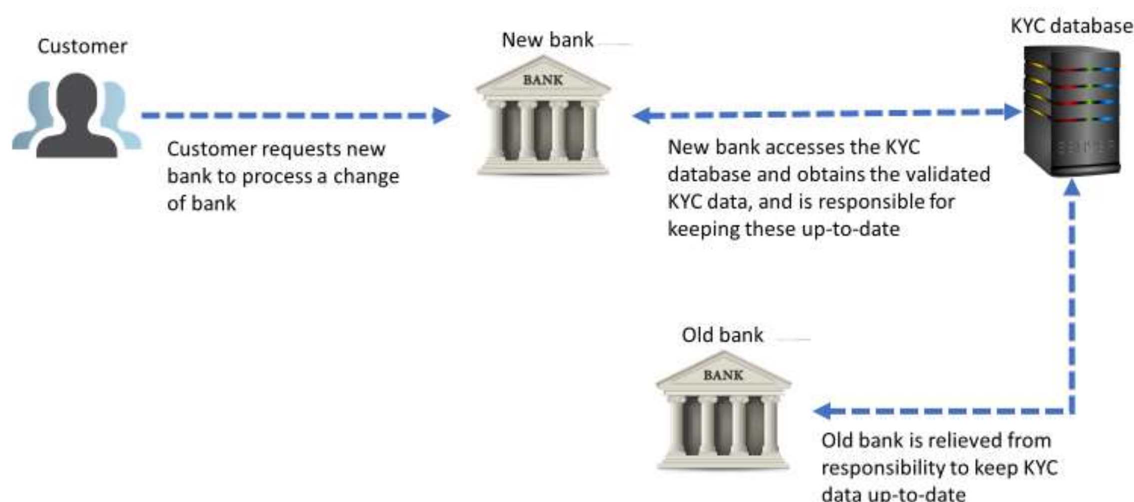
A centralised or coordinated KYC system would depend on various elements that would have to be established and various issues that would have to be resolved. At core would be a set of common KYC standards among participating banks, and one or more centralised databases to which they would contribute the data and enjoy shared access. The KYC database(s) would have to have secure electronic connectivity with the participating banks and any other organisations. One or more shared KYC providers would be responsible for verifying the KYC data and its completeness, validity and accuracy and storing, safeguarding and retrieving the KYC records – and making the data available to the participating banks.

One scenario would be for participating banks to continue to verify the identity of customers, carry out the due diligence, collecting KYC documentation from customers, scanning them and uploading them digitally to the shared database, and providing updates as necessary. Participating banks would then have access to the shared KYC data, thereby removing the need to collect KYC documentation when approached by a customer already registered in the system. KYC documentation would be collected only in particular circumstances, such as if the information in the database changes or some other reason makes it necessary to carry out enhanced due diligence, build a risk profile or verify the identity or address of the customer.

A KYC provider might issue a unique identifier for customers. It would have various data protection responsibilities, including controlling access to its KYC database, maintaining the integrity of the electronic systems for records, and making them accessible at all material times. It would have to take precautions ensuring that the electronic KYC records are not lost,

destroyed or tampered with, and ensure a back-up of electronic records is available at a different location.

**Figure 36 Example of a centralised KYC database**




*Source: Inquiry research*

Kenya would not be the first to set up centralised KYC. India, for instance, has established a Central KYC (C-KYC) Records Registry to receive, store, safeguard and retrieve the KYC records in digital form.[434]

***Design issues***

The design details would have to be worked through carefully among banks, KYC providers and possibly the CBK, and various key issues would have to be resolved. These include:

- what the ***scope*** of the scheme might be, including whether it would be restricted to licensed banks or whether SACCOs, unlicensed digital credit providers and other unlicensed lenders might also contribute to and benefit from the system;
- whether banks' participation would be ***voluntary or mandatory*** (i.e., by regulatory obligation);
- whether there would be a ***single or multiple providers*** of KYC services (and the nature of interoperability in the case of multiple providers);
- whether the central KYC service would take full ***responsibility for and ownership of the data***, or whether participating banks would continue to own and be responsible for it;
- what the ***funding*** arrangements would be, including whether funded by a fee or charge paid by banks or support from government, donor agencies or customers;
- ***governance*** arrangements for management of KYC service provider(s), including influence of different participating banks over the structure and processes; and
- ***regulatory framework***, such as whether the banks would require CBK approval to outsource KYC in the manner desired, and whether a provider of KYC services would

[434] The Government of India in its Notification dated November 26, 2015 authorised the Central Registry of Securitisation Asset Reconstruction and Security Interest of India (CERSAI), set up under sub-section (1) of Section 20 of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (54 of 2002), to act as and to perform the functions of the Central KYC Records Registry under the said rules, including receiving, storing, safeguarding and retrieving the KYC records in digital form of a "client," as defined in clause (ha) of sub-section (1) of Section 2 of the Prevention of Money-Laundering Act, 2002.

have to meet certain qualification criteria, require permission to operate (e.g., in the form of a licence), and be subject to reporting obligations and other oversight requirements.

- the feasibility of incorporating ***tiered KYC*** or other risk-based approaches, consistent with the recommendations of the Financial Action Task Force.

Some of these issues are of course related to one another. For instance, the wider the range of institutions that are to participate beyond banks, the greater its impact could be. Extending it to SACCOs could increase breadth of impact across the population and improve efficiencies of scale for the system. The KYC database could even be extended for purposes beyond banking in order to increase the social and economic return on the investment. However, the different regulatory regimes applicable to banks, SACCOs, unlicensed digital credit providers and lenders may make it difficult (and possibly inappropriate) to apply a mandatory system also applying to unregulated lenders.

Conversely, a market-led voluntary initiative might be approached with a smaller number of banks that already have securities business and so are familiar with shared KYC database provided for such purposes.

While there would be some upfront costs in establishing what is essentially a form of outsourcing, banks' operating costs should decline as customers are increasingly registered in the system. If the upfront investment appeared to be a blocking factor, in particular in achieving consensus and participation among the banks, some public funding (possibly with support from international development agencies) could be contemplated.

Gathering sufficient consensus among banks to achieve a purely voluntary system may be difficult. It is not clear that all banks will consider the benefits of efficiency gains arising from outsourcing KYC to exceed the perceived downside risk of making it easier for their customers to switch to other banks through an easier KYC process. Furthermore, one of the origins of the problem being addressed is the different KYC standards currently used in Kenya, and these originate in part from different assessments of and appetites for risk – what one bank will accept may not be acceptable to another.

In addition, banks that are foreign-owned may require KYC standards to comply with those in other jurisdictions and therefore may have requirements beyond other banks. Reaching agreement on a common set of standards may require significant consensus building efforts. In addition, there will inevitably be some complexity in integrating a new KYC platform with banks' existing procedures, databases and data reference systems currently used for new customers. So, to gain sufficient scale to have an impact, CBK support may be needed to bring a critical number of institutions on board.

Thus, even in a voluntary, market-led initiative, the regulatory authorities would likely have to play a significant role. Indeed, regulatory approval may be required for at least some elements of a coordinated or centralised KYC system. The CBK does generally allow outsourcing for KYC but where it relates to anti-money laundering (AML) the CBK must give its approval, and this is potentially a significant part of KYC activities.[435] Even where CBK approval is not required, the support of the CBK is likely to be an important factor in building trust and accelerating banks' participation. It may also be essential to attracting financing from multilateral agencies.

[435] The CBK's Guideline on Outsourcing CBK/PG/16, section 4.1.4.

The shared KYC system might also require competition approval of the CAK under its Exemption Guidelines for Horizontal Practices, 2012, as it would represent a horizontal cooperation among competitors. If the governance arrangements do not effectively discriminate against or exclude smaller banks, it is reasonable to think that the benefits to competition and efficiency gains would be viewed as exceeding any conceivable harm to competition through the banks combining this part of their activities.

Another issue would concern whether the system only applies to new KYC registrations or whether banks might also contribute KYC data already in their systems. (This would likely only be eligible if it was collected pursuant to standards aligned with those of the new shared KYC system.) Naturally, the larger the number of customers that can be brought on-board earlier the better, but the 'grandfathering' of existing KYC held in banks' proprietary systems may pose technical challenges (including whether the data is even held in digital form). It may also weaken the incentives of some banks to participate if they are not satisfied that the return on their effort outweighs the risk of losing customers and any imbalance in banks that agree to or are able to contribute KYC data of existing customers.

### 7.5.2 Designing for the Kenyan context

It would be important to design a shared KYC function in the context of the Kenyan banking market today and its anticipated evolution, as well as related sectors.

The shared KYC system would want to fit in appropriately with the development of other identification-related systems in Kenya. For instance, the Integrated Public Registry System (IPRS) is used now extensively for verifying customer identities, such as by MNOs for SIM registration purposes, and by CDSC for investment accounts, and is shifting to biometric identification.

Other identity-related infrastructure might also be leveraged. Country-wide centres used for registering identities with governmental portals might be used to widen the distribution network beyond banks, thereby easing consumers' ability to register and delink them from the necessity of doing so only in a bank branch. Such efforts would need to weigh the benefits of linking the shared KYC system with the higher burden of identification for government purposes, which may call for more advanced controls and access. The KYC system would be designed to comply with Kenya's anti-money laundering (AML) laws and international AML commitments, as well as data protection related legislation.

Similarly, in Kenya, some KYC and identification-related services are already carried out by companies in related fields. For example, the Central Depositary and Settlement Corporation (CDSC) manages KYC of investors for securities accounts and trading. CDSC acts under supervision of the Capital Markets Authority under the capital markets legislation. The customers' stock brokers and banks act as CDSC's agents, currently managing the registration and retaining KYC documents at their offices. CDSC is introducing a new system with a KYC module that will allow agents to upload all documents to a central CDSC database. This will also allow biometric information to be uploaded. Such an organisation could scale up its KYC infrastructure for mass retail and business banking and other financial services such as mobile credit. Existing systems could be adapted and developed to be used by banks, acting as agents, to upload KYC data to the system for retail banking. These could be extended beyond investment and securities accounts and banking to insurance and other financial services, and even other services such as mobile SIM registration.

Local institutions such as the Kenya Bankers Association (KBA) could be involved with a view to building consensus among banks on the shared KYC standards, as well as to offer views on the merits and demerits of different models.

Resolving the various issues mentioned above is a substantial task that would requires a broad view of financial regulation and the close involvement of the CBK and extensive consultation with the banking and possibly related sectors.

The benefits of a shared KYC service would take some time to materialise as customers are registered on the system, but in time they should reduce the effort required by a customer to switch bank.

**Recommendation 12.** The Inquiry recommends that the CBK confer with the CAK, the KBA, existing KYC providers and other appropriate bodies to consider the potential benefits of facilitating centralised or coordinated KYC, the design options for such a system, the costs of establishing and maintain the system, the incentives of banks to participate, and international examples. As consumers did not claim that the KYC process was a direct barrier to switching, it may be more prudent to commence with a voluntary approach than imposing it by regulation, although regulation could be used to establish a KYC provider status that might attract trust necessary to encourage substantial participation.

# 8. Other measures considered

## 8.1 Publishing quality of service indicators

Price is only one of several potential facets of competition in a well-functioning market. Others include product innovation and quality and variety of service. These less quantitative variables may be significant where they result in products that are better designed for the needs of consumers, or where attention to communication with customers and speed of resolution of their request and problems leads to greater confidence and ease in using the service.

Kenyan consumers do not tend to have ready access to comparative quality of service indicators. Some banks do monitor customer satisfaction with a view to attracting and retaining customers, including using customer willingness to recommend the bank to friends and family as a yardstick for satisfaction levels.

Some data relevant to consumers is published by banks, such as the number and location of their branches, which as discussed below has been found in Kenya to be the most important factor in consumer satisfaction. However, data comparing other quality of service factors, such as the time taken to open an account or speed of resolution of complaints, is not widely available to consumers. Kenyan consumer organisations, for instance, do not publish widely statistics in this area for ready access by consumers to enable quality of service to be a significant competitive factor.

### 8.1.1 Publication of comparative quality of service rankings

One possible means of increasing competitive pressure on banks in the area of quality of service would be to increase customer sensitivity to this competitive factor by providing consumers with more information. This could be achieved, for example, by obtaining and publishing comparative data in a standard form. Banks might be required to publish the data themselves,

or the data could be collected, compared and published by the CBK or the CAK, even ranking banks for their survey results.

Given the means of distribution and saliency of information to customers dealing with banks, the most effective means would likely be to require banks to publish prominently, at branches and on their websites, annual quality of service survey results, using customer satisfaction as the measure. The CBK or the CAK could also publish the results in the media on a bi-annual basis. However, intermediaries such as price comparison websites may also become useful disseminators of such comparative information, which may enable them to provide a fuller set of comparison services.

### 8.1.2 Indicators of quality of service

Customer satisfaction could be tested directly or, possibly more reliably, indirectly through comparing and ranking the readiness of customers to recommend to friends and family the bank's transaction and savings accounts, loans, online services, and (for SMEs) relationship banking.

Additional indicators which the Inquiry considered included customer service call centre performance (e.g., length of time to answer calls), unavailability of or interruptions to internet banking service, opening hours of branches and availability of staff, and time taken to resolve complaints. While useful for policy consideration, the Inquiry finds that requiring systematic collection and publication of such details is likely not a proportionate and effective remedy, and may not even result in changed outcomes, particularly if a large amount of information resulted in customer information overload. To the extent information should be required to be published, it should be kept reasonably simple.

### 8.1.3 Responsibility for data collection and analysis

The Inquiry considered whether data might be collected by banks directly from their customers annually on a standardised basis that would enable customers to compare banks, or, whether it should be obtained pursuant to an independent survey. The latter is clearly preferable in terms of efficiencies resulting from standardisation and scale, and should produce more robust and trusted results.

An independent survey would ideally carry out random inquiries, and would require access to banks' customer lists. The CBK or, in its consumer protection role, the CAK, which might oversee the selection and engagement of the consumer research firm, approve its methodology, and provide accreditation to the results.

While donor or public funding could be used to establish the survey system, a sustainable funding model would be required. For instance, the financial cost of a survey could be shared across the banks, for example in proportion to their financial scale or share of the customer market.

### 8.1.4 Ensuring remedies improve outcomes

However, the Inquiry considers that it is important, before imposing the cost of producing an independent survey and the regulatory burden for banks to publish the results, to examine the anticipated benefits and costs of doing so.

Although the Inquiry has not calculated them, the costs of establishing an independent survey are likely considerable. To be robust, the survey would have to cover a large enough number of customers from all of Kenya's banks. Requiring all banks to supply customer lists and contact information, as well as potentially funding the survey, would add to the burden.

It is thus important to have a view on how much of an impact such an intervention would have on competition among banks, and at this time this is not clear. As discussed in Section 4.3.3, customers tend to express fairly high levels of satisfaction with the quality of service of their banks, and this is consistent with academic and other surveys. This might be interpreted to suggest that the quality of service is generally good, or alternatively that, as with pricing, customers are not engaged in assessing banks for comparative quality of service with the possibility of switching.

The Inquiry's primary consumer research did not find that quality of service is a primary competitive factor in the Kenyan banking sector, or that customers have major quality of service concerns beyond those about transparency of costs, the remedies for which are addressed in Sections 7.2 and 7.3.

**Figure 37. Factors behind satisfaction of bank customers in Kenya.**

| What satisfies you most in your bank? (you can list up to three reasons) | | In total | Gender | | Age | | | Education level | |
|---|---|---|---|---|---|---|---|---|---|
| | | | $\chi 2$=3,84000* | | $\chi 2$=5,99000* | | | $\chi 2$=3,84000* | |
| | | | Men | Women | Under 30 years | 30 - 50 years | Over 50 years | University | Primary and secondary |
| Quick services at branches | % | 27,79 | 27,33 | 28,14 | 26,38 | 34,11 | 0,00 | 25,70 | 44,44 |
| | $\chi 2$ | | 0,032 | | 4,741 | | | 6,998 | |
| Quality of products and services | % | 23,57 | 22,09 | 24,68 | 23,31 | 25,00 | 20,00 | 23,74 | 22,22 |
| | $\chi 2$ | | 0,366 | | 0,127 | | | 0,052 | |
| Availability of branches | % | *57,82* | *58,72* | *57,14* | *59,20* | *51,39* | *60,00* | *58,38* | *53,33* |
| | $\chi 2$ | | 0,101 | | 1,488 | | | 0,419 | |
| E-banking presence | % | 45,41 | 48,84 | 42,86 | 43,87 | 55,56 | 0,00 | 46,64 | 35,56 |
| | $\chi 2$ | | 1,424 | | 7,465 | | | 1,980 | |
| Friendly services at branches | % | 35,48 | 37,79 | 33,77 | 34,97 | 34,72 | 80,00 | 33,80 | 48,89 |
| | $\chi 2$ | | 0,698 | | 4,405 | | | 3,973 | |
| Developed network of ATMs | % | 43,67 | 43,60 | 43,72 | 42,33 | 47,22 | 80,00 | 44,97 | 33,33 |
| | $\chi 2$ | | 0,0001 | | 3,302 | | | 2,199 | |

Note: critical values of $\chi 2$

*Source: Kombo, F. (2015)*

**Figure 38. Factors behind dissatisfaction of bank customers in Kenya.**

| What dissatisfies you most in your bank? (you can list up to three reasons) | | In total | Gender | | Age | | | Education level | |
|---|---|---|---|---|---|---|---|---|---|
| | | | χ2=3,84000* | | χ2=5,99000* | | | χ2=3,84000* | |
| | | | Men | Women | Under 30 yrs. | 30 - 50 years | Over 50 years | University | Primary and secondary |
| Slow services at branches | % | 52,61 | 52,91 | 52,38 | 53,37 | 51,39 | 20,00 | 53,91 | 42,22 |
| | χ2 | | 0,011 | | 2,252 | | | 2,190 | |
| High prices of products and services | % | 55,09 | 59,88 | 51,52 | 55,52 | 51,39 | 80,00 | 55,59 | 51,11 |
| | χ2 | | 2,791 | | 1,677 | | | 0,324 | |
| Impersonal approach | % | 17,37 | 18,02 | 16,88 | 18,40 | 13,89 | 0,00 | 18,72 | 6,67 |
| | χ2 | | 0,089 | | 1,902 | | | 4,043 | |
| Poor quality of e-banking presence | % | 34,00 | 31,98 | 35,50 | 32,82 | 37,50 | 60,00 | 32,12 | 48,89 |
| | χ2 | | 0,545 | | 2,101 | | | 5,008 | |
| Poor accessibility of branches | % | 15,14 | 13,37 | 16,45 | 14,42 | 19,44 | 0,00 | 13,97 | 24,44 |
| | χ2 | | 0,727 | | 2,063 | | | 3,417 | |
| Low acceptance of my needs | % | 42,43 | 45,93 | 39,83 | 44,17 | 36,11 | 20,00 | 44,13 | 28,89 |
| | χ2 | | 1,504 | | 2,612 | | | 3,803 | |

Note: critical values of χ2

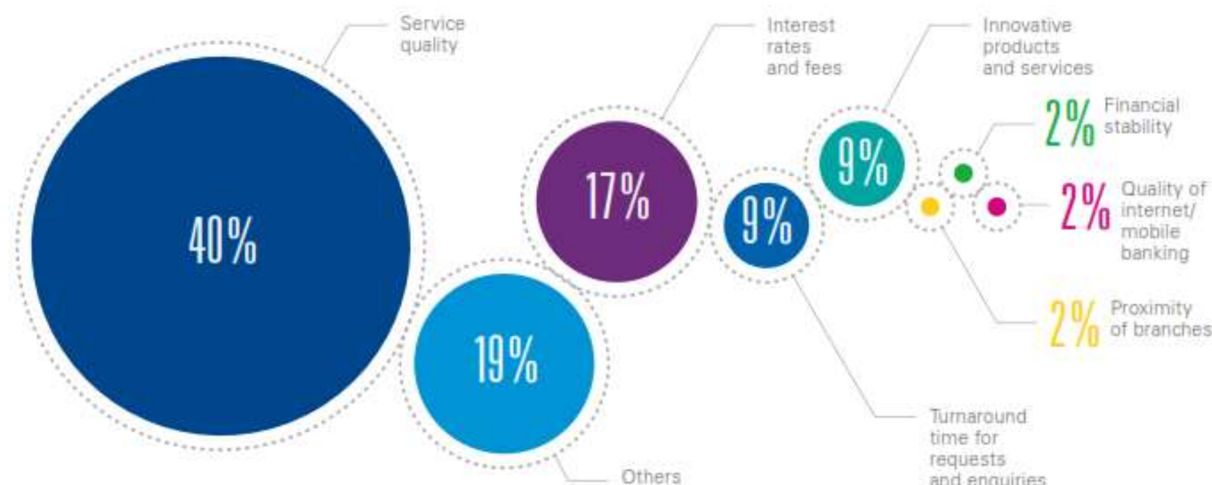
*Source: Kombo, F. (2015)*

Some surveys have found that customers tend to be focused on access and pricing when it comes to their satisfaction. For instance, as shown in Figure 37, a 2015 study by Kombo of 403 consumers found that 58% of customers considered the availability of branches and 45% the availability of digital services to be the most important factor for satisfaction, while only 27% considered quick service in branches and 23% considered the quality of products and services to be the most important factors.[436] Nevertheless, slow service and lack of focus on the customer's needs have featured as significant causes of dissatisfaction, though falling behind high prices.

KPMG's 2016 Africa Banking Industry Retail Customer Satisfaction Survey found that service quality is by far the largest reason why customers leave their banks. 40% of customers surveyed gave service quality as the reason for changing bank, compared with the next largest factor, where only 17% gave interest rates and fees as the reason.

[436] Kombo, F. (2015): "Customer satisfaction in the Kenyan banking industry," Journal of International Studies, Vol. 8, No 2, 2015, pp. 174-186.

**Figure 39. Reasons why customers leave their banks**




*Source: KPMG's 2016 Africa Banking Industry Retail Customer Satisfaction Survey*

Overall, the Inquiry finds that while quality of service may be a significant cause of dissatisfaction and the main reason for changing banks, there does not appear to be a lack of customer engagement with quality of service as a competitive factor. Indeed, customers already appear to be very sensitive to it and to act on it including to switch. Thus, it is not clear that the benefits from introducing new mandatory customer satisfaction surveys and comparisons are likely to outweigh the additional cost and effort involved. It may for instance be a better use of resources to concentrate regulatory effort of the CBK and the CAK, and the compliance effort of banks, on pricing, in particular improving the transparency of pricing through disclosures and price comparison remedies in Sections 7.2 and 7.3.

The Inquiry is also sensitive to the risk of such remedies leading to banks investing in administrative resources geared mainly to optimising statistical performance results. It is important to encourage banks not so much to compete for administrative industry rankings as to compete directly to win customers on commercial factors such as product innovation and better prices.

Although it does not recommend imposing quality of service ranking disclosure requirements, the Inquiry does recommend taking further steps to test whether providing consumers with comparative information on quality of service is likely to affect outcomes. Increasing the information load to consumers may create overload, or may distract from other areas which may be more important. Further study in the Kenyan market is needed to determine whether consumers will absorb information on quality of service that is provided under a regulated mechanism as opposed to information received from friends and family, the comparative reliability of such information, and whether consumers are likely to act on it.

## 8.2 Account number portability

### 8.2.1 The potential for ANP

The Inquiry considered introducing a powerful measure to enable switching by through account number portability (ANP). There are a variety of ways in which this could function. It might involve retaining the existing customer identifier system, or introducing a new one. Regardless,

it would likely require a centrally-managed repository for customer identifiers, a payments mandates database and a payments redirection database. These would have to be integrated with the payments infrastructure.[437]

An alternative would be a centralised 'utility' arrangement with a shared banking platform for a common payment infrastructure. This would provide back‑office functions to participating banks. This might have efficiency gains, while leaving banks to differentiate their products and services through pricing (price levels and structures) of charges and interest rates, as well as mobile banking applications and internet banking.

ANP would take switching further by allowing consumers to retain their bank account numbers and bank identification number. It is not necessary to inform third parties about a new account number, and should greatly reduce switching costs. There would be no need to change instructions for incoming payments, and outgoing payments (e.g., direct debits and standing orders) would be pulled from the new account without interruption.

The reduction of the customer's perception of risk – of payment errors, particularly incoming payments going missing – should be reduced as well. Increased consumer confidence in a smoother switching process might attract more customers to switch through a switching facility.

### 8.2.2 Appropriateness of the remedy

Some studies have indicated that number portability in mobile telecommunications, another network industry, has significantly increased switching.[438] If effective in retail banking, ANP for transaction accounts may have a magnifying effect because to some degree transaction accounts act as a gateway to other banking services, as it is easier to obtain credit from a bank where a customer holds his or her transaction account.

However, ANP is generally considered to be significantly costlier than switching facilities, at least at the outset, requiring substantial upfront investment by and coordination among banks to establish the necessary platforms. It also raises security concerns and risk of fraud as banks currently rely on a numbering system to identify each bank and removing these may introduce new risks of erroneous identification of banks as well as customers.

ANP is not a remedy that has seen take-up internationally in retail banking. In Sweden, there is a form of ANP for business customers that enables payments to a customer's unique number (a 'bankgiro' number) rather than their account number. The bankgiro number is portable. Customers need only delink the number from their old bank account and link it to a new bank account for payments to flow smoothly when they switch. However, regulators have tended not to introduce ANP where there was hope that the switching facility would still make a difference, particularly where prudential regulation weighs more heavily in the policy agenda than competition.[439] It is generally considered to be a heavily disproportionate remedy even where it might have the desired benefits.[440]

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[437] For different ANP options, see Moorhouse (March 2015), Account Number Portability Report commissioned by the Financial Conduct Authority.

[438] Grzybowski, L. (2005). Regulation of Mobile Telephony across the European Union: An Empirical Analysis. Journal of Regulatory Economics, 28(1), 47-67. Lyons, S. (2006). Measuring the Benefits of Mobile Number Portability. Department of Economics Trinity College Dublin.

[439] E.g., the Netherlands introduced switching as a lower cost alternative to account number portability. Dutch Parliamentary Papers II 2002/03, 27863, 12, p. 4.

[440] See, for example, Australian Government (2011) Banking Services: cost-effective switching arrangements. Canberra: Australian Government.

Furthermore, it is not clear that ANP would at this time have the desired impact. While many of Kenya's retail banking consumers do receive salaries and other incoming payments to bank accounts, they do not have the same degree of reliance on standing orders and direct debits with M-Pesa commonly used to pay accounts. The substantial check-off loan market and delays to salary payments to other banks provides an incentive for customers to maintain their transaction accounts with their employers' banks may also reduce the beneficial impact of ANP.

Lastly, Kenya's payment systems are undergoing change. The rise of mobile payment systems and introduction of the Kenya Interbank Transaction Switch (KITS) are but two important developments. To require at this time the scale of change to a fast-changing system that would be implied by introducing ANP would be a major regulatory intervention that is likely disproportionate to the benefits. For these reasons, while the Inquiry considers that ANP should remain under consideration, we recommend focusing on lower cost interventions.

The Inquiry does not recommend pursuing ANP at this time. We would recommend it only if it is shown that customers continue to show reluctance to switch, that such reluctance is primarily due to the administrative effort of doing so, that the potentially large costs of its establishment and operation are proportionate to the market failure it would be intended to remedy, and that there is evidence of its success elsewhere.

## 8.3 Switching facilities

The Inquiry considered the possibility that a lighter intervention, such as establishing a switching facility or service, could support the switching process and increase the tendency of customers to switch. This could involve a system that facilitates the transfer of transaction accounts, or of loans through loan buyouts.

### 8.3.1 Switching facility models

A switching facility would have the goal of automatizing switching upon instruction of a customer to the new bank. In the context of transaction accounts, the facility would be used for transferring the account to the new bank with:

- transfer of funds on deposit with the old bank;
- continuity of outgoing payments (direct debits and payment orders);
- continuity of incoming payments (salary) and other funds received over a subsequent period; and
- transfer of transaction history data.

The transfer would occur within a maximum period of days. To be effective and protect against distrust, any risk of error and loss to the customer would be minimised. For example, payments made by accident to or requested from the old account could be redirected to the new account for a period after the switch. This could be supported by a guarantee that any charges and interest applied if the switch does not work effectively will be refunded. The trust issues that have been identified in other countries for such a service may not be as strong in Kenya, where use of standing orders and direct debits is not as prevalent as in more developed markets.

The system would require banks to keep a record of previous account numbers in order to avoid reallocating the number of a customer who has switched away until the old account is closed, after which the bank could reuse the number.

Ideally, and to maximise the chance of take-up, a switching service would ensure that the customer is not required to double pay for accounts by paying charges for the old account when also paying charges for the new one (as occurred in early years of Dutch switching service).[441]

There are different approaches to switching facilities:

- ***A central multilateral platform*** involves a single, common system to which participants connect and which switches messages based on standard scheme rules, security and message formats.
- ***A bilateral system*** enables participants to connect with each other bilaterally using shared rules and procedures but without a common system.
- ***An open system*** uses shared rules and procedures to enable participants to connect using agreed formats. Participating banks may choose their own methods (e.g., paper, electronic or other bilateral communications).

A central multilateral switching facility could be owned, governed and operated by a public agency or a private sector consortium, and participation by banks could be voluntary or mandatory. For instance, the UK's CASS is a voluntary industry scheme set up as part of an industry wide programme by the UK Payments Council and owned and operated by the settlement and clearing system, Bacs Payment Schemes Ltd (Bacs), under the management direction of the participating banks. At another end of the spectrum, commercial switching agencies have cropped up that provide a switching service to customers, although typically in the online account context,[442] although the Inquiry does not believe that the demand for such agencies is likely to lead to substantial development of this market in the near future.

A bilateral system would require low-cost communications, avoid substantial upfront costs and may be easier to build incrementally.

An open system is flexible, though common customer service principles may be difficult to implement.

A switching facility is more likely to be used by customers if its cost were borne by the banking sector as opposed to customer charges, i.e., free to use. It would be rapid, i.e., quicker than the existing process that typically takes a customer a minimum of two weeks and often longer. The customer would ideally be able to choose and agree the date of the switch with their new bank.

To bring on board a sufficient number of banks to be effective, a voluntary switching service arrangements would need to strike an appropriate balance between banks that are likely to lose customers and those that are likely to gain customers. Some neutral external or regulatory influence or control on such a service would very likely be necessary, along with transparency and accountability of decision-making.

The switching facility would need to be subject to some regulatory oversight to ensure healthy governance and to secure trust from consumers. It could be governed by banks, but with participation at board or management committee level of independent members.

Similar services introduced in other countries have suffered from a lack of awareness of and confidence in such services.[443] A switching facility would require to be accompanied by a major

[441] Netherlands Consumer and Markets Authority (2014), Barriers to entry into the Dutch retail banking sector, p.84.

[442] Examples include Deluxe (http://fi.deluxe.com/onboard/account-switching-programs/) and ClickSwitch (http://www.clickswitch.com/).

[443] E.g., the UK's FCA reported in 2015 that only 41% of individuals surveyed has heard of the Current Account Switch Service (CASS). FCA, *Current Account Switch Service – effectiveness and potential enhancements*, 2015.

information campaign to inform Kenyan consumers of its existence, how to engage it, and generate trust in its efficacy and efficiency. Such information campaigns could combine centralised efforts by the Government, the CBK and the CAK with coordinated efforts by banks having an interest in increasing switching.

### 8.3.2 Appropriateness of the remedy

A switching service is typically most useful in the case of full switching rather than partial switching. The extensive multibanking practice in Kenya suggests that there is a high tolerance for leaving an account with an old bank open after switching to a new bank. Banks will in any case treat the account as dormant after a period of inactivity, and are not entitled to charge the customer for the account during that period.

There is, then, already a default process for closing accounts that does not impose excessive costs on customers. In addition, a switching service is most effective really where there is a culture of using extensive direct debits and standing orders, which there is not yet in Kenya.

International experience with switching services has been mixed. The UK's Current Account Switching Service (CASS), for example, reported 3.5 million customer switches (including 75,000 small business accounts) between its establishment in 2013 and the end of 2016.[444] However, this appears to reflect a low number of actual customers switching, with the proportion of customers switching bank accounts never exceeding 5% over five years, despite the introduction of CASS.[445]

These factors lead the Inquiry to consider that the benefits of a full switching service are not as high as in other countries at this time, and it is likely that the upfront costs in establishing such a service would be a disproportionate burden to impose by regulation. In particular, it is not clear that the anticipated benefits would be substantial because it has not been established that Kenyan consumers are reluctant to switch due to worries about transferring payment orders and funds received.

However, the Inquiry does find that there are elements that would reduce the barriers to switching that could usefully be introduced in Kenya without imposing the full burden of a switching facility. These involve access to a customer's transaction data from an existing or prior bank and centralised KYC. These are discussed in Sections 7.4 and 7.5 respectively.

The Inquiry does not recommend imposing a switching facility at this time. This remedy might be revisited at a later time after the market has matured and only after a careful weighing of the anticipated benefits of the remedy against the burden of introducing it.

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[444] CASS Annual Report 2016.

[445] Yvette Hartfree, Jamie Evans, Elaine Kempson and Andrea Finney (2016): Personal current account switching: Why don't more people switch and what could encourage them to do so?

# Annex 1 (Customer journeys)

In this Annex 1, we set out the basic customer journey for acquiring opening accounts in five bank products:

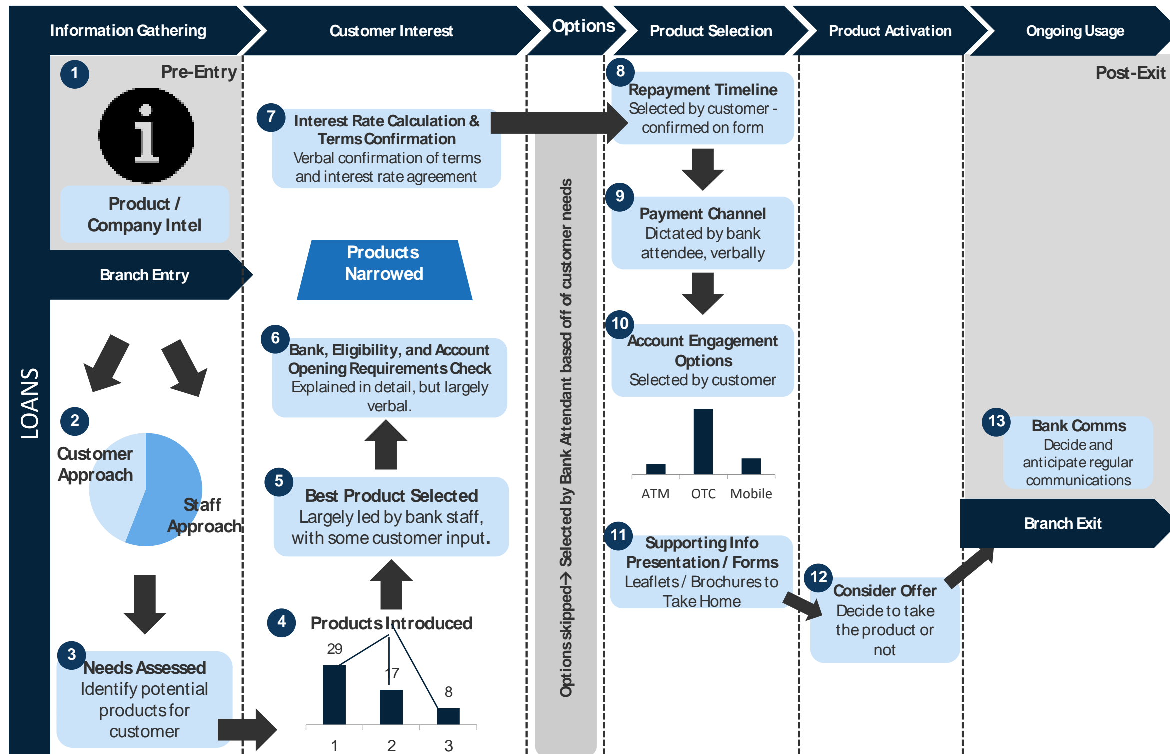
1. Traditional bank loans at a branch
2. Traditional bank savings account at a branch
3. Traditional transaction account at a branch
4. Digital bank savings account via mobile phone
5. Digital loan (bank and non-bank) via mobile phone

For the three categories of traditional products, the steps we set out below present an overview of the general customer experience as encountered during the mystery shopping exercise. Clearly there will be significant variation among the experiences of individual shoppers as they shop at different banks and branches of those banks, encounter different staff and have different needs and circumstances. The journeys we present here are meant to provide an outline of a typical bank experience.

For the two categories of digital products, the steps we set out below reflect an amalgamation of the journeys assembled for each of the individual products explored. For each digital product, the customer journey is fixed as a function of the user interface. For example, two users applying for an M-Shwari loan will encounter the same series of screens and be required to input the same type of information. The variation in these categories is between products, as, for example, M-Shwari and Branch have unique user interfaces. The journeys we present for these categories are made to generalize the typical customer experience across products, recognizing that significant variation exists.

## Traditional bank loans

**Figure 40: Customer journey map for traditional bank loans**




*Source: Busara Report, p. 12*

### *STEP 1: Product and bank intel (pre-branch entry)*

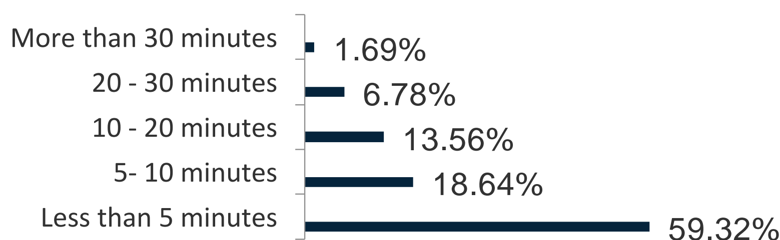
The first step in the customer journey for acquiring a traditional loan at a branch is acquisition of information about banks and products before entering a branch. Customers rely on a variety of external sources for information on banks and products and these are discussed in Section 4.1 of the report.

### *STEP 2: Staff approach and introduction*

This step captures the first interaction between customers and bank staff. The qualitative interviews indicate a perception among some customers that the loan application process required long wait times and lengthy queuing at branches.[446] However, in the mystery shopping exercise, wait times for initial service at branches were usually not excessive. 35 of 59 shoppers (59%) were approached by bank staff for service in less than 5 minutes, and 46 of 59 (78%) in less than 10 minutes (see Figure 41).[447] Only 4 of 59 shoppers (7%) reported that bank staff were not polite and approachable.

[446] Inquiry's Consumer Research Phase I Report, p. 56.
[447] Inquiry's Consumer Research Phase I Report, p. 14, Annex 8.

**Figure 41: Wait times for initial service at branches for loan-seeking mystery shoppers**




*Source: Inquiry's Consumer Research Phase I Report, p. 14.*

***STEP 3: Customer needs assessment***

In this step, bank staff assesses the particular needs of the customer in order to later introduce appropriate products. However, this step is often skipped, particularly in the case of low- and middle income customers.

***STEP 4: Products introduced***

In this step, bank staff present a selection of products that are compatible with the customer's needs assessed in Step 3. It is from this pool of products that the bank staff will next help the customer determine which product is the best fit. In the mystery shopping exercise, the products were presented verbally with only a few instances of detailed written descriptions offered.[448] Bank staff tended to only introduce a single product, regardless of income level.[449]

***STEP 5: Best product selected***

After introducing products, bank staff next selected a "best fit" product for the shopper. In the mystery shopping exercise, the best product selected was generally the first product offered, unless the customer exerted some pressure.[450]

***STEP 6: Customer eligibility check***

In this step, bank staff check the eligibility of the customer for the selected loan product. It is in this step that many mystery shoppers encountered the common requirement that the customer have a prior history with the bank or the bank have a relationship with the customer's employer.

***STEP 7: Interest rates and terms***

In this step, bank staff provide basic information on the nature of the loan product selected. In the mystery shopping exercise, this generally included disclosure of interest rates and sometimes a summary of the primary terms and conditions of the loan. [451] The term "annual percentage rate (APR) was rarely used and total cost of credit was rarely discussed.[452]

***STEP 8: Repayment timeline***

In this step, the bank staff walk the customer through the repayment timeline to select their rate of repayment and monthly payment schedule. In the mystery shopping exercise, this

[448] Inquiry's Consumer Research Phase I Report, p. 17.
[449] Inquiry's Consumer Research Phase I Report, p. 18.
[450] Inquiry's Consumer Research Phase I Report, p. 19.
[451] Inquiry's Consumer Research Phase I Report, p. 23.
[452] Inquiry's Consumer Research Phase I Report, p. 23.

information was typically provided verbally and rarely in full detail. It focused on the monthly payments, including penalties, but rarely provided a breakdown of interest versus principal. [453]

***STEP 9: Payment channel***

In this step, the bank staff inform the customer of the options for repayment of the loan. This could include direct debit from an account that receives the customer's salary, payments at a branch or an agent, mobile payments, or in the case of check-off loans salary deductions made by the employer.

***STEP 10: Account engagement options***

In this step, the bank staff provide information on the channels through which the customer can engage with the bank when the customer needs to obtain information on an as needs basis.[454]

***STEP 11: Supporting information presented***

In this step, the bank staff present the customer with supporting written materials, such as leaflets or brochures. In addition, customers are often given copies of loan contracts and other formal documents to take with them to review prior to signing.

***STEP 12: Consider offer***

In this step, customers are asked to make a decision on the loan product offered. In the mystery shopping exercise, bank staff were generally accommodating of requests to take forms home and consider them over an extended period of time.[455]

***STEP 13: Bank communications***

In this final step, the bank staff establish with the customer which methods of communications the bank will use to communicate with the customer about the loan product. This includes reminders for repayment and other fees that may be incurred.

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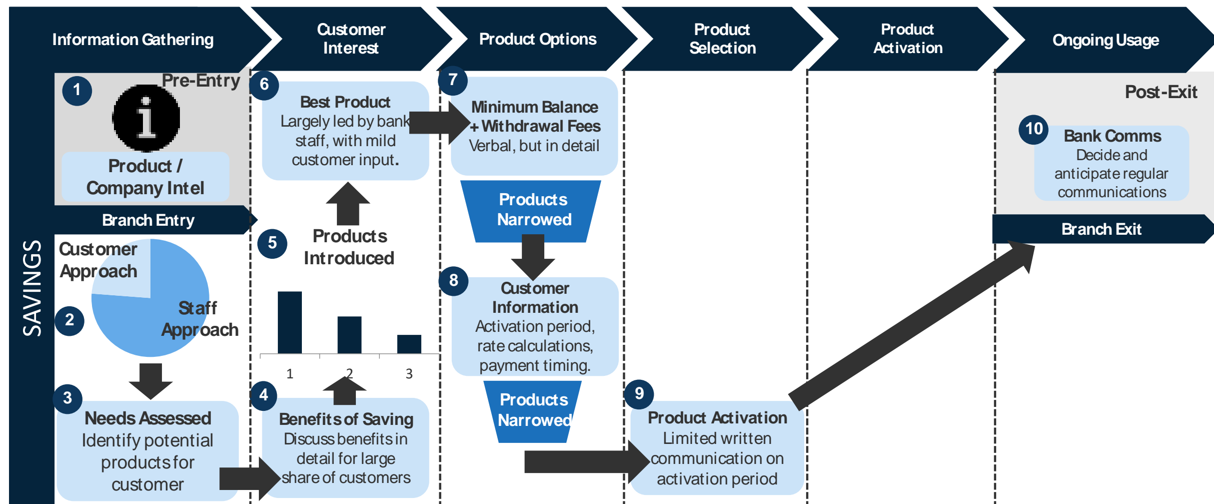
[453] Inquiry's Consumer Research Phase I Report, p. 25.

[454] Inquiry's Consumer Research Phase I Report, p. 27.

[455] Inquiry's Consumer Research Phase I Report, p. 29.

## Traditional savings accounts

**Figure 42: Customer journey map for traditional savings accounts**




*Source: Busara Report, p. 32*

### *STEP 1: Product and bank intel (pre-branch entry)*

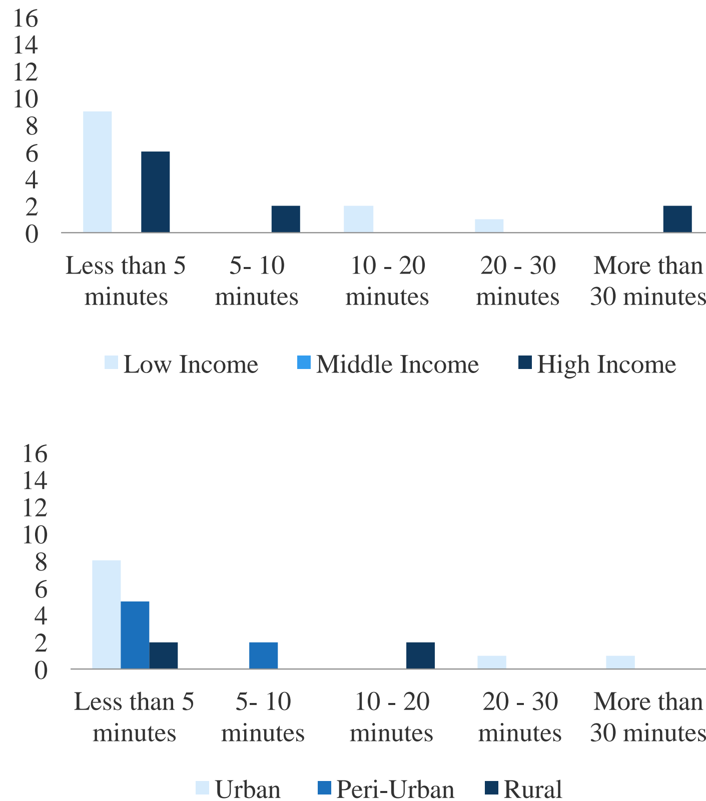
The first step in the customer journey for acquiring a traditional savings account at a branch is acquisition of information about banks and products before entering a branch. Customers rely on a variety of external sources for information on banks and products and these are discussed in Section 4.1 of the report.

### *STEP 2: Staff approach and introduction*

This step captures the first interaction between customers and bank staff. As with loan acquisition, the qualitative interviews indicate a perception among some customers that the account opening process required long wait times and lengthy queuing at branches.[456] However, in this Inquiry's mystery shopping exercise, wait times for initial service at branches were usually not excessive, with 15 of 21 shoppers served by bank staff in under 5 minutes (71%) and 17 of 21 shoppers (81%) in under 10 minutes (see Figure 43).[457] Only 2 of 21 shoppers (10%) had to wait over 20 minutes. Only 1 of 21 shoppers (5%) reported that the staff were not polite and approachable.[458]

[456] Inquiry's Consumer Research Phase I Report, p. 56.
[457] Inquiry's Consumer Research Phase I Report, p. 35, Annex 8.
[458] Inquiry's Consumer Research Phase I Report, p. 34, Annex 8.

**Figure 43: Wait times for initial service at branches for savings account-seeking mystery shoppers**




**Source: Inquiry's Consumer Research Phase I Report, p. 35.**

***STEP 3: Customer needs assessment***

In this step, bank staff assesses the particular needs of the customer in order to later introduce appropriate products. In the mystery shopping exercise, only slightly more than half of shoppers had their needs assessed by bank staff.[459]

***STEP 4: Benefits of savings explained***

In this step, bank staff explain to customers the benefits of saving for the future, including the benefits of setting long-term savings goals. In the mystery shopping exercise, 16 of 21 (76%) shoppers had bank staff explain the benefits of a savings account.[460]

***STEP 5: Products introduced***

In this step, bank staff present a selection of products that are compatible with the customer's needs assessed in Step 3. It is from this pool of products that the bank staff will next help the customer determine which product is the best fit.

***STEP 6: Best product selected***

After introducing products, bank staff next selected a "best fit" product for the customer. The best product introduced was generally the first product offered, unless the customer exerted some pressure. [461]

[459] Inquiry's Consumer Research Phase I Report, p. 36.
[460] Inquiry's Consumer Research Phase I Report, p. 38.
[461] Inquiry's Consumer Research Phase I Report, p. 40.

### *STEP 7: Disclosure of minimum balance and accrual of interest and fees*

In this step, bank staff disclose two important features of the selected savings account product, the minimum balance to accrue interest and how interest and fees accrue.

### *STEP 8: Customer information*

In this step, bank staff ask the customer for personal information, including things like banking history, account security and demographic information. [462] Some of this information may be required to confirm savings account eligibility, or is may be useful information to the bank aimed at transitioning the customer to credit or transaction account options. [463] In the mystery shopping exercise, of the 19 shoppers who were offered savings account products, 16 (84%) were asked to supply such information.[464]

### *STEP 9: Product activation*

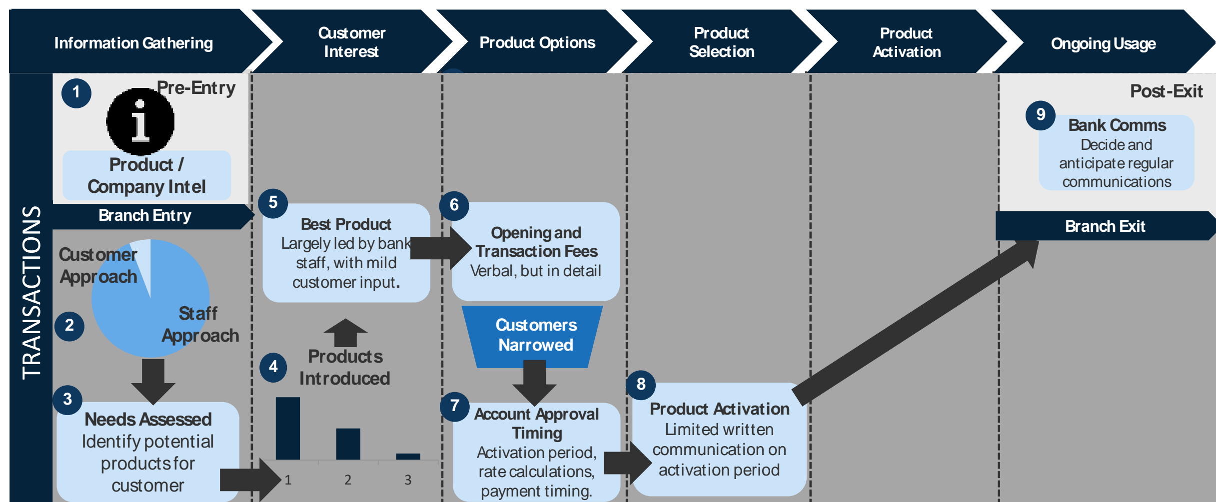
In this step, customers are asked whether they are ready to finalize product registration. If they had outstanding questions they are often offered supplementary written materials (brochures, leaflets and similar materials) which they can take home.[465]

### *STEP 10: Bank communications*

In this final step, bank staff inform the customer about the medium and frequency of future communications from the bank to the customer.

## Traditional transaction accounts

**Figure 44: Customer journey map for traditional transaction accounts**




*Source: Busara Report, p. 32*

### *STEP 1: Product and bank intel (pre-branch entry)*

The first step in the customer journey for acquiring a traditional transaction account at a branch is acquisition of information about banks and products before entering a branch. Customers rely

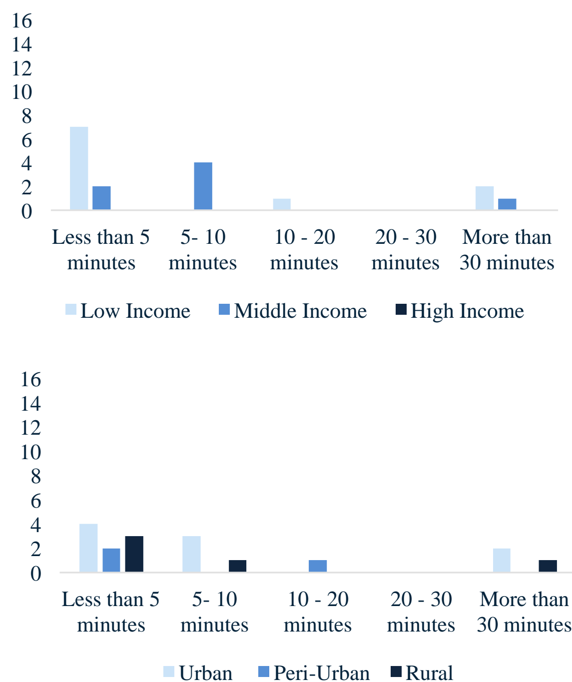
[462] Inquiry's Consumer Research Phase I Report, p. 45.
[463] Inquiry's Consumer Research Phase I Report, p. 45.
[464] Inquiry's Consumer Research Phase I Report, p. 45.
[465] Inquiry's Consumer Research Phase I Report, p. 47.

on a variety of external sources for information on banks and products and these are discussed in Section 4.1 of the report.

***STEP 2: Staff approach and introduction***

This step captures the first interaction between customers and bank staff. As with loan and savings acquisition, the qualitative interviews indicate a perception among some customers that the account opening process required long wait times and lengthy queuing at branches.[466] However, in this Inquiry's mystery shopping exercise, wait times for initial service at branches were usually not excessive, with most shoppers served by bank staff in under 10 minutes (see Figure 45).[467] Only 1 of 17 of shoppers (6%) reported that the staff were not polite and approachable. [468]

**Figure 45: Wait times for initial service at branches for transaction account-seeking mystery shoppers**




*Source: Inquiry's Consumer Research Phase I Report, p. 35.*

***STEP 3: Customer needs assessment***

In this step, bank staff assesses the particular needs of the customer in order to later introduce appropriate products. In the mystery shopping exercise, almost two-thirds of shoppers had their needs assessed by bank staff.[469]

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[466] Inquiry's Consumer Research Phase I Report, p. 56.

[467] Inquiry's Consumer Research Phase I Report, p. 35.

[468] Inquiry's Consumer Research Phase I Report, p. 34.

[469] Inquiry's Consumer Research Phase I Report, p. 36.

***STEP 4: Products introduced***

In this step, bank staff present a selection of products that are compatible with the customer's needs assessed in Step 3. It is from this pool of products that the bank staff will next help the customer determine which product is the best fit.

***STEP 5: Best product selected***

After introducing products, bank staff next selected a "best fit" product for the shopper. The best product introduced was generally the first product offered, unless the customer exerted some pressure.[470]

***STEP 6: Disclosure of opening and transaction fees***

In this step, bank staff disclose account opening and transaction fees associated with the selected transaction account product.

***STEP 7: Account approval timing***

In this step, bank staff inform the customer of how long it will take for their transaction account to be approved.[471] Approval is necessary for customers to initially access the account. In the mystery shopping exercise, of the 16 shoppers who were offered transaction account products, 7 (44%) were informed of the length of time for approval of the account. [472]

***STEP 8: Product activation***

In this step, customers are asked whether they are ready to finalize product registration. If they had outstanding questions they are often offered supplementary written materials (brochures, leaflets and similar materials) which they can take home.[473]

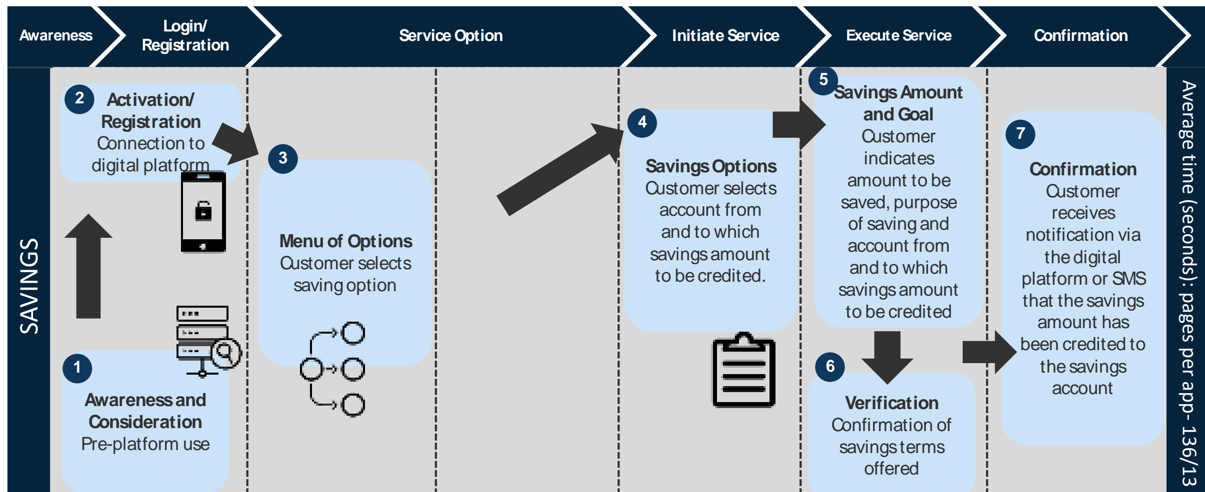
***STEP 9: Bank communications***

In this final step, bank staff inform the customer about the medium and frequency of future communications from the bank to the customer.

[470] Inquiry's Consumer Research Phase I Report, p. 40.
[471] Inquiry's Consumer Research Phase I Report, p. 46.
[472] Inquiry's Consumer Research Phase I Report, p. 46.
[473] Inquiry's Consumer Research Phase I Report, p. 47.

## Digital savings

**Figure 46: Customer journey map for digital savings**




*Source: Busara Report, p. 63*

### *STEP 1: Awareness and consideration (pre-platform use)*

The first step in the customer journey for acquiring a digital loan is acquisition of information about digital savings accounts before engaging with a digital platform. Customers rely on a variety of external sources for information on these products and these are discussed in Section 4.1 of the report.

### *STEP 2: Activation and registration*

In this step, a customer become registered with the digital savings account platform. For banking services that are linked to mobile money accounts (KCB M-Pesa, M-Shwari), the registration is linked to a SIM card. For platforms that are linked to traditional bank accounts (Equitel, MCo-op Cash) the phone subscription must be linked to the traditional bank account and may require a branch visit. [474]

### *STEP 3: Menu of options*

In this step, a customer navigates menu options to locate the option to open a savings account. Menus are designed to enable fast selection of the appropriate option, with most disclosure information buried at the bottom of the menu.[475]

### *STEP 4: Savings option*

In this step, the customer has selected a savings service option, or is offered a single option and, is asked to confirm interest. The platform then validates whether this option is available to the customer.

### *STEP 5: Savings amount and goal*

In this step, customers must specify the amount they wish to save. Some platforms permit customers to select options that align with their savings goals. These include locked accounts,

[474] Inquiry's Consumer Research Phase I Report, p. 72.

[475] Inquiry's Consumer Research Phase I Report, p. 74.

goal-based accounts, or labelled accounts. [476] In the customer observation exercise, Equitel was the only platform of the four examined that had a clear mechanism for customers to create a savings goal amount.[477]

*STEP 6: Verification*

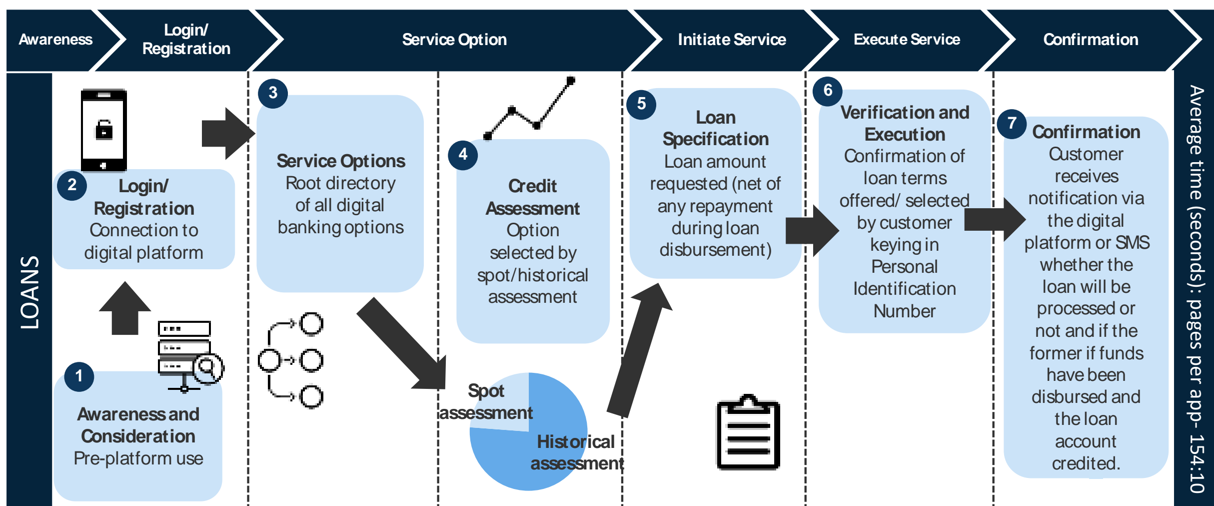
In this step, customers confirm that they wish to make a deposit by entering a PIN.

*STEP 7: Confirmation*

In the final step in the process, the platform sends the customer a confirmation of the savings deposit via SMS.

## Digital loans

**Figure 47: Customer journey map for digital loans**




*Source: Busara Report, p. 63*

*STEP 1: Awareness and consideration (pre-platform use)*

The first step in the customer journey for acquiring a digital loan is acquisition of information about digital loans before engaging with a digital platform. Customers rely on a variety of external sources for information on these products and these are discussed in Section 4.1 of the report..

*STEP 2: Login/registration*

In this step, a customer begins engagement with the digital platform. All platforms require some form of initial registration. For platforms that are "native" to an MNO (M-Shwari, KCB M-Pesa, Okoa Stima), the registration process is minimal,[478] as the platform likely pulls user information from MNO databases. Platforms that are more closely linked to traditional bank accounts (Equitel, MCo-op Cash), a branch visit is more likely required. [479] Non-bank lending applications (Branch, Tala) require a more extensive registration process through the platform.

[476] Inquiry's Consumer Research Phase I Report, p. 75.
[477] Inquiry's Consumer Research Phase I Report, p. 75.
[478] Inquiry's Consumer Research Phase I Report, p. 65.
[479] Inquiry's Consumer Research Phase I Report, p. 65.

[480] This likely the reflects the need to gather information on the customer for credit evaluation as there is no linkage to MNO data or prior history with a traditional bank.

***STEP 3: Service options***

In this step, customers are presented with service options which may access to a variety of credit facilities. Some platforms permit the customer to request a certain loan amount. Other options such as credit limit checks and loan repayment menus may also be available. [481]

***STEP 4: Credit assessment***

In this step, the platform assesses the credit of the customer. This generally takes two forms.

"Historical assessments" are made by the platform based on existing customer records available to the platform, including MNO and M-Pesa activity (in the case of KCB M-Pesa, M-Shwari and Okoa Stima) or traditional banking activity (in the case of Equitel and MCo-op Cash). [482] These historical assessments are not transparent to the customer, who may not know the extent of information the platform has available.

"On-the-spot assessments," utilized by Branch and Tala, rely on information provided by the customer during registration and tend to result in lower credit limits. [483] These assessments can utilize information provided by the customer to the app, as Tala in particular has an extensive registration process. However, the most pertinent information is likely provided to the provider directly from the customer's smartphone. Both the Branch and Tala apps access, with customer consent, SMS, social media, M-Pesa and other activity from a customer's smartphone which are analysed to determine creditworthiness.

***STEP 5: Loan specification***

In this step, the customer is informed of the details of the loan and formal disclosures on the nature of the loan can be made. As further discussed in Section 6.2.2, some lenders disclose interest and fees in this Step 5 and others do not make these disclosures until after execution in Step 7.

***STEP 6: Verification and execution***

In this step, customers verify the terms of the loan and commit to execution. When the platform operates over USSD or STK, execution is confirmed by entering a PIN (the exception being Okoa Stima which requires a PIN at the beginning of the session rather than at this Step 6). Branch and Tala which operate through Android apps rather than USSD or STK do not require a PIN at this Step 6.

***STEP 7: Confirmation***

In the final step in the process, the platform sends the customer a confirmation of the loan via SMS. Some platforms further require the customer to confirm this confirmation message to receive the loan.[484]

[480] Inquiry's Consumer Research Phase I Report, p. 65.
[481] Inquiry's Consumer Research Phase I Report, p. 66.
[482] Inquiry's Consumer Research Phase I Report, pp. 67-68.
[483] Inquiry's Consumer Research Phase I Report, pp. 67-68.
[484] Inquiry's Consumer Research Phase I Report, p. 71.

# Annex 2 (Input from market participants and stakeholders)

## Stakeholder Interviews

The Inquiry interviewed the following entities:

**First field visit to Nairobi, March 2016:**
*Banks*
1. Chase Bank
2. Family Bank
3. KCB

*Credit reference bureaus*
4. Metropol
5. Transunion

*Government entities*
6. The CAK
7. The CBK
8. National Treasury
9. SASRA

*Other stakeholders*
10. CIS Kenya
11. CGAP
12. The KBA

**Remote Skype interviews, March-April 2016:**
*Non-bank financial services providers*
1. Branch
2. Mwalimu Sacco
3. Jumo

*Other stakeholders*
4. CIN
5. CIS Kenya
6. CGAP

**Second field visit to Nairobi, January-February 2017:**
*Banks*
1. Bank of Africa
2. Barclays Bank
3. CBA
4. Co-operative Bank
5. Diamond Trust Bank
6. Equity Bank

7. Family Bank
8. KCB
9. NIC Bank
10. Sidian Bank
11. Standard Chartered Bank

*Non-bank financial services providers*

12. Jumo
13. Safaricom

*Government entities*

14. The CAK
15. National Treasury

*Other stakeholders*

16. CIS Kenya
17. CGAP

## Information submissions

The Inquiry received information from:

*Banks*

1. Barclays
2. CBA
3. Co-operative
4. NIC
5. Standard Chartered

*Non-bank financial services providers*

6. Jumo
7. Safaricom

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