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Thinking Policy Together

Addressing Digital Credit Burden in Kenya

By Valentine Michuki

Introduction

Digital credit[1] has expanded in popularity in the past ten years following the growth of financial access, from 40 per cent in 2009 to 84 per cent in 2021.[2] The credit ratio also significantly increased from 50 per cent in 2019 to 60 per cent in 2021 despite a substantial decline in usage of digital loan applications (apps) from 8.3 per cent in 2019 to 2.1 per cent in 2021. The decline in using digital loans, compared to other loan platforms through this duration could be attributed to the resultant problems associated with digital loans.

With increased access to Internet, mobile money is readily available, convenient, and the most convenient platform for any individual with a phone to effect payments and access credit and savings facilities. Despite the initial utilization of mobile money in making payments and money transfer services, mobile money has steadily revolutionized in Kenya to incorporate credit and savings functions. However, the mobile platform has not been fully utilized as a means of savings. Kenya experienced low increase in savings rate from 69.9 per cent in 2019 to 74 per cent in 2021, compared to the credit rate of 50.4 per cent to 60.8 per cent within the same duration.

Low savings can be attributed to increase in the percentage of the population having limited resources left to save and invest in future goals, after meeting the daily needs. Further, the percentage of the population experiencing a shock nearly doubled in 2021. According to the 2021 FinAccess report, the main shocks experienced were increased cost of living (83%) followed by health (32%) and loss of income (23%). There is, therefore, increased need to enhance savings by households, so that they can cushion themselves against the increasing shocks and meet future needs for finance. This policy brief focuses on the digital credit budget and possible interventions towards easing digital stress. The policy brief is based on a KIPPRA study (Michuki, 2023) on enhancing household savings behaviour through mobile money fintech innovation.

Status of Digital Credit in Kenya

Digital credit is one of the platforms that individuals can access credit from, alongside banks, savings and credit societies (SACCOs), micro finance institutions, mobile money platform, insurance, and other informal groups. Following the licensing of all the digital credit providers (DCPs) operating in Kenya, under the regulatory supervision by the Central Bank of Kenya (CBK), and pursuant to the publication of the CBK Digital Credit Providers Regulations 2022, only 10[3] of the 288 applicants were successfully licensed as of September 2022.

Issuance of digital loans by digital credit providers (DCPs) is associated with the use of one's previous data, such as mobile money's transaction history. The unsecure loans tend to have much higher-interest rates compared to secured loans from other financial service providers. Further, as licensing of DCP was not fully rolled out during the last two years, most providers charged exorbitant interests to the customers. The last two years (2020 and 2021) experienced increased shocks in the economy, notably the effects of COVID-19 pandemic, leading to increased demand for loan facilities as a substantial number of consumers sought quick sources of liquidity. Most of these borrowers were not fully aware of the loan default terms and the full charges of the sourced loans, they were faced with hefty charges applied, thus most ended up repaying late while some incurred punitive defaulting fees, thus limiting their future ability to borrow. As a result, many users were hindered from accessing credit facilities due to negative listing by the Credit Reference Bureau (CRB).[4]

The FinAccess Survey 2021 indicates that 45.8 per cent of borrowers either defaulted on a payment or paid late through 2021. Of this, 52 per cent were

male, and 48 per cent were female; and even of more policy concern, 52 per cent were below the age of 35 years, thus mostly the youth, and more than 70 per cent of them earning below Ksh 25,000 per month (FinAccess, 2021). The credit reference bureau (CRB) data show that the accounts negatively listed (defaulters) stood at 4.6 million out of the 15 million accounts as of December 2021, reflecting an increase from 3.2 million accounts in April 2020.

The increase in percentage of the population experiencing a financial shock almost doubled in 2021. The main shocks experienced were increased cost of living (83%) followed by health (32%) and loss of income (23%). The drought situation in most Arid and Semi-arid Lands (ASALs) in the country and high inflation rate across the year further enhanced the need for capital among the citizens to meet their daily needs.

Due to the high rate of digital indebtedness triggered by growing financial needs, most individuals, mainly the youth, had been negatively affected and denied from accessing credit from financial institutions that could cushion them in tough economic times. The analysis corroborates those of Wathome (2020) who established that most digital users were keen on bank-owned digital credit services directly linked to their mobile phone service providers, with KCB-M-Pesa and Mshwari being the most popular product names. Majority of the respondents opined that digital credit had generated positive spillover effects on the financial inclusion of the youth in Kenya. Further, the study established that most youth who are borrowers of digital loans were of the perception that these digital credit facilities had increased their access to financing. Wathome (2020) also established that digital credit had negative spillover effects on the financial inclusion of the youth in Kenya. About 39 per cent of the respondents had two or more digital loans; most of the individuals interviewed were listed in the Credit Reference Bureau as a result of defaulting on digital loans. Easy access to digital credit often resulted in over-indebtedness and inability for youth to access further credit in cases where they were listed in a Credit Reference Bureau due to default. Digital credit had also led to negative financial behaviour, with many users regularly using digital loans to finance expensive lifestyles or participate in varied gambling activities. Other potentially negative impacts from digital credit facilities include unending debt traps among borrowers as most creditors borrow to pay old due loans, and data privacy contravening measures due to coercive and punitive repayment tactics by some debtors. Debt burden is a worrying trend that has left many in a debt trap, with immense financial stress. This, therefore, is an issue that requires intervention from the government, especially in addressing the loopholes in the digital credit space to ease the digital credit burden.

The Central Bank of Kenya (CBK) has adopted the credit rating/scoring method where borrowers manage their creditworthiness based on how efficiently one repays their loans. Lenders in turn are adopting a risk profile pricing for the individual borrowers, with an enhanced credit sharing mechanism by the financial regulator. The recently rolled out Hustler's fund by the government in December 2022 is set to advance affordable, interest-friendly credit to the low-income cadres of the population. This will reduce the debt burden among the vulnerable groups.

There is an increased regulation of digital credit providers (DCPs) by the Central Bank of Kenya (Digital Players Regulations Amendment Act, 2021), which became effective on 23rd December, 2021, empowering CBK to license, regulate and supervise digital credit providers (DCPs) to ensure a fair and non-discriminatory marketplace for credit access to borrowers. Subsequently, the CBK Digital Credit Providers Regulations 2022 issued and operationalized on 18th March 2022 provide for the licensing and oversight of previously unregulated Digital Credit Providers. Digital lenders now have to obtain licenses to operate in Kenya, unlike previously when they just had to register, which led to the proliferation of rogue digital providers and applications.

The Central Bank of Kenya also has the mandate to revoke permits and withdraw licenses of operators who breach customer confidentiality and privacy, by sharing the personal data of loan defaulters with third parties. However, the genesis of the problem being at inception, when digital credit providers (DCPs) collect borrowers' phone data, including contacts, and demand access to messages to review history of mobile money transactions — for credit scoring and as conditions for disbursing loans. Some of these lenders proceed to use the contact information collected to recover the loans disbursed in cases where borrowers default. They, therefore, at times opt for debt-shaming tactics such as calling friends and family to compel their borrowers to repay the loans.

Digital credit providers are further subjected to the Data Protection Act 2019, which requires firms to disclose to customers the reasons for collecting their data. The Data Protection Act 2019 also ensures that borrowers' confidential information is safe from infringement by unauthorized parties. Digital lenders are therefore required to reveal all the information to borrowers on their loan products, including details on pricing, penalties for defaulters, and means of debt recovery.

Drivers of Digital Credit Burden

Increase in digital credit burden among the population has been triggered by several factors, which include:

(a) Unregulated players in digital loan sector

Unregulated entry of digital credit players and unregulated credit apps propelled the problem of debt trap burden as they operated within their own regulations and without being answerable to the Central Bank of Kenya nor relevant regulations.

(b) Deteriorating financial health among the population

Since 2016, financial health[5] has steadily declined across the population, reflecting the multiple shocks affecting households. As a result, many households are negatively affected by the state of their finances and the economy, with 74 per cent reporting that individual financial situation has worsened over time. Vulnerability to digital loans was associated with increasing financial vulnerability across the population between 2019 and 2021 due to COVID-19, a rise in the proportion of households reporting missing meals, going without health care when needed, and having children sent home from school for lack of fees.

(c) Exorbitant charges on loan facilities by digital creditors compared to other financial loan providers

As most digital credit providers offer collateral free, unsecured loans, they tend to be priced higher compared to other market loan facilities. This results to more defaulted loans and bad debts as they become expensive facilities to service for the common middle-income Kenyan households

(d) Fluctuating and increasing interest rates

Lack of transparency on the actual cost of some of the digital loans and instances of hidden charges have become particularly prevalent for digital credit users, and catalyzed by the discreet information sharing tendencies among digital lending firms, thus limiting transparency on the fine print of the full charges to borrowers, further increasing the debt burden.

(e) Financial illiteracy amongst some borrowers

Limited client education and information sharing on the loans by creditors leads to poor management of these loans by the borrowers, as the borrowers are not sufficiently prepared to manage the loans. Also, lack of financial discipline and financial know-how on budgeting and loan management leads to non-adherence to personal budgets by households, thus increasing the debt burden.

f) Lack of fool proof client protection via digital loan platforms

The practice of sharing client's data with third parties by some digital credit providers has increased cases of fraud and loss of money via digital money platforms and among mobile money users, with up to 3.5 million digital and mobile money users having lost money in the past 12 months, with approximately 900,000 reporting not being able to recover their funds, according to Central Bank of Kenya 2021 financial report.

Recommendations

Interventions towards addressing financial stress associated with digital credit include the following:

(i) Revoking license

The 2021 Regulation of Digital Creditors Amendment Bill gives the Central Bank of Kenya, which is also the financial regulator, the power to cap interest rates and to suspend or revoke the licenses of digital lenders that breach "the conditions of the Data Protection Act 2019 or the Consumer Protection Act. The Central Bank of Kenya could deepen oversight mandate of the creditors, and where need be, revoke licenses of those still contravening the regulations, as many Kenyans continue to suffer in the hands of some of the unscrupulous lenders.

(ii) Regulation of chargeable/ applicable rates

The regulator could also cap the limit of the penalty and interest/facility charges applicable to advanced loans and on defaulted loans, respectively. This will help cushion borrowers from punitive costs incurred by many in cases of loan default.

(iii) Robust credit information sharing

As most digital credit does not require securities backing, the Credit Reference Bureau could develop a robust Credit Information Sharing (CIS) mechanism for the digital credit facilities by conceptualizing an effective method of building a credible credit history for Kenyans. This will enable creditors to have a good and dependable indicator of an individual's financial health. In the long run, it will enable borrowers to access cheaper credit and reduce defaulting on loans.

(iv) Reduction of interest

With the prevailing shocks and economic slowdown in the past two years, many households are decrying the high cost of capital, instrumental in cushioning families in meeting their daily needs and revamping their businesses. A reduction in the general cost of credit would therefore not only relieve households of financial obligations but will also enhance

money circulation in the economy and improve the livelihoods of households.

(v) Client protection

There is need for further client protection by the regulator following the evolving financial technology space, which exposes most digital platform users and makes them vulnerable to digital credit burden. The regulator could ensure creditors appraise the client well in advance of their procedures and its debt recovery measures. The creditor could also identify a specific number of guarantors, handpicked by the borrower, who are contacted prior to the loan advancement, and informed of their role as guarantors. This would enhance clients' privacy and protect their personal businesses from sharing unsolicited personal data and information with their social circle, in case of digital loan default.

(v) Client education

Many digital credit clients increasingly become vulnerable to some digital credit scums due to limited education, awareness, and information asymmetry of this developing digital credit market. Critical, therefore, is enhancing trust, clients' confidence and the empowerment of digital borrowers by educating them on the operation of the digital credit market, and on their rights and channels of seeking compensation in case of breach of contract by either party. All these will ensure that affected parties collectively benefit and ensure digital credit works for both the lenders and the borrowers.

Endnotes

1. Digital credit refers to small, short-term loans that can be accessed instantly, automatically, and remotely, offering borrowers access to funds even without a formal credit history, over the digital platform
2. The 2021 FinAccess report https://www.knbs.or.ke/wp-content/uploads/2021/12/2021-Finaccess-Household-Survey-Report.pdf
3. These firms include: Ceres Tech Limited, Getcash Capital Limited, Giando Africa Limited, Flash Credit Africa, Jijenge Credit Limited, Kweli Smart Solutions Limited, Mwanzo Credit Limited, MyWagepay Limited, Sevi Innovation Limited, Rewot Civo Limited and Sokohela Limited
4. A credit reference bureau is a company licensed by the Central bank of Kenya to collect, store and collate credit information on individuals and companies from different sources and provide the information in form of a credit report upon the request of a lender. There are currently three CRB firms: Metropol, TransUnion and Credit Info.
5. Financial health is the state of one's personal monetary affairs. It analyses if one can realize their life goals and their ability to manage day-to-day needs; ability to cope with shocks; and the ability to invest in future goals. A financially healthy person is one who adequately and comfortably meets their day-to-day needs, cope with shocks and can save and invest in future goals, such as savings for old age.

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About KIPPRA Policy Briefs

KIPPRA Policy Briefs are aimed at a wide dissemination of the Institute's policy research findings. The findings are expected to stimulate discussion and also build capacity in the public policy making process in Kenya.

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For More Information Contact:

Kenya Institute for Public Policy Research and Analysis
Bishops Road, Bishops Garden Towers
P.O. Box 56445-00200, Nairobi
Tel: 2719933/4, Cell: 0736712724, 0724256078
Email:admin@kippra.or.ke
Website: http://www.kippra.or.ke
@KIPPRAKenya