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HIGHLIGHTS OF THE FINANCIAL MARKETS CONDUCT BILL, 2018

The draft Financial Markets Conduct Bill, 2018 (the **"Bill"**) aims to create an effective financial consumer protection environment through the supervision of conduct of providers in relation to retail financial customers. It also proposes to make credit more accessible and support financial innovation and competition, amongst other named purposes. The Bill defines a **"retail financial customer"** as the final user of a financial product or financial service, being a person to whom one of the following applies:

(a) the person is a natural person;

(b) the financial product or service is provided in connection with the conduct by the person of a micro enterprise or a small enterprise as defined under the Micro and Small Enterprises Act; or

(c) the person is in a class of persons as may be declared by regulations to be a retail financial customer in relation to the financial product or financial service.

This definition is indicative of a focus on the protection of natural persons, SME entities and smaller scale borrowers as opposed to large companies and wealthy individuals.

The National Treasury of Kenya has invited relevant stakeholders to submit their comments on the draft Bill by **5 June, 2018** and it remains to be seen whether it will be passed in its current form. The Bill is currently at discussion stage and has not been tabled in Parliament to date.

In this article, we highlight a few of the key provisions of particular concern to financial institutions.

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1. New Regulatory Entities

The Bill seeks to establish a number of new regulatory entities, details of which are provided below.

New Entity	HH&M Comments	Likely Implications
Creation of the **Financial Markets Conduct Authority** (the **"FMCA"**) to regulate providers of financial products and services to retail financial customers and to curb irresponsible financial market practices.	This is an attempt to introduce a 'twin peaks' financial regulatory system which has been implemented in countries such as South Africa, the Netherlands, UK and Australia with varying degrees of success. The regulation of business conduct of financial institutions, supervision of credit providers and the enforcement of consumer protection guidelines will be transferred from the ambit of the Central Bank of Kenya (the **"CBK"**) to the FMCA. The Cabinet Secretary for the National Treasury (the "**Cabinet Secretary**") and the Governor of the CBK will be on the board of directors of the FMCA.	- Financial institutions will be governed by two separate and distinct regulators. - Overlap between the CBK's functions and the envisaged role of the FMCA may cause duplicity in the regulatory and monitoring functions of both institutions. - It is essential that effective transitional provisions be implemented and enforced to avoid conflict between the roles of the CBK and FMCA.
Creation of the **Office of Financial Sector Ombudsman** (the **"Ombudsman")** to resolve complaints by retail financial customers and product and service providers in relation to the provision of financial products and services to the retail financial customers.	The Ombudsman will be a body corporate consisting of a chairperson appointed by the President of Kenya, a Chief Ombudsman and two other members appointed by the Cabinet Secretary. The planned functions of the Ombudsman are currently administered by the Central Bank of Kenya which holds investigative powers under the Banking Act (Chapter 488 of the Laws of Kenya).	- Unless the functions of the CBK and the Ombudsman are clearly defined, there will be duplicity in the investigation of complaints and the complaints resolution procedures. - The operational independence of the Ombudsman is provided for in section 120(3) of the Bill, however it remains to be seen whether this office will be independent and effective in its functions.

1. New Regulatory Entities (continued)

New Entity	HH&M Comments	Likely Implications
A **Financial Services Tribunal** (the **"Tribunal"**) will be appointed by the Judicial Service Commission to hear applications in relation to reviewable decisions and provide directives.	Parties aggrieved by a decision of the FMCA or retail customers who suffer a loss because of a breach of the Bill occasioned by a licensed service provider may apply to the Tribunal for a review of the decision. The Tribunal may set the decision aside, remit the matter to the decision-maker for further consideration, dismiss the application or make any other order as it feels just as necessary. A dissatisfied party may within 30 days of the decision of the Tribunal, appeal the decision to the High Court of Kenya.	- There is a likelihood of increased cost of litigation for cases which go through the tribunal and continue to be heard in the High Court of Kenya. - The effectiveness of this body will remain to be seen upon its creation, and regulations will be required to be passed in order to facilitate the Tribunal's operationalization in a free fair and independent manner.
A **Conduct Compensation Fund Board** (the **"Board"**) will hold and manage the Conduct Compensation Fund (the **"Fund"**), determine and make compensation payments for persons who take action in court who suffer loss out of a contravention of the Bill by another person.	The Fund shall consist of: - amounts appropriated by Parliament; - amounts payable to the Fund out of the Levy Account in respect of the Bill; - administrative penalties imposed in respect of contraventions of the Bill; and - any other amounts due to the Fund. The Board is set up as an independent body which will hold and administer funds received as penalties under the Bill. At this early stage it is unclear how this entity will interact with the Tribunal.	Should this Act be passed into law, regulations which govern the interaction of this body with the other bodies created under this Bill shall be required to be passed.

2. Offences

The Bill introduces a number of offences for financial institutions which attract hefty fines as set out below

Offence	Penalty	HH&M Comments
Failure to acquire a **Financial Conduct License** that will be issued by the FMCA. (Section 34)	A person who contravenes a provision of section 34 commits an offence and is liable on conviction to: a) a fine not exceeding KES 5,000,000 or imprisonment for 2 years; and b) a fine not exceeding KES 10,000,000 or imprisonment for 5 years for a second or subsequent offence.	A person will not be required to hold a financial conduct license to offer or issue securities issued under the Capital Markets Act (Chapter 485A, Laws of Kenya), that is, to offer or issue shares in the share capital of a company, debt securities, loan stock, bonds, warrants, units in a collective investment scheme, depositary receipts, or asset backed securities. Financial institutions that hold a license under a "sectoral law" that authorizes the institution to provide financial products or services at the commencement of Part IV of the Bill will receive a temporary exemption of 24 months (or such other time as may be specified in the regulations). Sectoral laws include: (a) the Banking Act (Cap 488); (b) the Capital Markets Act (Cap 485A); (c) the Central Bank of Kenya Act (Cap 491); (d) the Insurance Act (Cap 487); (e) the Microfinance Act (No. 19 of 2006); (f) the Retirement Benefits Act (No. 3 of 1995); (g) the Sacco Societies Act (Cap 490B); and (h) any other law as maybe specified in the regulations. These licensing requirements will be phased in 6 months after the commencement of the Bill. After the phase-in of Part IV in its entirety, providers of financial products and services holding licenses under sectoral laws that cover the financial products and services offered by the provider will be considered to have satisfied the requirements of the Bill. This section seeks to avoid the duplication of licensing requirements. Financial Conduct Licenses may be limited to specified financial products or services, or the provision to persons in a specified class or in specified circumstances.
Unfair business practices (i.e. practices that deceive, mislead or unfairly prejudice customers). (Section 52)	A provider who engages in conduct declared to be an unfair business practice commits an offence and is liable on conviction: a) for a first offence, to a fine of five million shillings; b) for the second and subsequent offence, to a fine of ten million shillings.	An 'unfair business practice' is defined as conduct declared by a conduct rule to be an unfair business practice. Conduct rules will be created by the Cabinet Secretary in consultation with the FMCA to ensure that consumers are treated fairly and to alleviate the risk of financial crime.
Soliciting applications for credit or soliciting for an increase of a credit limit through unsolicited contact with customers and outside certain hours of day to be specified by subsequent regulations. (Section 58)	A person who contravenes this section commits an offence and is liable: a) for a first offence to a fine of 5,000,000 shillings; and b) for a second and subsequent offence to a fine of 10,000,000 shillings.	The methodology of entering into customer contracts and the hours within which institutions may do so will be set by the regulations.

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2. Offences (continued)

Offence	Penalty	HH&M Comments
Contravening the requirement to have all regulated credit contracts in writing, in prescribed form including the layout and font size, in conformity with the pre-contract statement given to the borrower and a copy given to the borrower free of charge. (Section 64)	A person who contravenes this section commits an offence and is liable on conviction: a) for the first offence to a fine of 5,000,000; and b) for the second and subsequent offence, to a fine of 10,000,000 shillings.	The requirement for all regulated credit contracts to be in writing is essential to avoid the creation of ambiguous contractual terms and to provide relief to consumers who may not fully understand the implications of entering into such credit contracts.
Failing to submit pre-contract statements (specifying interest rates, insurance requirements, fees, charges and cost to be imposed and intervals of payment) and a quotation to the retail financial customer before accepting an application for credit. (Section 59)	A person who contravenes this requirement commits an offence and is liable on conviction: a) for a first offence to a fine of 10,000,000 shillings; and b) for the second or subsequent offence to a fine of 20,000,000 shillings.	This provision encourages full disclosure of all terms to the retail consumer before entering into a binding contract for credit.
Failing to provide reasons for declining credit. (Section 60)	A person who contravenes this section commits an offence and shall be liable on conviction to a fine of 2,500,000 shillings.	This provision requires financial institutions to provide reasons behind the decision to decline a credit application or to consider an application for credit on varied terms than those applied for in the interests of full disclosure to the consumer.
Failing to determine the borrower's ability to comply with their financial obligations without hardship. (Section 61)	A person who contravenes this provision commits an offence and is liable on conviction: a) for a first offence to a fine of 10,000,000 shillings or to an imprisonment of 2 years or both; and b) for a second and subsequent offence, to a fine of 20,000,000 or imprisonment of five years or to both.	This provision is intended to curb the prevalence of reckless lending by lenders.
Varying regulated credit contracts without the borrower's consent unless the lender determines the borrower's ability to comply with the financial obligations as varied. (Section 62)	A person who contravenes this section commits an offence and is liable on conviction: a) for a first offence to a fine of 10,000,000 shillings or imprisonment for 2 years or both; and b) for a second or a subsequent offence to a fine of 20,000,000 shillings or to an imprisonment for five years.	The fine does not apply if the variation reduces the borrower's obligations i.e. if the variation is not detrimental to the borrower.

2. Offences (continued)

Offence	Penalty	HH&M Comments
Increasing credit to be advanced or credit limits without the borrower's consent unless the lender determines the borrower's ability to comply with the financial obligations as varied. (Section 63)	A person who contravenes this section commits an offence and is liable on conviction: a) for the first offence to a fine of 10,000,000 or imprisonment for 2 years; and b) for the second and subsequent offence, to a fine of 20,000,000 shillings or to imprisonment of five years or both.	The fine shall not apply if the lender took all the steps required by the regulations and made all inquiries that were reasonable for it to make in order to comply with this requirement.
A financial institution entering into a guarantee contract with a guarantor that is not in writing or in prescribed form. (Section 77)	A person who contravenes this section commits an offence and is liable on conviction to a fine of 52,000,000 shillings.	The requirement for all regulated credit contracts to be in writing is essential to avoid the creation of ambiguous contractual terms and to provide relief to consumers who may not fully understand the implications of entering into such credit contracts. We note that the fine for committing an offence under this section is substantially higher than other offences, and it is our belief that this may be a typographical error.
Charging interest beyond the maximum rates as prescribed by the FMCA from time to time. (Section 87)	A person who contravenes this section commits an offence and is liable on conviction: a) for a first offence, to a fine of 5,000,000 shillings; and b) for the second and subsequent offence, to a fine of 10,000,000 shillings.	We note a number of drafting inconsistences in section 87 of the Bill which will require to be addressed before the Bill is in final form. Additionally, the interest rate provisions in the Bill do not dispense with the controversial state control of interest rate limits which are said to have negatively affected access to credit in Kenya since their introduction in 2016.

3. Amendment of Existing Legislation

The Bill proposes to amend contradictory provisions in the Banking Act and the Consumer Protection Act.

3.1. Summary of proposed changes to the Banking Act
The Bill seeks to remove credit oversight functions from the ambit of the CBK. Instead, the FMCA will be responsible for regulation of business conduct of financial institutions, supervision of credit providers and the enforcement of consumer protection guidelines. It is also envisaged that the FMCA will be in charge of issuing directives relating to the improvement, management and business methods of the institution.

3.2. Summary of proposed changes to the Consumer Protection Act
Amongst the amendments is a proposal to delete Part VII of the Consumer Protection Act on credit arrangements in its entirety. As with the changes made to the Banking Act, the Bill seeks to remove credit management responsibilities from the CBK and seeks to bring these monitoring and regulatory functions under the ambit of the FMCA instead.

4. Way Forward

Financial service providers will have to exercise added caution in their marketing practices and general business conduct to ensure compliance with the new provisions if the Bill becomes law. The Governor of the CBK on 29 May 2018 issued a statement voicing concern that the Bill has the potential to create a conflict between the current functions of the CBK as the financial regulator and the anticipated role of the Authority. Governor Patrick Njoroge's statement can be viewed by accessing the link provided in the following newspaper article:

https://www.standardmedia.co.ke/business/article/2001282264/we-are-under-attack-central-bank-boss-claims-over-new-bill

In light of the concerns highlighted above and in consideration of the subject matter of the Bill, we expect that there will likely be a challenge filed in court opposing some or all of the provisions of this Bill.

We shall continue to update you on further developments of the Bill. Please do not hesitate to contact Andrew Mugambi at amugambi@hhm.co.ke or Sigee Koech at skoech@hhm.co.ke should you require any further clarification.

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