



DRAFT DEPOSIT-TAKING MICROFINANCE BILL, 2005

**A Presentation to the Board and Senior
Management of SISDO**

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at

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BACKGROUND TO THE ESTABLISHMENT OF MICROFINANCE

- Financing “Real” Sectors of the Economy (1960s)
 - e.g. agriculture, manufacturing, trade
 - “market failure” argument
- Results (1970s)
 - subsidized interest rates
 - low savings
 - central bank financed government budget deficit

BACKGROUND TO THE ESTABLISHMENT OF MICROFINANCE (cont.)

- * Central Bank provided parastatals with liquidity
- * Central Bank lacked supervisory autonomy and capacity
- * Weakened instruments of monetary policy (e.g. unstable interest rates, exchange rates and price level; insolvent financial system)

BACKGROUND TO THE ESTABLISHMENT OF MICROFINANCE (cont.)

- Distressed Banking Systems (1980s)
 - Central Bank slow to react to banking crisis
- Rising Fiscal Deficits
 - directed credit led to inefficient use of capital
 - public sector borrowing led to high inflation (e.g 78%)

BACKGROUND TO THE ESTABLISHMENT OF MICROFINANCE (cont.)

- overvalued currencies led to import dependence
 - non-performing assets rose due to poor trade terms and mismanagement
 - Dramatic Reforms (1990s)
 - IMF supported SAF/ESAF implemented
 - World Bank supported SAC/SAL implemented
- *to achieve non-inflationary, private sector led growth



BACKGROUND TO THE ESTABLISHMENT OF MICROFINANCE (cont.)

- Results of Reforms
 - elimination of directed credit
 - liberalised interest rates and exchange rates
 - strengthening regulation and supervision
 - bank restructuring (e.g. branch rationalisation)
 - increased Central Bank autonomy



BACKGROUND TO THE ESTABLISHMENT OF MICROFINANCE (cont.)

- developing financial markets (including microfinance)
- ❖ World Bank/IMF Poverty Reduction Strategy Paper (PRSP - Sept. 1999)

Kenya's PRSP 2000-2003

- Components and Policy Objectives:
 - to facilitate sustained and rapid economic growth
 - to improve governance and security
 - to increase the ability of the poor to raise their incomes
 - to improve the quality of life of the poor, and
 - to improve equity and participation

Kenya's PRSP 2000-2003 (cont.)

- Financial Sector Reform

“The Government recognises that greater access to, and sustainable flow of credit to the informal sector operators, are critical to progress in poverty reduction. Therefore, development of an appropriate policy and legal framework to promote a viable and sustainable system of microfinance in the country will be initiated and completed in 2000/01. In doing this, the Government will consult with the stakeholders to get their

Kenya's PRSP 2000-2003 (cont.)

views on the best way to create the required enabling environment for the sub-sector. In addition, a full-fledged micro finance unit will be established in 2000/01 in the Central Bank of Kenya to regulate microfinance organisations. The unit will be required to formulate policies and procedures to address the problems facing these institutions and to build up a database to facilitate better monitoring of their operations”.

Institutional Framework

- The Treasury
- Central Bank of Kenya
 - Microfinance Division (2000)
 - Rural Finance Development Department (2004)
- AMFI
- Attorney General's Chambers

Institutional Framework (cont.)

- Develop microfinance policy, legislation and prudential guidelines
- Other financial intermediaries, e.g. SACCOs, KPOSB, DFIs (IDB, KIE, AFC etc.)
- Credit Reference Bureaus
- Credit Rating Agencies
- Process taken 2000 to 2005

Microfinance Policy Statement

- Role of microfinance in poverty reduction
- Legal & regulatory framework
- Institutional capacity
- Tiered approach to regulation & supervision
 - Tier 3: no – regulation (ROSCAs)
 - Tier 2: non-prudential regulation (credit-only MFIs – MoF)
 - Tier 1: prudential regulation (official supervision of deposit-taking MFIs - CBK)
- Deposit-taking Microfinance Bill

Economic Recovery Strategy

- Economic Recovery Strategy for Wealth and Employment Creation (ERS – June 2003)
 - Enable the microfinance sector to operate with the same level of depositor protection and professionalism as the banking sector.
 - Accelerate the enactment of the “Micro-finance Institutions Act” as a step towards enhancing competition in the financial sector.

Contents of the Draft Deposit-taking Microfinance Bill

- Preliminary
- Licensing: min. capital & capital ratios
- Prohibited business: loan limits, insider loans
- Ownership and Corporate Governance
- Accounts and Audit
- Information and Reporting Requirements
- Inspection and Deposit Protection
- Miscellaneous provisions: prudential regulations, penalties, disqualifications, supervisory powers, exemptions etc.



DRAFT THE DEPOSIT-TAKING MICROFINANCE BILL, 2005

A Bill for

An Act of Parliament to make provision for the licensing, regulation and supervision of deposit-taking Microfinance business and for connected purposes



1. Citation and Commencement

This Act may be cited as the Deposit-taking Microfinance Act 2005 and shall come into force within six months after assent.

2. Interpretation

‘deposit’ means a sum of money received or paid on terms under which it will be repaid, with or without interest or a premium, and either on demand or at a time or in circumstances agreed by or on behalf of the person making the payment and the person receiving it; except that the following shall not qualify as deposits for the purposes of this Act.



2. Interpretation (cont.)

- (a) Any sum of money which is paid by way of advance or part payment under a contract for the sale, hire or other provision of property or services, where the sum is repayable only if the property or services is not or are not in fact sold, hired or otherwise provided;
- (b) A sum of money which is paid by way of security for performing a contract;

2. Interpretation (cont.)

- (c) A sum of money which is paid as security for a loan granted or promised at a future date to be granted to the person making the payment, except that such sum or interest on it shall not be on lent.

2. Interpretation (cont.)

‘deposit-taking microfinance business’ means

- (a) a business which the person conducting the business holds himself out as accepting deposits on a day-to-day basis;
- (b) Employing such deposits wholly or partly by lending or extending credit for the account and at the risk of the person accepting deposits including the provision of short term loans to micro and small enterprises in low income households usually characterised by use of collateral substitutes such as group guarantees and compulsory savings.



3. Application of the Act

- (1) This Act shall apply to deposit-taking micro-finance business.
- (2) The Minister may by regulations -
 - (a) specify non deposit-taking microfinance business; and
 - (b) measures for the conduct of the specified non-deposit-taking microfinance business.

4. Qualifications for carrying out deposit taking microfinance business

- (1) No person shall carry out any deposit-taking microfinance business unless such person-
 - (a) is a company formed and registered under the Companies Act and the main objectives of such company is to carry out deposit-taking microfinance business; and
 - (b) is licensed under this Act to carry out deposit-taking microfinance business.



7. Categories of deposit taking microfinance business

The Minister may, by regulations, set out categories of deposit-taking microfinance businesses based on geographical, administrative criteria or such other criteria that the Minister may deem necessary.



11. Minimum Capital Requirements

- (1) An institution shall maintain minimum capital requirements as set out in the First Schedule to this Act.



12. Minimum Liquid Assets

- (1) An institution shall maintain minimum holding of assets as the Central Bank may, by regulations, prescribe.

14. Prohibited Activities

An institution shall not carry out any of the following activities –

- (a) issuing third party cheques;
- (b) opening current accounts;
- (c) foreign trade operations;
- (d) trust operations;
- (e) investing in enterprise capital;

14. Prohibited Activities (cont.)

- (f) wholesale and retail trade;
- (g) participating in the underwriting and placing of securities, or
- (h) purchasing or otherwise acquiring any land except as may be reasonably necessary for the purpose of expanding the deposit-taking microfinance business

17. Limit on Loans and Advances

- (1) No institution shall grant a loan or credit facility to an end user single borrower where the loan or credit facility in the aggregate exceeds such limit of the core capital as the Central Bank may by regulations, prescribe.
- (2) No institution shall grant a loan or credit facility against the security of the shares of the deposit-taking microfinance business.



18. Insider Lending

No institution shall grant a loan or credit facility to an associate, officer or staff member of the deposit-taking microfinance business, in excess of such limits as the Central Bank may, by regulations, prescribe.

19. Limit on Shares

- (1) No person shall own more than twenty five percent of the shares of a deposit-taking microfinance business.
- (2) The provisions of sub-section (1) shall not apply to -
 - (a) a wholly owned subsidiary of a bank;

19. Limit on Shares (cont.)

- (b) a financial institution licensed under the Banking Act; and
 - (c) any other company that the Minister may, in accordance with the Central Bank, deem necessary.
- (3) No person shall transfer or cause to transfer more than ten percent of shares in a deposit-taking microfinance business without the approval of the Minister.

20. Board of Directors

- (1) A deposit-taking microfinance business shall be managed by a board of directors consisting of not less than five directors and shall be headed by a chairman, who shall be a non-executive director.

21. Qualification of Director

A person shall not be qualified for appointment as a director if such person is -

- (a) is a minor or is under a legal disability;
- (b) been convicted of theft, fraud, forgery, causing financial loss or perjury or has been imprisoned for three months or more;



21. Qualification of Director (cont.)

- (c) has been removed from an office of trust on account of misconduct, abuse of office, corruption or incompetence in the last ten years;
- (d) is an auditor of a company licensed to conduct deposit-taking micro-finance business;
- (e) does not meet the criteria set out in the regulations.



23. Financial Year

The financial year of a deposit-taking Microfinance business shall be the period of twelve months ending on the 31st December in each year.



29. Appointment of External Auditors

- (1) An institution shall appoint, annually, an auditor qualified under Companies Act and approved by the Central Bank.

- (2) No institution shall remove or change its external auditor except with the prior approval of the Central Bank.

30. Qualifications of an External Auditor

No person shall be appointed as an auditor of an institution if such person is -

- (a) a director, officer or employee of that business;
- (b) a partner of a director, officer or employee of that business;
- (c) an employer or employee of a director, officer or employee of that business;

30. Qualifications of an External Auditor (cont.)

- (d) a director, officer or employee of an associate of that business;
- (e) a partner or an employee of that person, regularly performs the duties of secretary or book-keeper for that business; or
- (f) a firm or member of a firm of auditors of which any partner or employee falls within the above categories.



33. Collection of information by Central Bank

The Central Bank shall collect data and other information as may be necessary to enable the Central Bank to maintain supervision and surveillance of the affairs of an institution and the protection of depositors and, for this purpose, the Central Bank may require an institution to submit statistical and other returns on a periodic basis in addition to any other returns required by law.

34. Furnishing of information

- (1) The Central Bank may require any institution to furnish such information as the Central Bank may reasonably require for the proper discharge of its functions under the Act and in such time and manner as the Central Bank may direct.

35. Publication of Information

- (2) Notwithstanding the provisions of this section the Central Bank and institutions may, in the ordinary course of business, in such manner as the Minister may by regulations prescribe, exchange information for the proper discharge of their functions.
- (3) Regulations under sub-section (2) may provide for the establishment and operation of credit reference bureaus, for the purpose of collecting prescribed credit information on clients of institutions and disseminating the information amongst institutions for use in the ordinary course of business, subject to such conditions as may be prescribed.

39. Power of Central Bank to Intervene in Management

(1) The Central Bank may intervene in the affairs of an institution in the following circumstances -

- (a) where the institution has contravened the provisions of this Act or conditions upon which the license was granted;
- (b) where the business is being conducted in a manner detrimental to the interests of the depositors or creditors;

39. Power of Central Bank to Intervene in Management (cont.)

- (c) where the institution has failed to maintain the minimum core capital;
- (d) where the institution has insufficient assets to cover its liabilities.

40. Liquidation of an Institution by the Central Bank

(1) Where an institution becomes insolvent, the Central Bank may appoint the Deposit Protection Fund Board established under the Banking Act, to be a liquidator of the institution; and the appointment shall have the same effect as the appointment of a liquidator by the High Court under the provisions of the Companies Act.



41. Contribution to the Deposit Protection Fund

- (1) All institutions shall contribute to the Deposit Protection Fund established under the Banking Act.

42. Protection of Deposits

- (1) The Deposit Protection Fund Board shall, by order in the Kenya Gazette, determine the amount of balance to be maintained by a customer of an institution, as a protected deposit.

46. Orders by the High Court

- (1) The High Court, on application made ex-parte by the CBK or a manager or liquidator appointed by the CBK, may, if it considers it to be in the interests of the depositors of an institution, make an order-
 - (a) prohibiting the institution from carrying on business; or
 - (b) staying the commencement or continuance of any action or any proceedings against the inst. for a specified period of time on such terms and conditions, as the HC considers reasonable, and may extend the specified period up to a total of six months from the beginning of the stay.

47. Restriction on Use of the Word Deposit Taking Microfinance Business

No person shall use the word “deposit-taking microfinance business” or any of its derivatives or any other words indicating the transaction of deposit-taking microfinance business or the equivalent, in the name, description or title under which it transacts business in Kenya or make any representation that the person transacts deposit-taking microfinance business unless such person is licensed under this Act.

48. General Penalty

A person who contravenes any provisions of this Act commits an offence and is liable on conviction to a fine not exceeding one million shillings or to imprisonment for a term not exceeding three years or to both.

49. Default by Officers or Employees

- (1) Any officer or employee of an institution who fails to –
 - (a) take all reasonable steps to secure the compliance of Act;
 - (b) fails to take all reasonable steps to secure the accuracy and correctness of any statement submitted under this Act; or
 - (c) supply any information required under this Act to the Minister or the Central Bank, commits an offence and is liable on conviction to imprisonment for a term not exceeding three year or to a fine not exceeding one million shillings or to both.

50. Minister's Power to Make Regulations

The Minister may, in accordance with the Central Bank, make regulations generally for carrying out the purposes and provisions of this Act and without prejudice to the generality of the foregoing, any such regulations may make provision for-

- (a) prescribing anything which under this Act is to be prescribed;
- (b) the procedures for licensing; or
- (c) forms and fees to be used under this Act.



Thank You