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The changing landscape of digital lending in Kenya

In December 2021, the Central Bank of Kenya (Amendment)Act 2021 came into effect paving way for the subsequent gazettement of Digital Credit Providers Regulations, 2022 (the Regulations) in March 2022. The Regulations provide for the licensing and oversight of previously unregulated Digital Credit Providers (DCPs). Further, the Regulations introduced the need for corporate governance, data protection and disclosures on pricing models, among other requirements.

For sometime now, the digital credit sector has been stained by allegations of lack of transparency on the terms of borrowing, hidden charges, high annualized percentage rates (APR) on advanced amounts, unethical debt collection practises, abuse of personal information as well as lack of a cap on the amount of accrued interest on non – performing loans. The Regulations are therefore intended to bring sanity to the sector that has otherwise experienced exponential growth over the last couple of years. A focus report on digital lending by Financial Sector Deepening (FSD) in 2019 placed the total value of disbursed loans in 2018 by digital credit providers at KES 116.8 billion. Given the size of this portfolio and growing public concerns about the predatory practises of the unregulated digital credit providers, the sector was bound to attract the attention of the regulator.

One of the major discussion points in the aftermath of the Regulations becoming operational revolves around capacity versus willingness to repay. A system that is driven by the prospects of no rollover and penalty fee ceilings has seen many Kenyans become entangled in "poverty traps" of almost perpetual and increasing debt. The need to disburse quick loans with short turnaround times has also driven many digital lenders to focus on the "willingness to repay" aspect. Previously, basic information was obtained from borrowers with minimal initial background checks, whilst unethical debt collection practises were a norm in the sector.

With the Regulations now in force, it is expected that lenders will shift to "capacity to repay" business models, where borrowers' credit worthiness, including pricing, will be assessed based on existing credit information. This will include significant changes in credit scoring models, with a particular emphasis on use of data analytics. Increased application of data analytics is expected to be applied in, among others, use of accessible digital footprints in analysis of credit worthiness of borrowers. It is also expected that, based on the new law, significant investment will go into model development, data protection compliance as well as compliance to corporate governance requirements.

Considering the changing landscape, one of the major challenges is around the sector's response to the new requirements while maintaining the near - instant turnaround time which has been one of the key drivers of the sector's growth. The sector's exponential growth underpins a need in the mass market's access to credit via alternative channels. How that need is addressed by different players is what shall possibly define the next phase of access to credit for the largely unbanked population in Kenya.

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