ENDOXA

Safeguarding Customers: Developments in regulating Digital Lending

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Introduction

In an era where digital lending technologies are expanding rapidly across East Africa, the protection of customers and their data has never been more critical. Digital lending is the provision of loans and loan related services though digital channels. The rise of digital lending has sparked a crucial debate about consumer protection, data security, and ethical practices pertaining to areas such as marketing, pricing and debt collections in countries like Tanzania, Uganda, and Kenya. In 2024, new regulatory frameworks were introduced in Tanzania and Uganda to address predatory lending practices and ensure a safer digital lending ecosystem. Kenya had already adopted digital lending guidelines in 2021.

How It Started

Digital lending has become an essential aspect of financial inclusion, allowing individuals and small businesses to access credit via mobile applications, websites, and other digital platforms. However, concerns regarding consumer protection, high interest rates, and lack of transparency have led to the development of stricter regulations in East Africa.

In Tanzania, the Section 6 of the Banking and Financial Institution Act, 200[i]6 and Section 16 of the Microfinance Act of 2018[ii] grant the Bank of Tanzania (BOT) exclusive authority to regulate banking business and microfinance business and makes it an offence for anyone to conduct such businesses without a license. Banking business and microfinance business includes 'lending' activities performed via digital channels which are broadly referred to as digital lending.

Who are these digital lenders who are licensed by BOT? If you ask the public to name a digital lender, they will immediately think of the mobile network operators (MNOs) such as Vodacom, Tigo and Airtel who offer loans via e-money accounts such as Songesha, Nivushe and Timiza loans. In practice, MNOs don't offer loans. Instead, MNOs partner with BOT licensed credit providers to offer loans through the MNOs digital channels. There are two broad groups of digital lenders.

The first are licensed banks and financial institutions who offer digital loans via e-money accounts and other digital platforms. The second group are non-deposit taking institutions who are licensed by BOT to offer credit/ loans. This article will focus solely on this group of non-bank and non-MNO who are offering digital loans.

Until August 2024, there was no regulatory framework for non-bank and non-MNO digital lenders. Many opted to operate under the general Tier 2 microfinance service provider license for non-deposit taking institutions. Other local and foreign online credit providers were operating without a license, in some cases exposing borrowers to predatory lending and collection practices. It is for this reason BOT issued the public notice on prohibition for engagement in digital lending business without a license in May 2024[iii].

Recent Developments in Tanzania

On August 27, 2024, the BOT issued the Guidance Note on Digital Lenders under Tier 2 Microfinance Service Providers[iv] **(Digital Lenders Guidance Note).** It was issued under the Microfinance Act, 2018 and contains the below key provisions.

1. Applications

The Digital Lenders Guidance Note applies only to microfinance service providers who fit the new definition of a "Digital Lender". Digital Lender is defined to mean **"a microfinance service provider carrying out lending activities, from loan application, approval, disbursement and repayment through digital channels."**

Therefore, microfinance service providers who are not conducting all these four activities digitally will not qualify as digital lenders under the Digital Lenders Guidance Note.

Further, the Digital Lenders Guidance Note will not apply to institutions licensed under the Banking and Financial Institutions Act, 2006 or Tier 1 deposit taking Microfinance businesses, Tier 3 SACCOS and Tier 4 community microfinance groups which fall under the Microfinance Act, 2018.

2. Definitions

The Digital Lending Guidance Note introduced the following new definitions'

- Digital Lender has been defined above.
- Digital Lending Platform means **"a channel through which a microfinance service provider offers its digital products, such as loans or other financial services, typically through online or mobile platforms".**
- Digital Loan Product means **"a credit facility or arrangement where money is lent or borrowed through a digital channel".**
- Digital Loan Services means **"services or arrangements where money is lent, borrowed or repaid through a digital channel".**

3. Licensing Requirement

The eligibility criteria listed below include the requirement for the digital lender to hold a Tier 2 microfinance service provider license. This effectively means the digital lender must meet the regulatory requirements in the Microfinance (Non-Deposit Taking Microfinance Service Providers) Regulations, 2019[v] **(Tier 2 MSP Regulations)** including:

- minimum capital requirement of TZS 20,000,000 deposited into a Tanzanian bank account.
- having a place of business in Tanzania
- engage only in the permitted activities in Regulation 21 of the Tier 2 MSP Regulations.
- Prohibition on engaging in the prohibited activities in Regulation 22 of the Tier 2 MSP Regulations including but not limited to foreign exchange business, taking deposit and transfer of funds.
- Two local directors.

4. No Objection from BOT to offer digital loan product or services

Licensed Tier 2 microfinance service providers whose loan application, loam approval, loan disbursement and loan repayment is done digitally will need to seek a no objection from BOT before they can offer digital lending product and services in Tanzania.

5. Strong emphasis on consumer protection and data protection

This is seen in the below discussion of documentation requirements and prohibited activities.

6. Reporting Requirements

Digital lenders will be required to submit periodic reports. However, the frequency of reporting and the manner of reporting has not been includd in the Digital Lenders Guidance Note

Minimum Criteria for Digital Lenders

To operate as a digital lender in Tanzania, a microfinance service provider must comply with the minimum criteria set out in the Digital Lenders Guidance Notes. This is summarized below.

01 Licensing

As stated above, a microfinance service provider will require a Tier 2 Microfinance Service Provider license to be able to offer digital lending products and services.

03 Regulatory Compliance

Compliance with Data Protection Laws and protection of consumer data.

02 Digital Lending Platform

The provider must have a secure and robust digital lending platform which the following specifications:

- Ability to obtain consent from users for data collected from users' devices.
- Restricting permissions granted by users' devices to specific data needed for the loan process and revoking the permissions once the lender-borrower relationship ceases.
- The platform must use one-time passwords (OTP) and transaction messages that clearly identify the lender's name as indicated in the BOT license.

04 Landing Page Display

The landing page of the platform must contain the lender's full name as it appears on their BOT certificates and the following statement:
"This App (or Digital Lending Platform) is owned or operated by (name of microfinance service provider)."

06 Disclosure requirement

Duty to display interest rates, fees, charges, late payment penalties, payment frequency, loan limits, and loan tenures on the platforms.

05 Employment of competent personnel

Duty to use qualified personnel with ICT to manage digital lending operations.

07 Language

The platform must be available in Kiswahili, or both Kiswahili and English, with Kiswahili as the default language. The word used must be simple and understandable.

08 Display of Contacts

The platform must clearly display reachable phone numbers and email addresses for customer queries and complaints on the landing page.

Minimum Documentation for No Objection Request

In addition to meeting these operational criteria, existing licensed microfinance service providers who wish to offer digital loan products must apply for a No-Objection Letter from the BOT. The application process requires submission of:

1. An application letter in the format in Annexure 1 of the Digital Lenders Guidance Note signed by the Chairperson of the governing body or the sole proprietor.
2. A description of the digital lending platform, including process flow, screenshots of the user interface, and the privacy policy.
3. Screenshots of the platform's dashboard, showing account details including the organization and developer profile details, dates of initial uploads, category of digital lending platform and targeted regions.
4. A lending policy that incorporates digital loan products and services.
5. A pricing model for interest rates, late payment penalties, and other fees plus an explanation of the interest computation method.
6. A certified copy of the registration certificate from the Personal Data Protection Commission (PDPC).
7. A link for accessing the digital lending platform and its products.
8. A dully filled questionnaire as set out in Annexure 2 of the guidelines.

Prohibited Activities

Licensed digital lenders are required to prohibited from engaging in the following activities:

- Operating more than one digital lending platform.
- Using the digital lending platform to access customer contact lists, call logs, phone messages, pictures, storage, social media accounts, emails, media, photos, files, other applications either for KYC purposes or for managing delinquency.
- Digital lenders officers, employees, directors or agents are prohibited from disclosing the digital lenders customer information during and after they leave the employment or engagement of the digital lender.

- Using a lending policy before it was approved by BOT.
- Issuing loan agreements which don't contain the information in Section 39 (2) of the Tier 2 Microfinance Regulations. This includes information on loan amounts, annual and nominal interest rate, loan repayment schedule, sum of all fees and other payments until full loan repayment, interest rate computation method, late penalties, debt recovery fees etc.
- Issuing loans without complying with Regulation 22 (5) of the BOT (Financial Consumer Protection) Regulations, 2019[vi].
- Sharing customer data without consent, especially with entities outside Tanzania.
- Engaging in debt collection practices that involve threats, violence, or posting personal data online.
- Using a digital lending platform without prior approval from BOT.
- Changing the digital lending platform without approval of BOT.
- Failure to notify the bank within 14 days of their digital lending platform being suspended, removed or blocked by the owner of the hosting environment.
- Taking any form of deposits.
- Publishing false or misleading information about its products or services.
- Cross border lending.
- Using guarantors without having a mechanism for seeking the guarantor's consent including having a written guarantee agreement.
- Requiring upfront payment of interest before the loan due date.
- Assigning digital loans to third parties such as debt collectors without informing the customer before the third party contacts them.
- Offer loan products and services or collect repayments in any currency other than Tanzanian Shillings.
- Involvement in money laundering, terrorism financing or proliferations financing.

Comparative Practices in Uganda and Kenya

Licensing

Like Tanzania, digital lenders in Kenya are regulated by the Kenyan central bank known as the Central Bank of Kenya (CBK) under the CBK (Digital Credit Providers) Regulations, 2021[vii]. This is different from the position in Uganda, where the Uganda Microfinance Regulatory Authority (UMRA), the regulator of microfinance institutions and money lenders, regulates digital lenders under the Tier 4 Microfinance Institutions and Money Lenders Digital Lending Guidelines, January 2024[vii].

Interestingly, whilst Tanzania requires a digital lender to have a Tier 2 license microfinance service provider license and a product approval in the form of no objection for digital lenders, Kenya and Uganda have a more simplified process involving obtaining a single license to operate as a digital credit provider.

Further, the CBK (Digital Credit Providers) Regulations, 2021[ix] specifically excludes an institution licensed under the Kenyan Banking Act, Microfinance Act and SACCOS Societies Acts from getting a license under the said regulations. Presumably this indicates these licensed entities are already able to offer digital credit through their own regulatory frameworks.

Supervision

What is evidence is that across the three countries, the digital lending regulatory framework is designed to enhance consumer and data protection, encourage responsible lending by actions such as requiring disclosures and transparency, prohibiting unethical lending and debt collection practices, requiring robust risk management frameworks and embedding stringent anti-money laundering (AML) and data protection requirements.

Enforcement and Sanctions

Enforcement is a crucial aspect of the new digital lending regulations across East Africa. In Tanzania, violations of the Microfinance Act can result in heavy penalties. Unlicensed digital lenders are subject to fines ranging from TZS 20 million to TZS 100 million, imprisonment of up to five years and revocation of license and other sanctions.

In Kenya, the Central Bank can impose fines of up to KES 500,000 for non-compliance with digital lending regulations. Additional penalties apply for continued violations, and licenses can be revoked. Directors and officers of non-compliant institutions may also be suspended or disqualified from holding office in any financial institution

In Uganda, digital lenders face suspension or revocation of their licenses for failure to comply with the regulations. They also face administrative in the Tier 4 Microfinance Institutions and Money Lenders Act including fines, imprisonment of up to four years or both. Uganda Microfinance Regulatory Authority (UMRA) can also impose corrective action plans and carry out more frequent inspections to ensure compliance.

Conclusion

As the digital lending market grows, businesses must ensure that they comply with these evolving regulations to safeguard their operations and customers.

The new regulations in Tanzania and Uganda, and the Kenyan regulations represent a significant step towards creating a more transparent, ethical, and customer-focused digital lending industry. As the market evolves, continued oversight and enforcement will be essential to protect borrowers and ensure sustainable growth in the financial sector.

Endnotes

i Banking and Financial Institutions Act, (Act No 6 of 2006).
ii Microfinance Act, 2018 (Act No. 10 of 2018).
iii Bank of Tanzania, Public Notice on Prohibition for Engagement in Digital Lending Business Without a License dated 13 May 2024.
iv BOT Guidance Note on Digital Lenders under Tier 2 Microfinance Service Providers, 2024 https://www.bot.go.tz/Publications/Acts,%20Regulations,%20Circulars,%20Guidelines/Guidelines/en/2024082813141188.pdf
v BOT, Microfinance (Non-Deposit Taking Microfinance Service Provider) Regulations, 2019, GN 679 published on 13 September 2019.
vi BOT Financial Consumer Protection Regulations, 2019, GN No 884 published on 22 November 2019.
vii Central Bank of Kenya (Digital Credit Providers) Regulations, Legal Notice 46, dated 18th March 2022.
viii Digital Lending Guidelines for Tier 4 Microfinance Institutions and Money Lenders, Volume 1, issued on
ix January 2024 by Uganda Microfinance Regulatory Authority (UMRA).
Central Bank of Kenya (Digital Credit Providers) Regulations, Legal Notice 46, dated 18th March 2022.

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