

**ANALYSIS OF THE LEGAL FRAMEWORK ON
CONSUMER PROTECTION IN THE BANKING
SERVICE DELIVERY IN KENYA.**

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LLM-1153-01056-03222.

A Thesis Submitted To the School
of Postgraduate Studies and Research

In Partial Fulfilment of the award of Masters of Commercial Law
of Kampala International University

Kampala, Uganda

June, 2018.

DECLARATION

I declare that this is the work of LUVUNO LUNGA,NZI CHAI, alone, and has not been presented for a degree or any other academic awards in any university of institution of learning.

Name and Signature of the Candidate.

Date.....

APPROVAL

I certify that I have supervised and read this and that in my opinion: It confirm to acceptable standards of scholarly presentation and fully adequate in scope and qualify as a in partial fulfilment for award Degree of Masters of Law of Kampala International University.

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ACKNOWLEDGEMENT

I would like to extend my sincere gratitude to my supervisor, Muhamud Sewaya for the insightful and comprehensive guidance he afforded me while I undertook this study. I am honoured to have worked under his supervision.

I also extend my sincere gratitude to my beloved family. My father Mr. Lung'anzi Chai Mangale, who continuously encouraged and supported me in compilation of my course. I thank him for his financial , and moral support for sure I would not have come this far if not for him.

I would like to extend my gratitude to my supportive mother who gave me time, support and unconditional love in ensuring that I have completed my course. Special thanks go to Mrs. Luvuno Mangale, who encouraged me and believed in me enough. I thank all my siblings for the encouragement and believing in me all through the hard moments. I appreciate my late cousin Ali Nyondo, who although was bedridden kept on encouraging me.

Finally, I extend special thanks to my friends whose love and support was the source of my perseverance. God bless you all.

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LIST OF ACRONYMS AND ABBREVIATIONS

| | |
|-------|---|
| AF | Agricultural Finance Corporation |
| AC | Appeal Court. |
| CBK | Central Bank of Kenya. |
| CCK | Communication Commission of Kenya |
| COFEK | Consumer Federation of Kenya |
| DFCK | Development Finance Corporation of Kenya |
| DFI | Development Finance Institutions |
| ICDC | Industrial and Commercial Development Corporation |
| IBD | Industrial Development Bank |
| MFA | Micro Finance Act the Microfinance |
| MIWA | Monetary Institutions Watch |
| CDS | Central Depository System. |
| CDSC | Central Depository System Committee |
| DPFB | Deposit Protection Fund Board |
| PSR | Payment Services Regulations |
| FEPP | Financial Education and Consumer Protection Partnership |
| FSD | Financial Sector Deepening |

ABSTRACT

In Kenya most bank customer are victims of unfair banking contract terms. Banking institutions fail to apply the available laws that can protect a bank customer. The central objective of this is to investigate into the existing legislations that relate to banking business in Kenya. By doing so to clearly see how effective they are to the banking business law. Also to examine if the existing laws are implemented to aid in bank customer protection. The cardinal research problems are the gaps that exist in the laws and regulations in relation to bank customer protection. Though this research the gaps in the laws shall be exposed and recommend the suitable cure for protection of a bank consumer.

This is based on both primary and secondary data. The primary materials used were, statutes, analysing laws and regulations and decided cases, from Kenya, east Africa and from Common Law countries so as to give practical example. The secondary data used were articles, journals, Law books, materials from the internet, news papers articles that explain about bank customer protection and unpublished related work.

The major findings of the research, is that Kenya bank customer protection laws are not adequate, to protect the bank customer. The existing laws are not fully implemented by the financial institutions, hence the bank customer, are sometimes cheated. Also there are bank customer protection bodies in Kenya that are mandated to protect bank customers, but their functions are dormant. This is evident in the number of banks collapsing and how bank customers are defrauded.

In protecting the bank consumer in Kenya, it's argued that the regulating bodies should be given more mandate so that they can implement the bank regulation and solve disputes between bank customers and the banks. Also the legislature should formulate laws that will protect the bank customer.

CHAPTER ONE

GENERAL INTRODUCTION

1.1 Background to the Study

The introduction of banking systems in Kenya is traced to 1940, that was when banks were introduced in Kenya by Indians. At the time of independence, the banks that existed had their head offices in India and were mostly owned by Muslims. After independence they decided to establish their head office in Kenya, This laying the foundation of banking in Kenya.¹

The National Bank of Kenya was set up in November 1944, in crisis condition following the first trade, deadlock with India. The original intention was to establish it sometime in 1950. The plans for the establishment had to be advanced in view of the critical situation, which developed, especially in the exchange trade as a result of Indians refusal to accept the exchange rate of the Indian rupee following the Indian devaluation in 1949. In 1952, the National Bank of Kenya took over agency work of the State Bank of Kenya to transact government businesses and manage currency at places where the state bank did not have an office of its own.²

All Kenyan banks were nationalized with hundred percent federal government ownership under the Banking Act in 1974 and by now all nationalized banks stand disinvested and privatized. This is because there was the political reality that needed to be addressed, the need for visible ownership in the Kenyan economy by African Kenyans, and the government's stated policy of 'Africanisation' was also pursued through the financial system.

¹ Radha Upandhyaya and Susan Jonson, *Transformation of Kenyans banking Sector*, (2nd edition, 2000-2011)pg 32

² Ibid.

The government also established two new banks Cooperative Bank of Kenya and National Bank of Kenya. Specialised credit institutions, or development finance institutions (DFIs) including the Industrial and Commercial Development Corporation (ICDC), the Industrial Development Bank (IBD), the Development Finance Corporation of Kenya (DFCK) and the Agricultural Finance Corporation (AFC) were set up to give loans to Kenyans and also to purchase shares in public corporations.

In 1974, the banks in Kenya were nationalized through the *Nationalization Act*³. From 1991, the policy of liberalization of the economy had been adopted whereby, nationalized bank have been de- nationalized and banks are privately owned.

The current banking system in Kenya is a result of the Indian banks and British banks that first developed in Kenya. Other local banks have come up, numerous in number. These have made the banking industry to grow and have a great competition. With the growth and competition of banking industry. It is of great importance for these field to be regulated so as it is conducted in a manner that is line with the government policy.⁴

Hence there was formation of banking legislations in Kenya that would govern how the banking business is conducted and provides for the protection of the bank customer. These laws includes the: *The Constitution of Kenya 2010*, that enshrine the principles of public finance and measures to control public money.⁵ It also establishes the Central Bank of Kenya which is the regulator of the banking industry and inter-alia formulates monetary policy, promotes price stability and issues currency⁶

There is the *Central Bank of Kenya*⁷ . It establishes the Central Bank of Kenya. Bank has the power to make rules and regulations concerning banking and financial matters.

Also there is the *Banking Act*⁸ it deals with the business of banking and related matter. It provides for the process of licensing and under which such licenses may be revoked. There is

³ Nationalization Act 1974.

⁴ Radha Upandhyaya and Susan Jonson, *Transformation of Kenyans banking Sector*, (2nd edition, 2000-2011)pg 32

⁵ J. A. Spanogle and R. J. Rohner, *Consumer Law Cases and Material*, (1stEd, 1999).

⁶ Kenya constitution 2010, Article 231.

⁷ Central Bank of Kenya Act Cap 491.

the *Microfinance Act*,⁹ which governs the licensing, regulation and supervision of microfinance business. It offers banking related services and are subject to the Central Bank of Kenya and the Deposit Insurance Corporation in Kenya.

All these legislations exist so as to make sure that the banks and micro finances operate in a manner that does not deprive the customer's rights. The bank customer relationship brings mutual duties and obligations and it is therefore necessary define a customer, according to the provisions of the law.

Consumer protection can be understood as a fair exchange between goods and service providers on the one hand and consumers on the other hand.¹⁰ There is of great importance to give a legal frame work to supervise the inherent disadvantage of a consumer vis-a-vis the power, information and resources of their goods and service providers.¹¹

Hence there is need for reforms in the financial sector regulations that centre on the matter of consumer protection.¹² This is provided for in the *Kenya Constitution* ,which entrenches the right to consumer protection, that is, consumers should be protected from unfair market practices from services and goods provided.¹³This constitutional entrenchment, in conjunction with the *Consumer Protection Act*¹⁴ and sector-specific statutes, place enormous obligations and responsibilities on providers of financial services and goods .Both private and public to be discussed hereunder.

With regard to the foregoing observation this proposes to analyse the treatment of consumer protection in the financial services sector through the provisions of different banking related laws.

⁸ Banking Act of Kenya Cap 448.

⁹ Microfinance Act 2006.

¹⁰ Spanogle and Rohner, *Consumer Law Cases and Material* , (1stEd, 1999) at p8.

¹¹Ministry of Finance by FSD, 'Consumer Protection Diagnostic Study Kenya' [2011],FSD,3.

¹²Abridged Version, ' Bank of Republic of Kenya Vision 2030'(1st Ed ,May 2014)p4.

¹³ The Constitution of Kenya 2010 Article 46

¹⁴ Consumer Protection Act 2012.

These include: *The Central Bank of Kenya Act*,¹⁵ the *Banking Act*,¹⁶ and the *Insurance Act*,¹⁷ the *Capital Markets Act*,¹⁸ the *Retirement Benefits Act*,¹⁹ *Consumer Protection Act*,²⁰ the *Competition Act*,²¹ the *Micro Finance Act*,²² the *Microfinance (Deposit Taking MFI) Regulations*²³ and the *Central Bank Kenya Prudential Regulations*.

In Kenya, there are bodies that supervise and ensure that the bank customer is being protected to illustrate, there is the Consumer Federation of Kenya (COFEK), an independent, self-funded, multi-sect oral, non-political and non-profit Federation committed to consumer protection which recently registered a non-profit subsidiary – Monetary Institutions Watch (Miwa). These bodies are made to focus on the commercial banks and other financial institutions on consumer protection and dispute resolution.²⁴

The has at length provided for the institutional framework in Kenya that protects the bank consumers from bad market practice. The financial institutions include The Central Bank of Kenya that is established under Article 231 of the *Constitution of Kenya*²⁵ and section 3 of the *Central Bank of Kenya Act*²⁶. This institution can be referred to as the banks of banks. It has supervisory powers over all the institutions that offer banking services in Kenya. It has the powers to make monetary policy in Kenya, print money and ensure that the currency is stable; It has the powers to appoint a manager to a bank so as some they can get all the information required of the bank proper running. The Bank also has powers to dismiss a manager, director or employee who has not or had aided in not complying with the banking regulation in Kenya. Or has committed an action that will affect the stakeholders of the bank, they include the bank customers, the creditors and competing banks.

¹⁵ The Central Bank of Kenya Act Cap 491.

¹⁶ The Banking Act Cap 448.

¹⁷ Insurance Act cap 487.

¹⁸ Capital Market Act 2003

¹⁹ Retirement Benefit Authority Act Cap 179

²⁰ Consumer Protection Act of 2012.

²¹ Competition Act 2010.

²² Microfinance Act 2006.

²³ Microfinance (Deposit Taking MFI) Regulations, 2008

²⁴ Ibid.

²⁵ The Constitution OF Kenya 2010.

²⁶ Ibid foot note No;14.

In the institutional frame work there is also the Deposit protection fund board. This Board is established under Section 36 of the Banking Act. This board ensures that all banking institution save some funds with them that will be used by the bank in case they are winding up. This protects the bank customers against banks that are in liquidation.

In chapter three the thesis will explains in details the nature of a bank customer protection. This will give a live picture of the status of bank consumer in Kenya. It will enable the one to understand the level how a banking regulations in relation to bank consumer protection are a adhered to. It will explain in details the duty of the bank in ensuring that his bank customer is protected. Also to what extend does the duty go. Also does the bank consumer have a role also to ensure that he is protected too.

Chapter three will enable an individual to understand the extend of which a bank can be liable in case bank customers are being taken advantage of. The extent of liability will enable the bank consumers also to be diligent in the transactions they are conduction. They should be diligent in ensuring that there acts too are not too careless to put himself in a compromising situation.

Also the state of bank consumer protection in Kenya is compared to other jurisdiction so as to understand on how Kenya as a country can improve on its bank consumer protection laws to fully provide for the civilians. The comparison was made between Uganda and Switzerland bank consumer protection. This gives chance to the baking systems to emulate the other jurisdiction banking systems if they have protected the banks consumer better that Kenya.

The thesis captured the developed banking product that are offered to the bank customer under chapter four. The thesis explained about the nature of a bank product that may be use to take advantage of the bank customers. The guarantee is one of the methods that banks use to secure their loans. They sometime term it as a risk mitigation style in the banking business. A guarantee is a type is security where the a person who in the guarantor gives an assurance to the bank that he will pay the amount owed to the banks in case the principle debtor fails to pay as at the agreed time.

This type of arrangement comes along with rights and duties. The financial institution plays a vital role in ensuring that the bank customer gets all relevant information from the bank concerning the product that the principal debtor is about to take. The bank should be fair enough to trade in such a manner that it will not put the bank customer in a position where he is not aware of what he is getting involved with. Independent advice will help the guarantor to know the merits and demerits of the transaction he is about to get into. The bank legislations in Kenya have provided for laws and regulations the bank ought to adhere with to ensure that the bank customers are protected. This entails on how that bank should disclose the information to bank customer, full disclosure to a bank customer put him safe from all fraudulent financial providers in Kenya.

The thesis puts down all the findings in chapter five from the research that has been conducted. This chapter the author will be able to draw done findings where she can give a stand as to the state of bank consumer protection in Kenya. He will also draw the reasons as to why the bank consumers are not fully protected. Hence afterwards the drawing of a conclusion.

The conclusions that was given, if adhered to will make a positive contribution in the improvement of that bank consumer protection in Kenya. The recommendations are majorly aimed at, educating the bank consumer of their right and what they ought to have in the country and in their individual banks to ensure they are protected. Also the bank through this piece of work will be able to improve on their banking internal regulations. Good regulations will boost the growth of the bank. This is because the banks will gain confidence among the Kenyan citizens. By matching bank consumer protection with the company vision will make the citizen to invest in that bank. This is because they will not be worried about fraudulent banks. Hence the bank customer will come for bank services in that institution and make recommendations generally.

1.2. Statement of the problem

The thesis aims to address the issue of bank customer protection in Kenya. The bank is a place of business hence has its own policy and regulations it of great importance to ensure that the regulations are in line with protection of the general public. Since bank customers are

the lifeblood of bank and financial institutions, without them, such business will perish.²⁷Hence these making it very important to ensure that the bank customers are protected. The will address the protection of bank customers through looking at the laws and the gaps that exist in the laws and regulations. Though there are several legislations that protect a bank customer in Kenya, still customers' end up being defrauded by these financial institutions. These is evident in the way customers are not given full disclosure of the terms of the loans, there is high rate of illiteracy in Kenya. Banking as business, involves different packages, where the customer should be aware of the advantages and the disadvantages. The customer should understand that the banks depends on them and their deposits to make profit. Hence they have a right to bargain for a better condition. Also they have right to full disclosure of all the necessary information needed for the customer to make a decision the banks do not give them enough information on how the interest is charged. Hence customers are deceived and end up losing the properties they have out as securities for their loans. There is no full implementation of the law as some financial institutions that offer financial business, don't abide by the law.

The thesis will address the issue of the unreasonable technicalities that the banks tend to put when giving loans to customers. These includes the high interest loan that the bank customers have to pay, the terms that the bank put for the customer, including the time one is to pay the amount and the security the bank customer has to give for him or her to get a loan.

This is meant to address on the implementation of the laws and regulations that have been made by the parliament. It will examine whether the financial institutions puts the laws into application. In most cases banks avoids implementing some of the legislations so that they may favour the interest of the bank rather than the bank customers.

In a nutshell, the banks in Kenya have their internal regulations that should go hand in hand with public interest. That is they should provide banking services without taking advantage of the bank customers. But this is not the case in Kenya; instead banks draft their internal regulations that will favour them in profit making. And not putting into consideration the rights of the bank customer. Bank customers are not fully protected against commercial

²⁷ Omar K. Mburu, *Marketing Services and Business Ethic Bankers Wokbook Series*, 1st publisher the Tanzania Institute of bankers (2004)

banks. This is because although there are regulations for protection of bank customer, still banks do not comply with them to the latter. The remedies that are available to the bank customers do not aid all bank customers. Court being a way of solving disputes between the bank customer and the bank is too expensive and not all bank customers can afford it. There is weak enforcement of the existing laws, towards protection of a bank customer.

1.3 .Research questions

- a) What are the existing banking law in Kenya and how adequate have they protected the bank customers in Kenya?
- b) What is the available institutional framework in Kenya that aids in protection of a bank customer and implementations of bank customer protection laws?
- c) What measures should be introduced to be able to protect the banks customer in Kenya?

1.4. Objective of the study.

1.4.1. General objectives

The general objective of the study is to investigate into the existing legislations that relate to banking business in Kenya. By doing so to clearly see and know how effective they are to the banking business law. Also to examine if the existing laws are implemented, how are they implemented in Kenya in relation to the protection of a bank customer in Kenya?

1.4.2. Specific objectives

The study is aimed at:

- a) To analyse the existing banking laws in Kenya and to examine how effective they have protected the customer in Kenya.
- b) To analyse the available institutional framework in Kenya that aids in protection of a bank customer and implementations of bank customer protection laws?
- c) To analyse the measure that can be introduced to able to protect the bank customer in Kenya.

1.5. Significance of the study

This research comes up with the recommendations that will convince the law makers to improve on the laws and regulations that exist in Kenya. The new laws will capture provisions that will ensure bank customers are fully protected when being offered services by the bank. The proposed recommendations will increase awareness and transparency to the customers, lawyers, researchers on understanding banking laws and policies. This will solve the challenges arising in the banking sectors, especially in bank customer protection.

The research will come up with methods to reduce financial exploitation by the banks to their customers. When the customers are well informed about the services they want. And explained for the advantages and disadvantages that bank product, this will help in making informed decisions.

Generally, when the bank customers are protected banking as a business will improve because the general public will gain confidence and entrust their monies in the banks and take loans too, hence there will be an improvement in the banking sector hence the economy of the country will improve.

1.6 Scope of the study

The geographical scope if the study is in Kenya and a comparison study from other jurisdictions that is Uganda and Switzerland. The time scope if the study is ten years, where the author will examine how bank consumer protection has been archived in Kenya and the two other jurisdictions for the past ten years. Also on time scope the research was conducted within one year. The content scope is in the baking business ad the consumers of the bank services offered.

1.7. Literature review

There are several legislations that provide for bank consumer protection in Kenya. This provisions emanate from the Constitution of Kenya²⁸ Article 46 of the *Kenya 2010 Constitution* entrenches the right to consumer protection, that is, consumers should be protected from unfair market practices from services and goods providers. Consumers have

²⁸ The Constitution of Kenya,2010.

the right (a) to goods and services of reasonable quality,(b) to the information necessary for them to gain full benefit from goods and services;(c) to the protection of their health, safety, and economic interests, and(d) to compensation for loss or injury arising from defects in goods or services.

1.7.1.Statutory literature review

(a) The Central Bank of Kenya Act Cap 491.

The Central Bank Act establishes the Central Bank of Kenya under section 3 as the top most institution in the banking sector. Its framework for regulation of the banks conduct, however, is derived from the Banking Act.

The Central Bank plays a unique role in the economy and performs various functions not normally carried out by commercial banks. Currently its main task, is that of "maintaining price stability and fostering liquidity, solvency and proper functioning of a stable market-based financial system".²⁹ That is in connection to other function of bank of Kenya, of printing money, formulates and execute monetary policy, supervising and regulating depository institutions.

The Central Bank of Kenya supervises all the commercial bank in Kenya and ensures that they provide quality services and also ensuring that the bank customers are not disadvantaged.³⁰For regulatory purposes, a registered bank must keep certain amount of funds with the Central Bank.³¹ This ensures it operates within the established limits and regulate funds in circulation.

The central bank of Kenya Act Section 3(3) as read together with section 4 mandates the central bank of Kenya to formulate and implement monetary policies to sustain price level stability. By using this system the central bank ensures that the bank customers are protected

²⁹ The Central Bank of Kenya Act Cap 491, S (3), (4).

³⁰ Bryan A. Garner, *Black's Law Dictionary*, (9th Ed, 2009),

³¹ Ibid, pg 15to collect the insurance proceeds.

from unfair bank practises. Deposit-taking Micro-Finance Institutions are also regulated by the CBK with the same conventions found in the Banking Regulation.³²

(b)The Consumer Protection Act 2012

The Act sets out to provide for the protection of the consumers, prevent unfair trade practices in consumer transactions and to provide for matters incidental thereto.³³ In its application no regard is paid to any other agreement made between a consumer and a manufacturer or service provider which agreement contradicts the substantive provisions of the Act, thus the Act states substantive and procedural rights given under this Act shall apply to every consumer despite any agreement or waiver to the contrary.³⁴

Section 4 (a) ³⁵ which lowers the *locus standi* whenever a consumer wishes to bring forth a suit in respect to a breach of a provision of the Act. Section 7 of *Consumer Protection Act* provides for contra-preferentum rule synonymous to contracts by providing that any ambiguity that allows for more than one reasonable interpretation of a consumer agreement provided by the supplier to the consumer or of any information that must be disclosed under the Act shall be interpreted to the benefit of the consumer.³⁶ With this provision of interpretation of the statute in favour of the bank customer tends to be a more of an exemplary law. Section 89 of the *Consumer Protection Act* establishes the Kenya consumer protection advisory committee whose among its many functions is to establish dispute resolution mechanisms, investigating complaints and referring to the relevant authority.³⁷

(c) *The Banking Act Cap 448.*

(i) Bank customer protection against closing banks.

³² Since 2008 when the *Microfinance Act* and attendant regulations became operational, 6 deposit-taking *microfinance institutions (DTMs)* have been granted licenses by the CBK. DTMs do not only complement the role of commercial banks but they do satisfy financial needs of otherwise excluded segments like the rural and semi urban areas

³³ The Consumer Protection Act, 2012, s 2.

³⁴ *Ibid* , s 3(2)

³⁵ The Consumer protection Act 2012 s 4 (a).

³⁶ The Consumer Protection Act, 2012,s 7.

³⁷ The Consumer Protection Act 2012 s 89 ,s90.

Section 37 lists the sources of funds contributed which include profits from the investments of the board, but more importantly contributions from the member institutions.³⁸ The existence of the Deposit Protection Fund Board, helps the bank customers to against losing their money when banks are shutting down. The board comes in to investigate the cause of the bank shutting down. Afterward they make the fraudulent parties to refund the money that belong to the bank customers.

(ii) Consumer Compensation

Section 36 of the *Banking Act*³⁹ established a Deposit Protection Fund Board (DPFB) with a wide mandate. The DPFB's main tasks is to manage the deposit insurance fund and carry out the liquidation of insolvent institutions once they have been closed by Central Bank Kenya. This archived by repaying protected deposits and dividends, carrying out debt recovery, and winding up the institutions under liquidation. DPFB offers protection to small depositors up to Kshs 100,000 against loss of their savings in case of a bank failure.⁴⁰ Its mission is to enhance public confidence in the nation's financial system by providing a sound safety financial system. All depositors' funds held by institutions are sufficiently insured against loss. That may occur as a result of bank failure and to efficiently liquidate and wind up failed institutions for the maximum benefit of all depositors and creditors⁴¹

(d) Guideline on Consumer Protection Central bank of Kenya

The *Prudential Guidance* came into existence in 2006, where it mainly focused on creating transparency between banking institutions and individuals and corporations with whom they conduct business.⁴² The Guidelines are issued under Section 33(4) of the *Banking Act*, which empowers the Central Bank of Kenya to issue guidelines to be adhered to by institutions in order to maintain a stable and efficient banking and financial system.⁴³ This Guideline applies

³⁸ Banking Act Cap 448, s 38.

³⁹ Banking Act cap 488 Section 36,.

⁴⁰ Ibid

⁴¹ Deposit Protection Fund Board Kenya “*Annual Report & Accounts*” (2009) pg1.

⁴² The Central Bank of Kenya Prudential guidelines for institutions licensed under the Banking Act, On consumer protection CBK/PG/22/419. '(2006)210 .org/article/cbk/view/accessed 2/6/2018.

⁴³ Banking Act Cap 448, s 33(4)

to all institutions licensed under the *Banking Act* and the agents and subagents of these institutions who transact on their behalf.⁴⁴

(i) Protection of bank customer under the Guidelines.

The Guideline provides a clear framework for protecting customers against risks of fraud, loss of privacy, unfair practices and lack of full disclosure.⁴⁵ Part 3 of the guidelines provides for activities that should not be done to the customer by the bank. The institution shall not: take advantage of a consumer whether or not he or she is able to fully understand the character or nature of a proposed transaction⁴⁶; include an unconscionable term in an agreement⁴⁷; exert undue influence or duress on a consumer to enter into a transaction⁴⁸. An institution will be deemed to have lent recklessly when; either it took no steps to assess the proposed consumer's general understanding and appreciation of the risks and total cost of the proposed credit agreement and his or her rights and obligations under the agreement;⁴⁹ Banks shall ensure that a consumer is notified, at least thirty days in advance before implementing any changes to the terms and conditions, fees or charges, discontinuation of services or relocation of premises of the institution.⁵⁰

(ii) Loan recovery

The regulations have gone to an extent of protecting the bank customer even in a situation where they are unable to pay for a loan. This is to ensure that the banks do not take advantage of the customers. Clause 3.2.8 of the Guidelines provides that, where a consumer is unable to repay a loan as per agreed terms in the loan contract, an institution shall have the right to take steps to recover the amount owing to it by the consumer.⁵¹

⁴⁴ The Central Bank of Kenya Prudential guidelines for institutions licensed under the Banking Act, On consumer protection CBK/PG/22/419, s1.2.

⁴⁵ Supra, n111. S2.2.

⁴⁶ The Central Bank of Kenya Prudential guidelines for institutions licensed under the Banking Act, On consumer protection CBK/PG/22/419, s3.2.1(a) ,(iv).

⁴⁷ Ibid(v).

⁴⁸ Ibid(vi).

⁴⁹ Ibid , 3.2.1.(b)(i)

⁵⁰ The Central Bank of Kenya Prudential guidelines for institutions licensed under the Banking Act, On consumer protection CBK/PG/22/419, clause 3.2.7 (a),

⁵¹ Ibid, clause 3.2.8 (a)

In recovering the amount owing, an institution: Banks Shall not claim from the consumer unreasonable costs and expenses⁵², provide the consumer with a detailed breakdown of the costs and expenses ⁵³ shall not try to recover the debt from a third party including the consumer's referees, of the consumer⁵⁴; and should be transparent ,assets to be sold off should have a fair value in line with the market rate. ⁵⁵

(iii)Transparency

(a)Disclosure of relevant information to the bank customer

A bank should be able to disclose all relevant information to the bank customer. Clause 3.4.1 provides that the institution shall: ensure that all information is given to a consumer on among other things benefits, prices, risks and the terms and conditions; whether in writing, electronically or orally is fair, clear and transparent and should be easily comprehensible so that a consumer can make an informed choice about a product or service .

(b)Disclosure of Interest Rates

Clause3.4 of the regulations provides For both interest-bearing deposits and loans, institutions shall prior to the consumer signing the contract: inform the consumer of the term of the fixed deposit or loan,⁵⁶ inform the consumer of the charges, if any, for, and consequences of, prematurely terminating a fixed deposit or loan, ⁵⁷inform the consumer of whether the interest is fixed or variable, ⁵⁸give a consumer information on the applicable interest rates for the contracted period and the basis and frequency on which interest payments or deductions are to be made.⁵⁹

⁵² Supra ,n124. clause 3.2.8 (b)(i).

⁵³ Ibid ,n124. clause 3.2.8 (b)(ii).

⁵⁴ Ibid ,n124. clause 3.2.8 (b)(iii).

⁵⁵ bid ,n124. clause 3.2.8 (b)(iv).

⁵⁶ The Central Bank of Kenya Prudential guidelines for institutions licensed under the Banking Act, On consumer protection CBK/PG/22/419clause 3.4.4.(a).

⁵⁷ Ibid (b).

⁵⁸ Ibid (c).

⁵⁹ Ibid (d).

(c) Disclosure of Fees and Charges

Institutions shall, for all charges and fees to be levied: provide a consumer with a schedule of all fees and charges including commissions payable for the product or service that a consumer has chosen,⁶⁰ display prominently its standard fees and charges at all its branches, promotional materials and through any other communication channels which it uses,⁶¹ inform a consumer, at the time the services or products are offered and on request, of the basis of charges for services rendered which are not subject to standard fees and charges,⁶² and inform a consumer of any additional charges or expenses that a consumer has to pay, such as search fees to retrieve... available past records.⁶³

(d) Dispute settlement of the clients and the institution

The Central Bank of Kenya Prudential Guidelines for Institutions licensed under the *banking Act*, on consumer protection , provides that the Institutions shall ensure that information about procedures for handling consumer complaints is easily available at its branches, websites, brochures and any other communication channels which it uses.⁶⁴

(e) Investigating and Determining Complaints

Once a complaint has been received by an institution, the institution shall, investigate the complaint competently, promptly and impartially, assess fairly and promptly the subject matter of the complaint, whether the complaint should be upheld and what remedial action or redress (or both) may be appropriate, offer any redress or remedial action which is appropriate, explain to the complainant, in a way that is fair, clear and not misleading, its assessment of the complaint, its decision on it, and any offer of remedial action or redress and

⁶⁰ The Central Bank of Kenya Prudential guidelines for institutions licensed under the Banking Act, On consumer protection CBK/PG/22/419, clause 3.4.5.(a)(i),

⁶¹ Ibid (ii).

⁶² Ibid (iii).

⁶³ Ibid(iv).

⁶⁴ The Central Bank of Kenya Prudential Guidelines for Institutions Licensed under the Banking Act, On consumer protection CBK/PG/22/419.

comply promptly with any offer of remedial action or redress which the complainant accepts.

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1.7.2 Other Authors.

In Kenya Rahael Mutua,⁶⁶ explains the nature of banking and what has contributed to the increase of banks in Kenya. The traditional banking that had low level of demand, low levels of bank of income, high bank fees, untailored products and services and limited geographical reach ensured only a small percentage of Kenyan population had access to banking services.⁶⁷ Banking was driven by income generated from fees for services rendered, interest earned deposits and interest received from loans. The move from traditional banking to agency banking and currently mobile banking has been beneficial to both the banks and customers as it reduces operating cost of the institution and its convenient and cheap as lesser fees are charged on mobile transaction. She explains that with such growth and transformation in the banking sector in Kenya, there is need for the protection of the bank customer. She also explains that the mobile banking in Kenya is not regulated hence leaving the bank customer vulnerable and exposed to fraudster, system fails and other technical problems that may arise out of the failure of the mobile banking.

Daniel Asher,⁶⁸ Explains the challenges that are faced by the bank customer in Kenya. He explains that there are no laws or regulations for non-bank companies that offer financial services. Kenya legal provisions are lacking in terms of financial customer protection. Also the customer participation has been absent in many of the financial institutions in the country. Also the uncertainty in the available options for recourse. The recourse systems in place are not friendly or timely, redress requires hiring lawyers which is expensive.

He gave recommendations which includes an enforcement agency with a market wide protection mandate to protect all financial consumers and have sound regulations that

⁶⁵ Ibid, clause 4.3(a-e).

⁶⁶ Rahael W. Mutua, ‘ Effect of Mobile Banking on the Financial Performance of Commercial Banks in Kenya’ (Mba thesis Dar Salaam University 2010.)

⁶⁷ Chogi B. F. M. *The Impact of Mobile Communication Technologies in Medium and Small Enterprises: Case Study of Nairobi City, MSc.* (2006).

⁶⁸ Daniel Asher, “Kenya financial consumer protection” (2012) 3rd Ed.pg27,32.

provides for financial customer protection.. It is important to ensure that the passed law are complied with by the banks.

Samuel Aywa, in his work⁶⁹, explained about the existing legislation that protect the bank customer and gave the recommendations. But his work did not analyse on the extent the existing laws protect the bank customer. He did not give examples and cases where banks took advantage of the customer. Hence my research will analyse on the extent the existing laws protect the bank customers, and give decided cases on how customers are not protected by the bank.

Centre for Financial inclusion, in their article⁷⁰ explains the challenges that are facing the banking industry in Kenya. These challenges hinder the protection of bank customers. It explains that political stagnation between the county's power brokering fractions has prevented the government from taking actions on customers protection policies. The status of customer protection in Kenya is weak due to little or no action taken by government, no-government and banking entities. There has been action against corruption, with a commission passing a general code of conduct for co-operative societies, but the code is vague and falls short of creating a consumer protection framework.

Also no actions on consumer protection by the banking network have been made public o data

Though I agree with this article but it did not come up with measures that will increase on bank customer protection in Kenya..

In Uganda, Tumwine Mukubwa, in his work ,⁷¹ explains about the nature of the bank customer relationship, and the duties that the bank has towards the bank customer. He provides that the bank has a duty in ensuring that the bank customer is protected from fraudulent banking practices. He analysed the duty of care of the bank towards the bank customer. The bank should care for the finances of the bank customer; in that it should not make careless mistakes that may the bank customer t loose his or her money. He gave an

⁶⁹ Samuel Aywa, "*Consumer protection in financial services sector in Kenya*" (2014) Moi University.

⁷⁰ Centre for Financial inclusion, "*Client protection in Kenya.*" (2009) 2nd Ed, pg 23, 41, 67.

⁷¹ Tumwine Mukubwa, "*African banking Law Practice Uganda Law Watch*" (2009) 2nd Ed.

examples in cashing in a cheque. Where a person come to the bank to can in a cheque signed by the bank customer. The bank has a duty to ensure that reasonable care is taken . The bank can call the owner of the account to ensure that he give the consent to cash in the amount written on the cheque. By exercising this, it protects the bank customer from fraudsters.

He also explained about the fiduciary duty that the bank owes to the bank customer. He explained that a fiduciary duty is the highest standard of care that a bank offers to it customer. If a bank breaches the fiduciary duty then the bank will have to account for the losses that the bank customer has encountered. The bank customer being the beneficiary then is entitled to damages for the loss. Under the fiduciary duty, the bank should practice care of the highest level and stop ant transaction in case it suspects there is a fraudulent transaction that is about to take place. Though he explained about the relationship that should exist between the bank customer and the bank, but he did provide on measures that protect the bank customer from the bank itself. He did not look at situations where the bank can deprive the bank customer.

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Mwesigwa Rogers, in his work⁷² explains about the fear the bank customer have in relation to internet banking. Bank customers fear that when conducting a bank transaction via internet banking they are not protected by the banks. They believe that their accounts can be hacked by fraudsters and their finances stolen. He explains how lack of confidence on internet banking has made it not to be used by many ban customers.

Though he gave he explained on the fear for the risk of internet banking, still his research did not provide for measures that can be put across to ensure that customers are protected when doing an internet transaction.

Wilson Muyindu Mande, in his article⁷³ examined the extent of commercial banks of Uganda applying the code of good backing practice. He explained that though most commercial banks have subscribed to the code but they don't apply it in full to ensure that the customers are protected. He explains that the bank puts high interest rates on the loan the bank customers

⁷² Mwesigwa Rogers, "Consumer attitudes, perceived risk, trust and internet banking, adoption in Uganda" 2008.

⁷³ Wison Muyindu Mande, 'Ethics policy and risk mitigation in Commercial, banks in Uganda', (Mba thesis, Nkumba University, Uganda. 2014.)

take. When they fail to pay, the bank comes in to take over their securities. This leaves the bank customers in a vulnerable position, as the banks fail to observe the code.

Although he explained about banks taking advantage of the customers a result of not observing the code. But he did not come up with recommendations that will increase on the protection of the bank customer.

Hari Mohansinha defines bank as a corporation, association, partnership or private individual engaged in the business of receiving deposits of money, discounting negotiable papers and lending money with or without security, The essential characteristic is the solicitation and receiving of deposits, which must be paid to the depositor or demand. ⁷⁴

This research was carried out by **Dary Collinj**⁷⁵, in South Africa. He explained that in banks customer protection, it is very vital for the financial institutions to provide adequate information to the bank customers. He explained that, the fact that financial institutions fail to disclose some information that is necessary for the customer to make a decision of a product. The financial information, illiteracy of the clients has made the consumers to be vulnerable to abuse. In his research explained the significance of the customer getting all the necessary information before he or she makes up his mind about the financial product he is interested in.

In south Africa, in order to ensure that the bank customer is protected, The Financial Services Board, published an article on Treating Customers Fairly, and brought up a framework for tougher market conduct oversight. It focuses on an outcomes-based approach, requiring firms to incorporate the fair treatment of customers at all the stages of the product life-cycle, including the design, marketing, advice, point-of-sale and after-sale stages. The initiative encourages firms to re-evaluate their company culture and to foster the attitude of treating customers fairly. It is hoped that the initiative will lead to more optimal outcomes from the perspective of the regulators, consumers and ultimately, firms.⁷⁶

⁷⁴ Hari Mohan Siha, *Legal dictionary*, pioneer publication(1993).

⁷⁵ Dary collinj, “*Incorporating Consumer Research into Consumer Protection policy making.*”(2003-2004). Where she detailed on hoe the financial institutions are doing in relation to putting up regulations that protect the consumer.

⁷⁶ TCF Discussion Paper , Bank customer protection in South Africa,(Seminar presentation, south Africa,2010.)

The desired outcomes of the *Treating Customers Fairly* initiative are: Consumers should be confident that they are dealing with firms where fair treatment of customers is central to corporate culture. Products and services marketed and sold in the retail market should be designed to meet the needs of identified consumers. Advice should be suitable and take account of the consumer's circumstances. Consumers must be provided with clear information and kept informed before, during and after the point of sale.⁷⁷ Darys research helps to explain the measures to be taken to ensure that the consumers are protected generally. Though his research was resourceful but he focused on the protection of consumer in general, but not a bank customer specifically.

Bradley, L. and Stewart, K, acknowledge that adoption of information and communication technologies (ICT) in providing banking services and goods is fairly new, which has led to development of more flexible payment methods and more user friendly banking services resulting to a more efficient banking industry. In the article they explained how bank customers can get bank service at the convenience of their workplaces or even home. This article was very helpful in showing the improvement of the bank services to their customers, but it was not complete. This is because it did not bring out the disadvantages that have come up with the improvement of this technology and how the bank customer is protected from fraudsters and problems that may arise out of the failure of the technology.⁷⁸ There are some instances where a customer will make money transfer and because of the system failure the money does not reach the receiver. And because of these the bank customer may have breached a term in the contract they have agreed on.

B. W. Harvey and D. L. Perry, in their work, explains in details what consumer protection means. Consumer protection entails measures meant to safeguard consumers of goods and services especially by legal means, from unfair market practices and fraudulent transactions

⁷⁷ National Treasury policy document, 'A safer financial sector to serve south Africa better', (Republic of South Africa 23/feb 2012)

⁷⁸ Bradley L. and others "Study of Internet banking, ". (2003) pp.272-281

which includes bank customers being protected from fraudulent transactions.⁷⁹ It is informed by an understanding of the complexities prevalent in financial market, and thus the need to enact laws to curb exploitation of consumers by according them maximum protection of the law. Though he explained about protection of bank customers, it was not very wide and did not narrow down to bank customer protection.

1.7.3.The gaps of the literature review.

- (a) Rachael W. Mutua, "in her, but she failed to give practical cases where technology in banking has gone ahead of the legislations in Kenya.
- (b) Daniel Asher, in his work explains the challenges that are faced by the bank customer in Kenya, but he failed to explain the challenges faced by the bank customers and also did not provide for formation of other independent bodies that will ensure the laws formulated are put into practice
- (c) Samuel Aywa, in his work ,explained about the existing legislation that protect the bank customer and gave the recommendations. But his work did not analyse on the extent the existing laws protect the bank customer. He did not give examples and cases where banks took advantage of the customer.
- (d) Centre for Financial inclusion, in their article" *Client Protection in Kenya.*" explains the challenges that are facing the banking industry in Kenya. Though I agree with this article but it did not come up with measures that will increase on bank customer protection in Kenya.
- (e) In Uganda, G.P.Tumwine Mukubwa, in his work " explains about the nature of the bank customer relationship, and the duties that the bank has towards the bank customer. Though he explained about the relationship that should exist between the bank customer and the bank, but he did provide on measures that protect the bank customer from the bank itself. He did not look at situations where the bank can deprive the bank customer.

⁷⁹ B. W. Harvey and D. L. Perry, the *Role of a Consumer in the Community*

- (f) Mwesigwa Rogers, in his work ,explains about the fear the bank customer have in relation to internet banking. Though he gave he explained on the fear for the risk of internet banking, still his research did not provide for measures that can be put across to ensure that customers are protected when doing an internet transaction.
- (g) Wilson Muyindu Mande, in his article, examined the extent of commercial banks of Uganda applying the code of good backing practice. Although he explained about banks taking advantage of the customers a result of not observing the code. But he did not come up with recommendations that will increase on the protection of the bank customer.
- (h) Bradley,L., and Stewart, K, in their works acknowledge that adoption of information and communication technologies(ICT) in providing banking services and goods is fairly new, which has led to development of more flexible payment methods and more user friendly banking services resulting to a more efficient banking industry. His work did not bring out the disadvantages that have come up with the improvement of this technology and how the bank customer is protected from fraudsters and problems that may arise out of the failure of the technology.

1.8. Methodology

This research is a qualitative research, where the library and desk research was used to gather the materials. This research is based on both primary and secondary data. The primary data used were statutes, laws and regulations and case laws. The author also employed comparative research where she made comparison of the legal provisions of other jurisdiction and also decided cases, east Africa and from Common Law countries so as to give practical examples. The secondary data used were law text books, articles and journals. The author also uses materials from the internet. The author also referred to news papers articles that explain about bank customer protection. The author also made reference to other unpublished related work.

The data collected from the above sources were analysed through identifying the relevant provisions of the bank consumer protection in Kenya and other selected jurisdictions too.

Also there was a comparison of how bank consumers are protected in Kenya and other jurisdictions like Uganda and Switzerland.

1.9. Chapterization

This is divided in to five chapters. Each chapter has several sub-sections within it. Chapter one contains the background of the study, research problem, purpose of the study, specific objective of the study, hypo, significance of the study, the scope of the study and literature review. Chapter two contains materials for applicability of bank customer protection in Kenya in relation to the laws and regulations which explain about the protection of a bank customer. It also contains the financial institutions that will aid in enforcing the laws of consumer protection in the banking sector.

Chapter three discusses the nature of bank customer protection and comparison with other jurisdictions. Chapter four analyses the bank customer protection on a bank guarantees. Chapter five provides the conclusion and recommendations based on the findings.

1.10. Conclusion

In conclusion there are weaknesses on bank customer protection in Kenya. This is attributed to the weak regulations that have been legislated upon. This study will bring about recommendations that will be put to use to ensure that customer are protected from financial institutions that look at how much profit that how much the customer may lose due to the clauses they incorporate into contract. The detailed discussion shall be shown in the subsequent chapters.

CHAPTER TWO

THE LEGAL AND INSTITUTIONAL FRAMEWORK FOR PROTECTION OF A BANK CUSTOMER IN KENYA.

2.1. Introduction.

The desire of every government is to become more accountable to the citizens. There are existing legislations in Kenya that affect the bank customer protection, but still there is a need to review them. This is to ensure that the available legislations are not contradicting with the objectives of bank customer protection. The fact that technology develops every day, brings the need of re- examining these legislations governing matters of bank customer relationship. It is very important to note that bank customer protection is not only on the loans and disclosure of information, it extends to other products like bank guarantee, banking where a bank customer may be defrauded, and the exceptions where the banks will not be liable in case the bank customer is at a losses. Hence it is very important to look at the banking law if they contain updated information on bank customer protection.

Consumer protection frameworks in the financial service industry are evolving as products become more complex and a greater number of people rely on financial services. An effective consumer protection framework includes three complementary aspects. First, it includes laws and regulations governing relations between service providers and users and ensuring fairness, transparency and recourse rights. Second, it requires an effective enforcement mechanism including dispute resolution. Third, it includes promotion of financial literacy and capability by helping users of financial services to acquire the necessary knowledge and skills to manage their finances.⁸⁰

⁸⁰ Rutledge, S.L. 'Consumer Protection and Financial Literacy ;Lessons from Nine Country Studies,' (2006)Europe and Central Asia Region, Financial and Private Sector Department, the World Bank.pg 32.

2.2 Nature of bank customer protection

Consumer protection, in the broader sense, refers to the laws and regulations that ensure fair Interaction between service providers and consumers.⁸¹ Government intervention and regulation in the area of consumer protection are justified on the basis of inherent information asymmetries and power imbalances in markets, with producers or service providers having more information about the product or service than the consumers. A consumer protection framework generally includes the introduction of greater transparency and awareness about the goods and services, promotion of competition in the marketplace, prevention of fraud, education of customers, and elimination of unfair practices.⁸²

Bank customer protection is well explained in the case of, *Bernard Murage v Fineserve Africa limited, Equity Bank, Communications Authority of Kenya and Central bank of Kenya*⁸³, Where the court explained with the emergence of new technology, it should go hand in hand with the provision of a corresponding regulation that will protect the Bank customer. The basis for this Petition lies on the introduction of a new technology by the 2nd Respondent known as Thin SIM (Subscriber Identity Module) Technology which entails overlaying a SIM card on a pre-existing SIM card belonging to a third party.

The thin SIM sits between the microchip of the primary SIM card and the SIM card socket of a mobile handset and allegedly has visibility of all communications taking place between the primary SIM and the mobile handset. The Petitioner, therefore filed this Petition claiming a violation of *Articles 31(c) and (d) and 46 of the Constitution* on the grounds that; firstly, the decision to roll out the thin SIM technology has been made in the absence of a data protection law in Kenya and as such there is an apparent fear of uncontrolled transmission of personal data to third parties without the consent of handset and Thin SIM owners. Secondly, that the 1st Respondent is carrying out trial tests that have real possibility of that contamination of data within inter and intra agencies. Lastly, that 2nd Respondent has already entered into contractual engagements of transmission of data with various stakeholders thus raising the

⁸¹ Gokhale, K. 'A Global Surge in Tiny Loans Spurs Credit Bubble in a Slum.' (The Wall Street Journal, August,13 2009.).PG 54

⁸² Reuters 'Balkan Loan Guarantors Struggle to Pay Others' Debt' (*Reuters*, August 2009. 16.].pg9

⁸³ Constitutional and Human Rights Division petition no.503 of 2014.

risk of data contamination. In this case the court explained that, the technology may be very helpful in the day to day operation of the bank. But it should not be implemented unless the right authorities have permitted for it to be used. The fact that it can gain access to personal data of the user without his consent this infringes the right to confidentiality of the bank customer. As such the rights of the bank customer are not protected.

Most countries have witnessed an unprecedented expansion of the financial services industry in the decade preceding the crisis. ⁸⁴Hundreds of millions of people opened bank accounts, started transferring payments electronically and took out consumer loans. In most cases, the development of the retail financial services industry preceded the development of consumer protection legislation.⁸⁵

Continued progress in expanding financial access requires introduction of basic protections for the clients of financial services. Knowing that their rights are effectively protected may bring in new customers to the financial sector, and encourage the uptake of new products. ⁸⁶Additionally, the lack of sufficient competition for financial service providers and less awareness by consumers increases the degree of asymmetric information in underdeveloped financial markets, leading to a disadvantage on the part of consumers. Hence, an effective financial consumer protection framework is a key component of financial inclusion strategies.

2.3 The importance of bank customer protection

According to constructive group to assist the poor, research (2009),⁸⁷ only 30 percent of adults in developing countries are estimated to have access to basic deposit services and even fewer to credit, insurance and other financial services. The consequence of this is that the poor have to rely on more costly informal financial services. To save and to borrow they

⁸⁴ Ibid.

⁸⁵ Ibid 74.

⁸⁶ Rutledge, S.L. ‘*Consumer Protection and Financial Literacy: Lessons from Nine Country Studies*,’ (Working Paper, Europe and Central Asia Region, Financial and Private Sector Department, the World Bank 2010.)

⁸⁷ CGAP ‘*Financial Access 2009: Measuring Access to Financial Services around the World*,’ (2009 Washington, DC: CGAP and the World Bank,pg14.)

depend on shylocks, money lenders .The informal service providers tend to put very high interests and short period of repayment of the money. This brings unfairness in opportunities of the bigger population in Kenya to be able to get financial assistance. And even though if they get they are exposed to unfair terms that tends to discourage others .These challenges hinder economic development. Effective consumer protection regulations and strengthening of financial capability promote equal access to financial services. It reduces information asymmetries, enhancing competition and innovation, and increasing consumer participation in the financial system.⁸⁸

2.4. The Constitution of Kenya

Consumer protection is about ensuring fair exchange between goods and service providers on the one hand and consumers on the other hand.⁸⁹ A deliberate legal framework is necessary to counter-balance the inherent disadvantage of a consumer vis-a-vis the power, information and resources of their goods and service providers. ⁹⁰As a result, reforms in the financial sector regulations centre on the concept of consumer protection.⁹¹

From the onset, the Article 46 of the *Constitution of Kenya 2010* entrenches the right to consumer protection, that is, consumers should be protected from unfair market practices from services and goods providers. Consumers have the right (a) to goods and services of reasonable quality,(b) to the information necessary for them to gain full benefit from goods and services;

(c) to the protection of their health, safety, and economic interests, and(d) to compensation for loss or injury arising from defects in goods or services. ⁹²The Parliament shall enact legislation to provide for consumer protection and for fair, honest and decent advertising.⁹³ This Article applies to goods and services offered by public entities or private persons.⁹⁴ This

⁸⁸ Oya Pinar Ardic,Joyce A. Ibrahim,Nataliya Mylenko, '*Consumer Protection Laws and Regulations in Deposit and Loan Services*' (2010)3 A Cross-Country Analysis with a New Data Set)pg62.

⁸⁹ J. A. Spanogle and R. J. Rohner, *Consumer Law Cases and Material* , (1stEd, 1999) at p8.

⁹⁰ Ministry of Finance by FSD, 'Consumer Protection Diagnostic Study Kenya' [2011],FSD,3.

⁹¹ Abridged Version, ' Bank of Republic of Kenya Vision 2030'(1st Ed ,May 2014)p4

⁹² The Constitution of Kenya 2010,Art 46.

⁹³ Ibid (2).

⁹⁴ Ibid(3).

constitutional entrenchment, in conjunction with the *Consumer Protection Act* ⁹⁵ and sector-specific statutes, place enormous obligations and responsibilities on providers of financial services and goods (both private and public) to be discussed hereunder.⁹⁶

Before *the 2010 Constitution*, Kenya lacked a comprehensive consumer protection law. The measures in existence to provide quality checks to products and services offered did not adequately protect consumers in the financial markets. Article 46 of the *constitution of Kenya* provides for consumer rights, essentially setting out the inspirational dimension of steps towards achieving the set goals. The provisions, provides in details on how consumer should be protected for goods and services offered. Also the constitution provides that the providers should give enough information to the consumers so that they can make informed decisions. Also the constitution, Set out pre and post budget requirements for sellers in their way of trade.

Additionally the legislators were mandated to enact a legislation to provide for consumer protection and for fair, honest and decent advertising.⁹⁷In compliance, the *Consumer Protection Act* was enacted.⁹⁸

2.5 The Central Bank of Kenya Act

The *Central Bank of Kenya Act* ⁹⁹establishes the Central Bank of Kenya under section 3 as the top most institution in the banking sector. Its framework for regulation of the banks conduct, however, is derived from the Banking Act.

The Central Bank plays a unique role in the economy and performs various functions not normally carried out by commercial banks. Currently its main task, as stipulated in the *Central Bank of Kenya (Amendment) Act*, ¹⁰⁰is that of "maintaining price stability and fostering liquidity, solvency and proper functioning of a stable market-based financial

⁹⁵ Consumer protection Act 2012.

⁹⁶ Aywa Samuel "consumer Protection in the Financial Service Sector in Kenya."(2014) pg7

⁹⁷ *Supra* n 87 Art 46(2).

⁹⁸ The Consumer Protection Act 2012.

⁹⁹ The Central Bank of Kenya Act, Cap 491, pursuant to the 2010 Kenya Constitution under Article 231.

¹⁰⁰ 1996.

system".¹⁰¹ In other words the central bank of Kenya is responsible for ensuring that the currency of Kenya maintain its value. That is in connection to other functions of the bank of Kenya, of printing money, so as to maintain the required money that circulates in the country. The Central Bank of Kenya is responsible for formulating and executing monetary policy, supervising and regulating depository institutions. By assisting the Kenya Government's financing operations and serving as Kenya Government banker. The role of formulation and executing monetary policy gives the central bank of Kenya a bigger role to ensure that the financial institutions in Kenya are answerable. Hence ensuring that they offer quality services to the bank customers. This is very much in line with contemporary central banking practice the world over.

A function it oversees in relation to consumer protection is its supervisory role over commercial banks to ensure efficient and sound financial system in the interest of depositors and the economy as a whole - maintain public confidence, though a fairly controversial one. The Central Bank of Kenya supervises all the commercial banks in Kenya and ensures that they provide quality services and also ensuring that the bank customers are not disadvantaged.¹⁰² For regulatory purposes, a registered bank must keep certain amount of funds with the Central Bank.¹⁰³ This ensures it operates within the established limits and regulate funds in circulation. The Central Bank is empowered by the Act to demand a certain proportion of commercial banks' deposits to be held as non-interest bearing reserves at the Central Bank. A reduction in the reserve ratio would be viewed as an expansion of credit as it increases the credit creation power of the banks.

The powers of the Central Bank of Kenya were well explained in the case of *Imaran limited, Reynolds & company limited east Africa motor industries And others v Central Bank Of Kenya, Kenya Deposit Insurance Corporation and others*¹⁰⁴ This application was made by the shareholders of the Imperial Bank Of Kenya, According to the applicants, on the appointment of the receiver the CBK announced that the receiver would be working closely with the Bank's Board for a resolution mechanism in order to facilitate its reopening and

¹⁰¹ Central Bank of Kenya Act Cap 491, s 3&4.

¹⁰² Bryan A. Garner, *Black's Law Dictionary*, (9th Ed, 2009), Thomson Pub, p387.

¹⁰³ Ibid, pg15 to collect the insurance proceeds.

¹⁰⁴ High Court of Kenya at Nairobi Milimani law Courts, Miscellaneous civil application no. 43 of 2016

resumption of its operations. To this end the CBK proposed the injection of new capital, conversion of some of the large deposits to equity, recovery and collateralisation of the fraudulent loans, as well as a change of the Board and senior management, with the proposal entailing full access to small deposits and a structured schedule of repayment to large deposits.

Pursuant to this the applicants contend that they presented their own restructuring and recovery plan for the Bank. Despite this, the applicants contended that the CBK proceeded to release a statement by which it unprocedurally, illegally, unreasonably, unfairly and unconstitutionally decided to start a process of exclusion and transfer that entails the transfer and alienation of the assets and liabilities of the Bank to the 1st and 2nd Interested Parties herein. To the applicant this process is geared towards the liquidation of the Bank without consideration the other options.

In these proceedings therefore the applicants seek to prohibit the Respondents from unilaterally taking the said action to their exclusion and declarations that the decision by the Respondents to treat them as culprits in the events leading to the receivership of the Bank is also unlawful.

Court held that the Central Bank of Kenya has all the powers to take the said action as provided for under the *Central Bank of Kenya Act*¹⁰⁵. This is for the best interest of the bank customer. By putting Imperial bank limited under liquidation, then the bank customers shall be able to get back their deposits from the bank hence protected.

Section 3(3) as read together with section 4 mandates the central bank of Kenya to formulate and implement monetary policies to sustain price level stability. The Central Bank of Kenya sets standard charge that the commercial banks would not exceed it, when offering loan in relation to bank customers. By using this system the central bank ensures that the bank customers are protected from unfair bank practises. Deposit-taking Micro-Finance Institutions are also regulated by the CBK with the same conventions found in the Banking

¹⁰⁵ Central Bank of Kenya Act Cap 491

Regulation.¹⁰⁶The *Microfinance (Deposit Taking MFI) Regulations*,¹⁰⁷ forbid fraudulent or reckless credit and prescribe Know-Your-Customer(KYC) requirements.

2.6 The Banking Act, Cap 448.

2.6.1 Bank customer protection against closing banks.

In order to improve the role of the Deposit Protection Fund Board in enhancing depositor confidence, in 2012, the *Kenya Deposit Insurance Act*¹⁰⁸ was enacted. It established a new and separate Kenya Deposit Corporation¹⁰⁹ having autonomy in its operations but with the same earlier mandate but for a few more roles.¹¹⁰ Such a Deposit insurance scheme is often seen as an integral part of a financial safety, purposing to protect small savings and prevent bank runs.

Across countries with deposit insurance, structure, funding and mandates vary a lot. While some countries have pure pay-box deposit insurance funds, such as in Brazil and Uganda, other schemes have wide-ranging supervisory powers, such as in Canada or the U.S. In Kenya, Section 37 lists the sources of funds contributed which include profits from the investments of the board, but more importantly contributions from the member institutions.¹¹¹ Implementation of such a scheme is seen as more likely to carefully monitor banks and intervene rapidly into failing banks as they have to carry the costs in terms of higher pay-out to indemnified depositors. Cross-country comparisons show indeed that banks in countries where the deposit insurer has the responsibility of intervening failed banks and the power to revoke membership in the deposit insurance scheme are more stable and less likely to become insolvent.

¹⁰⁶ Ministry of Finance by FSD, 'Consumer Protection Diagnostic Study Kenya' [2011],FSD,3.

¹⁰⁷ Microfinance (Deposit Taking MFI) Regulations of 2008

¹⁰⁸ The Kenya Deposit Insurance Act, 2012.

¹⁰⁹ *Ibid.*, s4.

¹¹⁰ Banking Act Cap 448, the Act provides the DPFB with powers to request the Central Bank to carry out an inspection of a member institution and, where deemed necessary, to conduct the examination itself.

¹¹¹ The Banking Act Cap 448 ,s 38.

The role played by the DPTB is well elaborated in the case of *Ajay Shah and Deposit Protection Fund Board as Liquidator of Trust Bank Limited v Praful Shah*¹¹² Ajay Shah and Praful Shah were Directors of both Trust Bank Ltd and Trust Capital Services Ltd. Trust Bank Ltd went into liquidation on 16th August 2001. Investigations by the liquidation agents are said to have revealed that Ajay Shah and Praful Shah owed money to Trust Bank Ltd , hence bringing this matter to court in an attempt by the liquidator to recover Shs.241,442,376.80 found to be owing by Ajay Shah and Praful. The liquidator also alleged that Ajay Shah and Praful Shah diverted from Trust Bank Ltd to Trust Capital Services Ltd money. Thereon the liquidator sought an order that both Ajay Shah and Praful Shah be declared jointly and severally liable. The Liquidator also alleged fraud on the part of Ajay Shah and Praful Shah and further.

That the funds belonging to Trust Bank Limited were fraudulently channelled to Trust Capital Services Ltd. The Liquidator, Deposit Protection Fund Board, was appointed by the Central Bank of Kenya under Section 36 of the *Banking Act*¹¹³, which under subsection (2) gives it perpetual succession and a common seal and is capable in its corporate name or in the name of the institution under liquidation of suing and being sued without the sanction of the court or a committee of inspection. In his investigations, the liquidator alleged that the money claimed was withdrawn from the Trust Bank Ltd and channelled to Trust Capital Services Ltd without the sanction of the Trust Bank Ltd to an account that was officially non- existent in The latter's books and further that no security was held on account of the money to guarantee repayment. In a space of seven days, from 9th to 16th September 1998 a massive withdrawal of funds from Trust Bank Ltd was made to the tune of 207,385,083 and two days later, Trust Bank Ltd was placed under Statutory management by Central Bank. It was the liquidator's position that Ajay Shah and Praful Shah Stood in a fiduciary relationship to the customers of Trust Bank Ltd whose funds they held as custodians And were enjoined to safeguard customers' funds and to discharge their duties with diligence and Transparency and to eschew fraudulence. The Court found Mr. Ajay shah and Praful Shah to be guilty of defrauding the depositors and the bank. Though not all closing banks had have been put into

¹¹² Civil application no.186 of 2013 (ur 132/2013)

¹¹³ Banking Act Cap 488

liquidation but to some extent the Deposit Protection Fund Board, played a role in helping the falling banks and also protect the bank customers from losing their deposited amounts in the bank.

The existence of the Deposit Protection Fund Board, helps the bank customers to against losing their money when banks are shutting down. The board comes in to investigate the cause of the bank shutting down. Afterward they make the fraudulent parties to refund the money that belong to the bank customers.

2.6.2 Consumer Compensation

Section 36 of the *Banking Act*¹¹⁴ established a Deposit Protection Fund Board (DPFB) with a wide mandate. The DPFB's main tasks is to manage the deposit insurance fund and carry out the liquidation of insolvent institutions once they have been closed by Central Bank Kenya. This achieved by repaying protected deposits and dividends, carrying out debt recovery, and winding up the institutions under liquidation. DPFB offers protection to small depositors up to Kshs 100,000 against loss of their savings in case of a bank failure.¹¹⁵ Its mission is to enhance public confidence in the nation's financial system by providing a sound safety financial system. All depositors' funds held by institutions are sufficiently insured against loss. That may occur as a result of bank failure and to efficiently liquidate and wind up failed institutions for the maximum benefit of all depositors and creditors¹¹⁶

Though this body exists in Kenya still there are challenges as the effectiveness is not fully felt to the bank customer's. This is seen in the manner banks are collapsing in Kenya and shutting down without being put into liquidation. Hence the depositor's money is lost. From 2007 to 2015 banks like Kenya Financial Corporation, Trade Bank, Euro Bank and Charter House are some of the banks that shut down yet none of them has been put on liquidation. Also in 2015, Dubai Bank, the amount that the bank customers had deposited amounted to 1.7 billion, it was placed under statutory management by the Central Bank of Kenya for a period of one year with Kenya Deposit Insurance Corporation as the receiver manager.¹¹⁷

¹¹⁴ Banking Act Cap 488, s 36.

¹¹⁵ Ibid

¹¹⁶ Deposit Protection "Fund Board Kenya ,Annual Report & Accounts" (30th June 2009) Pg1.

¹¹⁷ Ibid.

2.7 The Consumer Protection Act 2012

The Act sets out to provide for the protection of the consumers, prevent unfair trade practices in consumer transactions and to provide for matters incidental thereto.¹¹⁸ The Act applies in respect to all consumer transactions if the consumer or the person engaging in the transaction with the consumer is located in Kenya when the transaction takes place. In its application no regard is paid to any other agreement made between a consumer and a manufacturer or service provider which agreement contradicts the substantive provisions of the Act, thus the Act states substantive and procedural rights given under this Act shall apply to every consumer despite any agreement or waiver to the contrary.¹¹⁹ With this provision to protect the consumer of goods and services, it puts the bank customer in a position that the law protects them against fraudulent service providers.

Section 4 (a) of the *Consumer Protection Act*¹²⁰ which lowers the *locus standi* whenever a consumer wishes to bring forth a suit in respect to a breach of a provision of the Act. This, according to experts, is a welcome move as banking institutions and insurance companies which often make huge profits through barely credible sales pitch are now open to legal challenges from consumers.¹²¹ They make the bank customer to feel they are in a better position as they can sue in case they are disadvantaged. The enables the bank customer to bring the banks to court when they have been deprived . This gives enough confidence to the bank customer and other people who wish to open bank accounts.

Also to note, Section 7 of *Consumer Protection Act* provides for contra-preferentum rule synonymous to contracts by providing that any ambiguity that allows for more than one reasonable interpretation of a consumer agreement provided by the supplier to the consumer or of any information that must be disclosed under the Act shall be interpreted to the benefit of the consumer.¹²² With this provision of interpretation of the statute in favour of the bank

¹¹⁸ The Consumer Protection Act, 2012, s 2.

¹¹⁹ *Ibid* , s 3(2).

¹²⁰ The Consumer protection Act 2012, s 4 (a),

¹²¹ Jane Kimani, 'New law widens door for consumer rights activism,' Business Daily (Nairobi,29,May 2017)www.businessdailyafrica.com/New-law-widens-door-for-consumer-right, accessed 13 Feb 2017.

¹²² The Consumer Protection Act, 2012 s7 .

customer tends to be a more of an exemplary law. That is any financial institution that drafts a contract that is vague and confuses the bank customer, or a clause that has two different meanings, then the clause will be interpreted in favour of the banks customer so the banks will not take advantage of the clients.

Section 89 of the *Consumer Protection Act* establishes the Kenya consumer protection advisory committee whose among its many functions is to establish dispute resolution mechanisms, investigating complaints and referring to the relevant authority.¹²³ The committee provides for measures that enable bank customers to develop confidence the financial service providers. When there is body that will investigate and refer disputes to the relevant authority, it makes the banks not to draft clauses that are going to deprive the bank customer. Hence protecting the bank customer, building confidence in the people of Kenya and generally developing the economy of the country.

2.8 Guideline on Consumer Protection Central bank of Kenya

The *Prudential Guidance* came into existence in 2006, where it mainly focused on creating transparency between banking institutions and individuals and corporations with whom they conduct business.¹²⁴ The Guidelines are issued under Section 33(4) of the *Banking Act*, which empowers the Central Bank of Kenya to issue guidelines to be adhered to by institutions in order to maintain a stable and efficient banking and financial system.¹²⁵ This Guideline applies to all institutions licensed under the *Banking Act* and the agents and subagents of these institutions who transact on their behalf.¹²⁶

The purpose of the Guidelines is to promote fair and equitable financial services practices by setting minimum standards for institutions in dealing with consumers. To increase transparency in order to inform and empower consumers of financial services, foster

¹²³ The Consumer Protection Act, 2012 s,89 and 90.

¹²⁴ ¹²⁴ The Central Bank of Kenya Prudential guidelines for institutions licensed under the Banking Act, On consumer protection CBK/PG/22/419. '(2006)210 .org/article/cbk/view/accessed 2/6/2018.

¹²⁵ Banking Act Cap 448, s 33(4)

¹²⁶ ¹²⁶ The Central Bank of Kenya Prudential guidelines for institutions licensed under the Banking Act, On consumer protection CBK/PG/22/419. '(2006)210 .org/article/cbk/view/accessed 2/6/2018. S.2

confidence in the banking sector and to provide efficient and effective mechanisms for handling consumer complaints relating to the provision of financial products and services.¹²⁷

2.8.1 Protection of bank customer under the Guidelines.

The Guideline provides a clear framework for protecting customers against risks of fraud, loss of privacy, unfair practices and lack of full disclosure.¹²⁸ Part 3 of the guidelines provides for activities that should not be done to the customer by the bank. The institution shall not: take advantage of a consumer whether or not he or she is able to fully understand the character or nature of a proposed transaction¹²⁹; include an unconscionable term in an agreement¹³⁰; exert undue influence or duress on a consumer to enter into a transaction¹³¹. Though there are guidelines that protect the bank customer against, fraudulent financial institutions. The situation has not had a positive change in bank customer protection. The banks do not fulfil their part, but instead they put terms in the contract that are unfair.

An institution will be deemed to have lent recklessly when; either it took no steps to assess the proposed consumer's general understanding and appreciation of the risks and total cost of the proposed credit agreement and his or her rights and obligations under the agreement; his or her debt repayment history for credit; his or her existing financial means, prospects and obligations; and whether there is a reasonable basis to conclude that any commercial purpose may prove to be successful, if the consumer has such a purpose in applying for the credit¹³²; or after conducting an assessment, the institution still entered into the credit agreement with the consumer despite the fact that the prevalence of information available to the institution indicated that the consumer did not generally understand or appreciate his or her risks, costs or obligations under the proposed credit agreement; entering into that credit agreement would

¹²⁷ Ibid ,s.2.1

¹²⁸ Supra, n111. S2.2

¹²⁹ The Central Bank of Kenya Prudential guidelines for institutions licensed under the Banking Act, On consumer protection CBK/PG/22/419. '(2006)210 .org/article/cbk/view/accessed 2/6/2018s3.2.1(a) ,(iv

¹³⁰ Ibid(v).

¹³¹ Ibid(vi).

¹³² 3.2.1.(b)(i) Ibid .

make the consumer over-indebted; or that there is no reasonable basis for concluding that any commercial purpose for applying for the credit may prove to be successful.¹³³

In protecting the bank customer the, guideline provides that, an institution shall ensure that a consumer is notified, at least thirty days in advance before implementing any changes to the terms and conditions, fees or charges, discontinuation of services or relocation of premises of the institution.¹³⁴ At least thirty days of any planned changes in interest rates regarding the product or service. ¹³⁵ Though the guidelines protect the bank customer, still there is no compliance by the commercial banks. The major challenge if that most bank customers do not know their right. This is due to high rate of poverty and they are left with little or no choice than to accept poor terms in the contracts.

2.8.2 Loan recovery

The regulations have gone to an extent of protecting the bank customer even in a situation where they are unable to pay for a loan. This is to ensure that the banks do not take advantage of the customers. Clause 3.2.8 of the Guidelines provides that, where a consumer is unable to repay a loan as per agreed terms in the loan contract, an institution shall have the right to take steps to recover the amount owing to it by the consumer. ¹³⁶

In recovering the amount owing, an institution: Shall not claim from the consumer unreasonable costs and expenses which the institution has incurred¹³⁷, shall provide the consumer with a detailed breakdown of the costs and expenses incurred¹³⁸ shall not try to recover the debt from a third party including the consumer's referees, family members or friends if the third party has not signed a contract to guarantee the liability of the

¹³³ Ibid 3.2.1.(b)(ii).

¹³⁴ The Central Bank of Kenya Prudential guidelines for institutions licensed under the Banking Act, On consumer protection CBK/PG/22/419. '(2006)210 .org/article/cbk/view/accessed 2/6/2018. clause 3.2.7 (a

¹³⁵ Ibid clause 3.2.7 (b),

¹³⁶ Ibid, clause 3.2.8 (a)

¹³⁷ The Central Bank of Kenya Prudential guidelines for institutions licensed under the Banking Act, On consumer protection CBK/PG/22/419. '(2006)210 ,n124. clause 3.2.8 (b)(i).

¹³⁸ Ibid,n124. clause 3.2.8 (b)(ii).

consumer¹³⁹; and should be transparent and assets to be sold off should have a fair value that is in line with the market rate. ¹⁴⁰Where an institution plans to outsource collection of a debt, the person who can collect the debt and the manner in which that debt can be collected should be brought to the customer's attention at the time when the loan agreement is being entered into between the institution and the customer. ¹⁴¹

When the banks are recovering loans, from a bank customer. They do not comply with the above provision. Most of the assets that are taken are sold at a throw away price. Hence they do not yield the sum that the bank customer took as a loan. An example is the Kenya Women Finance Trust, where when a client has defaulted in payment. They go an extent of taking iron sheets of a house, in the rural areas. ¹⁴²

2.8.3 Transparency

2.8.3. (a) Disclosure of relevant information to the bank customer

A bank should be able to disclose all relevant information to the bank customer. Clause 3.4.1 provides that, the bank customer has a right to get all the relevant information concerning the financial product that he or she is about to take. The regulations provides that the institution shall: ensure that any information given to a consumer on among other things benefits, prices, risks and the terms and conditions; whether in writing, electronically or orally is fair, clear and transparent .The information in clause 4.1(a) above is should be easily comprehensible so that a consumer can make an informed choice about a product or service.

The banks should ensure that the information is given the best language that the bank customer can understand better. Where a consumer is unable to understand written information, explain orally to the consumer the written information, ensure that where an oral explanation in .The bank should ensure that information on its products and services is updated and current and easily available at its branches, websites and any other communication channels which it uses; and ensure that it discloses at its branches, websites,

¹³⁹ Ibid,n124. clause 3.2.8 (b)(iii).

¹⁴⁰ Ibid ,n124. clause 3.2.8 (b)(iv).

¹⁴¹ Ibid,n124. clause 3.2.8 (c).

¹⁴² 12/4/2017.

advertisements, promotional materials and any other communication channels which it uses that it is regulated by the Central Bank of Kenya.¹⁴³ Disclosure of the name and contact details of the regulator will make a consumer aware that the institution is regulated; and will assist the consumer contact the regulator if the consumer considers that the institution has failed to comply with the regulatory requirements.¹⁴⁴

For a bank customer to make a wise decision, then the bank has role to play in giving the right information. Though this is not the case in Kenya, To illustrate most of the financial institution do not give enough information about their products. In Rafiki Bank of Kenya, the financial institution, will only ask for a security, and offer the money. They don't explain to the bank customer the security will be sell to settle the loan in case he fails to pay. The bank request for security that has more value compare to the money they will give. This put a bank customer a victim of financial institution, that do not care about their welfare.

2.8.3.(b) Disclosure of Interest Rates

For both interest-bearing deposits and loans, institutions shall prior to the consumer signing the contract: inform the consumer of the term of the fixed deposit or loan,¹⁴⁵ inform the consumer of the charges, if any, for, and consequences of, prematurely terminating a fixed deposit or loan,¹⁴⁶ inform the consumer of whether the interest is fixed or variable,¹⁴⁷ give a consumer information on the applicable interest rates for the contracted period and the basis and frequency on which interest payments or deductions are to be made,¹⁴⁸ explain the method used to calculate interest rates¹⁴⁹ disclose prominently the total amount of income the consumer shall receive on the fixed rate deposits of the consumer¹⁵⁰ provide a repayment

¹⁴³ The Central Bank of Kenya Prudential guidelines for institutions licensed under the Banking Act, On consumer protection CBK/PG/22/419. '(2006)210, clause 3.4.1.(a-g)

¹⁴⁴ Ibid, clause 3

¹⁴⁵ Ibid. clause 3.4.4.(a).

¹⁴⁶ The Central Bank of Kenya Prudential guidelines for institutions licensed under the Banking Act, On consumer protection CBK/PG/22/419. '(2006)210 (b).

¹⁴⁷ Ibid (c).

¹⁴⁸ Ibid (d).

¹⁴⁹ Ibid (e).

¹⁵⁰ Ibid (f).

schedule over the term of the loan indicating periodic principal repayments and interest charged¹⁵¹ and disclose the total cost of credit.¹⁵²

2.8.3. (c) Disclosure of Fees and Charges

Institutions shall, for all charges and fees to be levied: provide a consumer with a schedule of all fees and charges including commissions payable for the product or service that a consumer has chosen,¹⁵³ display prominently its standard fees and charges at all its branches, promotional materials and through any other communication channels which it uses,¹⁵⁴ inform a consumer, at the time the services or products are offered and on request, of the basis of charges for services rendered which are not subject to standard fees and charges,¹⁵⁵ and inform a consumer of any additional charges or expenses that a consumer has to pay, such as search fees to retrieve... available past records.¹⁵⁶ A consumer is entitled to pay the full outstanding balance under a loan agreement at any time without any prepayment charge or penalty¹⁵⁷

The disclosure is of great importance as it prepares the bank customer when entering into a particular contract. He or she knows that, when he fails to pay, there are charges that he or she is going to pay. This enables the bank customer to make decisions independently.

Where third party fees and charges are involved, an institution shall inform a consumer in advance of the relevant service or product and applicable fees and charges.¹⁵⁸ For the purposes of clause 3.4.5(b) above, third party fees and charges are fees and charges which are not levied directly by an institution but arise when another institution, agent or party is used.

¹⁵⁹

¹⁵¹ Ibid (g).

¹⁵² Ibid (h).

¹⁵³ clause 3.4.5.(a)(i).

¹⁵⁴ Ibid (ii).

¹⁵⁵ Ibid (iii).

¹⁵⁶ Ibid(iv).

¹⁵⁷ Ibid(v).

¹⁵⁸ The Central Bank of Kenya Prudential guidelines for institutions licensed under the Banking Act, On consumer protection CBK/PG/22/419. '(2006)210, clause 3.4.5.(b).

¹⁵⁹ Ibid ,clause 3.4.5.(c).

2.8.4 Dispute settlement of the clients and the institution

The Central Bank of Kenya Prudential Guidelines for Institutions licensed under the *banking Act*, on consumer protection , provides that the Institutions shall ensure that information about procedures for handling consumer complaints is easily available at its branches, websites, brochures and any other communication channels which it uses.¹⁶⁰ This protects the bank customer in a way that they build confidence towards their banks, because they feel secured as their complaints will be handled. Though the Prudential Guidelines have provided for an alternative disputes resolution in the challenges that may be faced by the bank customers, but this only remains in the statute and not practical. So far in Kenya there is no active body that may solve or handle bank customer problems apart from the court system.

2.8.4. (a) Investigating and Determining Complaints

Once a complaint has been received by an institution, the institution shall, investigate the complaint competently, promptly and impartially, assess fairly and promptly the subject matter of the complaint, whether the complaint should be upheld and what remedial action or redress (or both) may be appropriate, offer any redress or remedial action which is appropriate, explain to the complainant, in a way that is fair, clear and not misleading, its assessment of the complaint, its decision on it, and any offer of remedial action or redress and comply promptly with any offer of remedial action or redress which the complainant accepts.

¹⁶¹When assessing the track of an institution in investigating and determining complaints, central bank of Kenya will have regards to the quality and fairness of the providers investigations and determination s and to clarity of the written communications complainants.

The institution should keep the complainant informed. On receiving a complaint, it should provides the complainant with a prompt written acknowledgement at least within 2 days of receipt that it has received the complaint and is dealing with it. However, an institution need

¹⁶⁰ Ibid.

¹⁶¹ The Central Bank of Kenya Prudential guidelines for institutions licensed under the Banking Act, On consumer protection CBK/PG/22/419. '(2006)210, clause 4.3(a-e).

not send a written acknowledgement where it resolves the complaint by the end of the business day after it has received the complaint.¹⁶²

The Institutions are given a time frame where they can be able to resolve the bank customer complaint. Institutions shall send a final response to a complainant by the end of two weeks after it has received the complaint. However, if the complainant takes more than a week to reply to a written request by the institution for further information, the additional time in excess of a week will not count for the purposes of the two weeks' time limit.¹⁶³ Central Bank of Kenya will have regard, when assessing an institution's track record in investigating and determining complaints, to the clarity and reasonableness of requests which the provider has made to complainants for further information.

The compliance of the above provision has been applied in some of the commercial banks in Kenya. Where clients can complain about particular matters and are handled within two weeks. Cooperative bank of Kenya, allows a customer to make complaints, in the bank and also online. The bank immediately responds to the complaints and works on the matter. The bank handles matters like, higher interest rate charged on a bank loan than the customer had previously negotiated.¹⁶⁴ Though not all banks are applying the provision, but some compliance has been experienced.

2.9. Institutional framework in banks consumer protection in Kenya.

Apart from the laws that govern banking and protect the bank customer there exist some institutional that aid in ensuring that the bank consumers are protected against unfair market practice. They include:

2.9.1 The Central Bank of Kenya

The Central Bank is established under Article 231 of the constitution of Kenya.¹⁶⁵ The *Central Bank of Kenya Act*¹⁶⁶ establishes the Central Bank of Kenya under section 3 and also gives its alternative corporate name *Bank kuu ya Kenya*. It is a body corporate with perpetual

¹⁶² Ibid 4.4(a).

¹⁶³ Ibid 4.5.

¹⁶⁴ Jack Omolo, "Business Kenya, banks approach on solving customers complaints" *The Standard* 23rd, March 2017. p.14.

¹⁶⁵ The Constitution of Kenya, 2010 Art 231.

¹⁶⁶ The Central Bank of Kenya Act, Cap 491, pursuant to the 2010 Kenya Constitution under Article 231.

succession, a common seal, power to acquire, own, possess and dispose of property, to contract and to sue and to be sued in its own name. The Central bank is not subject to the Company Act¹⁶⁷ and the Banking Act¹⁶⁸

The bank is authorised to exercise any type of Central banking function which is not specifically excluded under the Central Bank Act. It also enjoys all the prerogatives of a central bank. It has power to make its own rules of conduct or procedure for its good order and proper management provided that they are not inconsistent with the provisions of the central bank.¹⁶⁹

The Central Bank plays a unique role in the economy and performs various functions not normally carried out by commercial banks. Currently its main task, as stipulated in the *Central Bank of Kenya (Amendment) Act*,¹⁷⁰ is that of "maintaining price stability and fostering liquidity, solvency and proper functioning of a stable market-based financial system".¹⁷¹ That is in connection to other function of bank of Kenya, of printing money, so as to maintain the required money that circulates in the country. The Central Bank of Kenya is responsible for formulating and executing monetary policy, supervising and regulating depository institutions. By assisting the Kenya Government's financing operations and serving as Kenya Government banker. The role of formulation and executing monetary policy gives the central bank of Kenya a bigger role to ensure that the financial institutions in Kenya are answerable. Hence ensuring that they offer quality services to the bank customers. This is very much in line with contemporary central banking practice the world over.

Section 3(3) as read together with section 4 mandates the central bank of Kenya to formulate and implement monetary policies to sustain price level stability. The Central Bank of Kenya sets standard charge that the commercial banks would not exceed it, when offering loan in relation to bank customers. By using this system the central bank ensures that the bank customers are protected from unfair bank practises.

¹⁶⁷ Company Act 2015.

¹⁶⁸ Banking Act Cap 488.

¹⁶⁹ Njaramba Gichuki" *Law of financial Institutions in Kenya*."2017,2nd Ed pg 299.

¹⁷⁰ 1996.

¹⁷¹ The Central Bank of Kenya Act Cap 491, s 3&4.

Section 34 (2) of the Banking Act¹⁷²The Central Bank of Kenya has powers to appoint a manager to assume the management, control and conduct of the affairs and business of an institution to exercise all the powers of the institution to execution of its board of directors. Also the Bank has powers to remove any officer or employee of an institution who in the opinion of the Central Bank has ceased or contributed to contravention of the Banking Act or to deterioration in the financial stability of the institution or has been guilty of conduct detrimental to the interest of depositors or other creditors of the institutions. With the above powers, the Central bank of Kenya can protect the bank consumer, by either employment of a manager or the removal of an employee whose action may be detrimental to the fair market practice.

2.9.2. The deposit protection Fund Board

Section 36¹⁷³ of the Banking Act establishes the Deposit Protection Board. The purpose of the board is to hold, manage and apply the deposit protection fund and levy contributions for the fund for institutions. The board consists of the governor of the central bank as the chairman, the permanent secretary to the treasurer and five members appointed by the minister for finance to represent the interest of institutions.

The functions of the Board are, to provide insurance scheme for customers of member institutions and liquidate and wind up the operations of any institution in respect of which the Board is appointed as a liquidator in accordance with the banking Act. Also to hold, manage and apply the deposit protection fund, The Board levy contributions for the Deposit protection Fund from Institutions, And perform such functions conferred to it under the Banking Act or any other law.

The minister is empowered to fix the size of the fund sufficient to protect the interests of depositors to be made up by contributions from institutions, this is done on consultation with the central Bank and by notice in Gazette He may also authorise the board to borrow from Central bank. In Kenya, Section 37 lists the sources of funds contributed which include

¹⁷² The Banking Act Cap 488, s, 34(2).

¹⁷³ Ibid, s, 36.

profits from the investments of the board, but more importantly contributions from the member institutions.¹⁷⁴

Implementation of such a scheme is seen as more likely to carefully monitor banks and intervene rapidly into failing banks as they have to carry the costs in terms of higher pay-out to indemnified depositors. The existence of the Deposit Protection Fund Board, helps the bank customers to against losing their money when banks are shutting down. The board comes in to investigate the cause of the bank shutting down. Afterward they make the fraudulent parties to refund the money that belong to the bank customers.

This archived by repaying protected deposits and dividends, carrying out debt recovery, and winding up the institutions under liquidation. DPFB offers protection to small depositors up to Kshs 100,000 against loss of their savings in case of a bank failure.¹⁷⁵ Its mission is to enhance public confidence in the nation's financial system by providing a sound safety financial system. All depositors' funds held by institutions are sufficiently insured against loss. That may occur as a result of bank failure and to efficiently liquidate and wind up failed institutions for the maximum benefit of all depositors and creditors¹⁷⁶

2.9.3 Financial Reporting Centre

It is established under section 21, of The proceeds of Crime and Anti- Money Laundering Act,¹⁷⁷. It is a body cooperate whose main objective is to assist in the identification of the proceeds of crime and the combination of money laundering. They receive and analyse reports of unusual or suspicious transactions made by reporting institutions. It sends reports recovered to that appropriate law enforcement authorities, any intelligence agency or any any other supervisory body for further handling if having considered the report, the director also has reasonable grounds to suspect the transaction is suspicious.

This functions are not limited to the bank customers who come and make transactions in the banks, but also to the stuffs of he bank. A bank director may steal the bank consumer money

¹⁷⁴The Banking Act Cap 448 ,s 38.

¹⁷⁵ Ibid

¹⁷⁶ Deposit Protection “*Fund Board Kenya ,Annual Report & Accounts*” (30th June 2009) Pg1

¹⁷⁷ The Proceeds of Crime and Anti-Money Laundering Act, 2009.

and try to make it look clean by making several deposits in other banks, The Center will investigate and put a keen eye on the employees of the banks, so as to ensure that bank customers are protected.

2.10 Definition of key word

It's important that the term "customer" be properly conceptualized as it is at the centre of this research. The relevance of defining who a bank customer is to, have detailed understanding of the banking sector. This will further give a clear view of the law and regulations that are required to ensure bank customer protection.

2.10.1 Consumer

Section 38 (7) of *Banking Act*¹⁷⁸ provides for a definition of a bank customer to includes persons entitled to a deposit as trustees or persons holding any deposit jointly.¹⁷⁹ The *Consumer Protection Act*, Section 2¹⁸⁰ gives a wide definition of consumer to mean; a person to whom particular goods or services are marketed in the ordinary course of the supplier's business' person who has entered into a transaction with a supplier in the ordinary course of the supplier's business, unless the transaction is exempt from the application of this Act,

A more comprehensive definition of a consumer is found in the *Competition Act 2012*¹⁸¹ as any person who purchases or offers to purchase goods or services otherwise than for the purpose of resale. but does not include a person who purchases any goods or services for the purpose of using them in the production of any goods for sale.¹⁸²

2.10.2 Bank

There has been no precise definition of the word "bank or banker". A bank can easily be identified than to be define. These come up from the numerous functions that the banks performs. The functions were well elaborated in the case of *United Dominions Trust V*

¹⁷⁸ The Banking Act Cap 448 s 38(7)

¹⁸⁰ The Consumer Protection Act, 2012, s 2

¹⁸¹ Competition Act 2012.

¹⁸² Competition Act, 2012,s 2.

*Kikwood*¹⁸³ Lord Denning and Lord Diplock formulated the following characteristics of a banker or a bank. Conducting accounts on which they deposit money from customers and which shows deposits and credits. Lending out money deposited with it for its own profits. Payment of cheques drawn on the bankers. Collecting cheques and orders for its own customers.¹⁸⁴

The *banking Act of Kenya* ¹⁸⁵ defines a bank under section 2 to mean a company which carries on or proposes to carry on, banking business in Kenya but does not includes the central bank.¹⁸⁶ *Bills of Exchange Act* of the Laws of Kenya, under Section 2 of that Act, the definition of Banker is defined in the following terms “Banker includes a body of persons whether incorporated or not who carry on the business of banking.”¹⁸⁷

1.10.3 Consumer Protection

Consumers protection can well be understood as measures or methods put across to safeguard Consumers of goods and services especially by legal means, against unfair market practices and fraudulent transactions.¹⁸⁸ This comes from the nature of banking transaction, which are complicated to understand for an ordinary citizen who has no knowledge about the banking system,¹⁸⁹ and hence there is need for the enactment of regulations that will help in stopping the exploitation of bank customers by providing maximum protection of the law.¹⁹⁰ The preamble to the *Consumer Protection Act* provides for the protection of the consumer, prevent unfair trade practices in the consumer transactions and to provide for matters connected with or incidental thereto.”¹⁹¹

¹⁸³ [1946]2qb431.

¹⁸⁴ The Banking Act Cap 488.

¹⁸⁵ Ibid.

¹⁸⁶ Ibid.

¹⁸⁷ Exchange Act Cap 27 ,s 2.

¹⁸⁸ B. W. Harvey and D. L. Perry, *The Law of Consumer Protection and Fair Trading*, (6th Ed, 2000) p25.

¹⁸⁹ These include market imbalances, asymmetries of information and other risks incidental to mundane market Transactions.

¹⁹⁰ This can be done by ensuring price stability, consumer compensation, effective information channels, and dispute resolution mechanisms in case a consumer is aggrieved by any financial service provider.

¹⁹¹ Consumer protection Act Cap 2012.

2.11 Conclusion

Although Kenya has laws and regulations that have been passed to ensure bank customer protection, still the compliance is at a low level. Most financial institution have a fear of losing customers. They have a mentality that when full disclosure is given to the bank customers, customers will be scared of taking the Bank product.

To illustrate when a bank explains to a bank customer about the charges that will be added in case of failure to pay the loan on time. The sum may sound outrageous and scare away the bank customers. Also most bank customers do not want too much bureaucracy when they want financial products. These leads them to unfair terms in the contract because they want the money faster.

CHAPTER THREE

NATURE OF BANK CUSTOMER PROTECTION AND COMPARISON WITH OTHER JURISDICTIONS

3.1 Introduction

Banking industry contributes an important role in this modern society.¹⁹² In Kenya, the World Bank's Findex Survey Program 2014 gave estimation that nearly 3 in 4 adults have a bank account.¹⁹³ This is a good evidence that the banking industry is growing. With the rapid growth, it is of great importance to ensure that the bank customers are protected. Bank customer protection means the bank customer being protected from being cheated by the banks or any other financial institution that has a higher advantage than the customer himself.

3.2 Bank customer protection

Financial consumer protection entails on ensuring that there is a fair exchange between the providers and customers of bank services. A strict regulation framework is a necessity to counterbalance the emanating misfortune of bank customer vis-à-vis the level of power, and resources, information of their providers. If there is no clear regulation framework, bank customer find it very expensive and hard to get enough information or even a good detailed understanding of the bank products or services they are about to purchase. When a bank customer is knowledgeable about the bank product and empowered, the consumers will not only protect his or her own interest but also be able to market the financial institution she is getting the service from. All this will arise out of the customer being satisfied by the services she has been offered. This system will motivate or encourage the financial institutions to compete on the basis of providing quality services and financial products. A comprehensive consumer protection framework can therefore improve efficiency of financial intermediation, build trust in financial systems, and reduce risks to financial stability.¹⁹⁴

¹⁹² David Haulers, 'customer relationship in United States' (*Banking law*, 1st June 2015.) <www.bank customer relationship.com.uk/2015/6/index.html> accessed 30/October 2017.

¹⁹³ Financial Sector Deepening Kenya research report conducted, in 2014.

¹⁹⁴ Flaming, M., Owino, And others "Consumer protection diagnostic study" (2011). 1st Ed pg83.

Bank customer protection is well elaborated in the case of *Lazaras Masayi v Kenya Commercial Bank Ltd*,¹⁹⁵ In this case the banks account of the plaintiff was wrongly debited and frozen by the bank. The appellant was a customer of the respondent Bank at Mumias Branch. He maintained three savings accounts and one current account. He made bank transactions in this accounts, after a deposit was made in the account, he wanted to make a cash withdrawal. The banks stopped him from it. He was informed that the accounts had been frozen and he and not do any bank transaction. This is because the money was wrongly paid into another account, the court held that , Although The appellant was on his part, content to argue that the debit of his account by the Bank without reference to him was in breach of the contractual relationship between banker and customer. The respondent was equally contented to impress on the Court that this was not an ordinary case of banker and customer but one where the customer had fraudulently induced the deposit made into his account with the respondent. The court held that where the bank has made a mistake in manner that caused damages to the bank customer, the bank will pay general damages and special damages for the lose that the customer got.

In the above case it is clear that bank has a duty to ensure that the customers money that is deposited in the account is protected, and in case of failure to do so then the financial lose got by the customer will be reimbursed by the bank.

3.3 Relationship between the bank and the customer

The general relationship between a bank and the customer is a contractual one which begins when an account is opened. The contract between the bank and the bank customer gives the obligation imposed on the bank and the customer, although some obligations are agreed as the relationship continues. Typically the commencement of the relationship in practice is documented in the sense that the Bank will impose standard terms and conditions on the customer on which that relationship is to be based. To the extent that there are express stipulations in that contractual relationship then the question of whether or not one of the

¹⁹⁵ Civil Appeal No. 259 of 2007 Kisumu.

parties to that relationship is in breach of the express terms is a matter of interpretation of the express terms of the contract.¹⁹⁶

The bank customer relationship is well elaborated in the case of *Woods v. Martins Bank*¹⁹⁷ the court held that on the facts of that case it was within the scope of the banks business to advise on financial matters and that in doing so, the bank owed a duty of care to the Plaintiff to advise him with reasonable care and skill. The bank in this case was seeking to avoid liability to the Plaintiff on the grounds that it was not part of bankers business to advise on financial matters. The court found and made the statement that what is to be defined as bankers business is not a matter to be laid down by the courts as a matter of law. What constitutes banking business is a matter to be decided on the facts before the court.

This case is important for immediate purpose in terms of establishing that a bank that gives financial advice assumes responsibility of reasonable care and should the customer suffer as a result of negligent advice then the bank will be held responsible.

Salmon J. says “I find that it was and is within the scope of the Defendant Bank’s business to advise on all financial matters and that as they did advise him they owed a duty to the Plaintiff to advise him with reasonable care and skill in each of the transactions.”¹⁹⁸

The relationship between a bank and a bank customer was well explained in the case of *Otieno- Omuga and Ouma Advocates v CFC Stanbic Bank Limited*¹⁹⁹, This case explained on the relationship the is established between a bank and a customer. The bank customer who had an two accounts with the bank, gave a cheque, to be cashed by a customer . The plaintiff before giving the cheque confirmed that there was enough money in the account. When the cheque was presented to the bank. The counter returned it, indicating that there was no money in the account. Because of the bounced cheque the plaintiff reputation to this customer was ruined. He sued for specific damages and general damages. The court explained that when a bank customer opens an account in a bank. The bank will have certain duties toward

¹⁹⁶ .Aywe Samuel, ‘Kenya laws online’(Banking law, 1st June 2015.)<www.bankcustomerrelationship.com.ke/2015/6/index.html>accessed 30/October 2017

¹⁹⁷ (1959) 1 QB 55.

¹⁹⁸ Ibid.

¹⁹⁹ Civil Suit No. 75 of 2012.

that customer. The bank should act with care with bank customer account, and protect the money in the account. The fact the plaintiff proved that there were enough funds in the account, yet the cheque bounced. This amounted to breach of duty of secrecy. Hence the bank was to pay the damages caused.

The bank is considered as a debtor of the customer after the customer deposits some money in his or her bank account. The money that will have been deposited by the customer becomes the property of the bank, hence the bank can use the deposited money of the customer as it deems fit. The banker is under no obligation to provide information of how the money shall be used but, they have to repay the money if requested by the customer.²⁰⁰

Still the relationship between the bank and the customer changes according to the transaction that the parties have conducted. Hence if a bank lends money to a customer, the bank becomes a creditor of the customer and the customer becomes a debtor of the bank.²⁰¹

The relationship between the bank and the customer is important, as it gives the customer some rights. When there is a relationship then the bank customer can be protected in case of breach of duty on the part of the bank.

3.4 Duties that arise out of bank customer relationship

The relationship that is in between the banker and the customer can generally be understood as that of debtor and creditor.²⁰² It is also contractual in nature²⁰³ and while the relationship is not that of trustee and cestui que trust,²⁰⁴ greater rights and duties exist than are found in a mere debtor and creditor relation.²⁰⁵ "When disbursing the customer's money, the bank can refund the money to the customer in the usual course of banking business and in accordance with the customer's instructions. In debiting customer account the bank is not supposed to charge any amount except the amount made at the time when, to the person whom, and for the amount authorized by him. Here the bank receives the customer's funds on the promise of

²⁰⁰ Lloyds TSB 'Banking terms and conditions', (2012 1st Ed) pg 14.

²⁰¹ Ibid.

²⁰² Ibid.

²⁰³ Ibid.

²⁰⁴ Walter William Fell, *A Treatise on the Law of Mercantile Guarantees and of Principal and Surety in General* (London: J Butterworth,)pg 18.

²⁰⁵ Ibid

disbursing them in accordance with his, and upon an accounting is liable for all such sums deposited as it has paid away without receiving valid direction therefore." ²⁰⁶

3.4.1 Fiduciary duty of the bank.

Ruth Plato-Shinar, explains that the bank customer contract is a special one.²⁰⁷ banking contract is sometimes referred as a special contract, that is why it is termed as a fiduciary contract.²⁰⁸ In a fiduciary contract, the bank, is subject to a fiduciary duty to the, customer.²⁰⁹ A fiduciary duty puts a very high standard of obligation on the bank, the duty is way much higher than that, imposed in an ordinary contract. The fiduciary approach of the bank customer relationship puts the customer in a better position and well protected from being taken advantage of by the bank.

The fiduciary duty placed on the bank makes the bank to have a high duty, obligating it to act with fairness, integrity, skill, and professionalism. The fiduciary duty was explained in the case of *Ajay Shah v Deposit Protection Fund Board as liquidator of Trust Bank Limited (in liquidation) and Praful Shah* ²¹⁰ The grounds in support of the application are that the DPFB in the course of winding up Trust Bank established that the business of the Bank was carried out with intent to defraud the creditors and for other fraudulent purposes and the appellant and 2nd respondent as Directors were knowingly parties to the said fraud; that DPFB as liquidator further established that the two Executive Directors were guilty of misfeasance or breach of trust in relation to the Bank; that the Bank through the fraud and misfeasance of the two directors lost money the account of Trust Capital Services Limited; that the appellant and the second respondents are jointly and severally liable to Trust Bank Limited for all losses incurred as a consequence of the said transactions and fraud in the said account of Trust Capital Services Limited. The court held that the appellant and 2nd respondent as directors of Trust Bank Limited were agents of the Bank and owed the bank fiduciary duties of loyalty and good faith analogous to the duties of trustees *stricto sensu* and also owed the duty of care

²⁰⁶ E Jenks, *Jenks' Digest of English Civil Law*, 2d ed (London: Butterworths, 1921)

²⁰⁷ Ruth Plato-Shinar "The Banking Contract as a special contract: The Israeli approach" (2007 1st Rec Ed) pg 27,

²⁰⁸ Ruth Plato-Shinar, *An Angel Named "The Bank": The Bank's Fiduciary Duty as the Basic Theory in Israeli Banking Law*, [36 common l. World rev. 27 (2007)] .

²⁰⁹ Ibid pg 27.

²¹⁰ Court of Appeal at Nairobi ,Civil Appeal No. 158 Of 2013.

and skill in discharge of their duty as directors of the Bank. Hence they were liable for the loss that had been incurred by the bank that finally lead to receivership.

The fact that the directors were agents of the bank, they represent the bank when handling the money of the bank customer. They had a fiduciary duty to work in manner that will not defraud the bank customer. When the fiduciary duty is observed, by the bank towards the bank customer, it protects them against the loss of their money.

3.4.2. The Duty to Provide an Explanation

The aim of the duty of disclosure is to ensure that the bank customer has adequate information in relation to the bank product that he or she is about to purchase. Nevertheless, even though the bank may fulfil their duty to give adequate information, there may be customers who may not understand the weight of the contract and what is technically involved or to grasp the financial and legal implications that stem therefore. In such a situation the bank has a duty to explain the product in the best way and language that the customer may understand and enable him or her make a decided decision.

In banking contracts, there is a fiduciary duty a special duty is imposed on the bank to provide an explanation to the customer. Even if it is possible to deduce from the banking document itself the nature and essence thereof, a duty should be imposed on the bank to give the customer a detailed explanation regarding the content of the contract and the essence of the transaction. Furthermore, there will be instances where an obligation is imposed on the bank to advise a customer and to explain the transaction to him or her, even if the customer does not request such an explanation because he or she is unaware of how essential the explanation is.²¹¹ According to the fiduciary approach, the bank is under the obligation to clarify the essence of the transaction and to provide explanations regarding the full significance, consequences, and implications thereof. The duty to provide explanations, which is imposed on the bank, should be a broad obligation in various aspects.²¹²

²¹¹, *supra* note 70, at 324, 326.

²¹² The Central Bank of Kenya Prudential guidelines for institutions licensed under the Banking Act, On consumer protection CBK/PG/22/419. '(2006)210.

Provision of information to customers is well elaborated in the *Central Bank of Kenya Prudential Guidelines For Institutions licensed Under the Banking Act*. It provides that, Prior to a consumer choosing a product, an institution shall, explain clearly in plain language the key features of the range of products and services that the consumer is interested in. This will enable the consumer to arrive at an informed decision about these products and services. And will be informed of any charges and fees which would be incurred. The institution should request the consumer to provide all the information needed to verify whether or not the consumer is eligible for a product or service in which the consumer is interested

Rule 3.2.3 of consumer protection, under the *Central Bank of Kenya Prudential Guidelines for institutions licensed under the Banking Act*, provides that where an institution gives advice to a consumer, the institution shall ensure that the advice is suitable. The bank should take into account the circumstances and needs of the consumer. Also any product or service which the provider recommends a consumer to buy it should be suitable for the consumer. and it clearly informs the consumer of any actual or potential conflict of interest.²¹³

The bank is required to explain to the customer, properly and clearly, the significance of the document which he or she is about to sign, the scope of its application, and the possible implications thereof. The bank does not fulfil its obligation by simply relying on the wording of the documents.

Secondly, the obligation of the bank to provide an explanation to the bank customer should go beyond the factual details that are provided by virtue of the duty of disclosure in the narrow sense. Explanation should also include an obligation to provide legal explanations. The bank should also be obligated to give the customer an explanation regarding the main legal issues connected to the transaction, even though there may be many.²¹⁴ This was explained in the case of *Margaret Njeri Muiruri v Bank of Baroda (Kenya) Limited*²¹⁵, Where Margaret who is the administrator of the estate of Joseph Muiruri Gachoka deceased, brought the matter to court. The couple had a company known as Central Kenya Agencies Limited,

²¹³ The Central Bank of Kenya Prudential guidelines for institutions licensed under the Banking Act, On consumer protection CBK/PG/22/419. '(2006)210 Clause 3.2.3(a)(i), (ii) and (iii).

²¹⁴ Plato-Shinar, "the bank's fiduciary duty," (2000, Rev Ed) 43, at 237.

²¹⁵ Court of Appeal at Nairobi, Civil appeal no 282 of 2004.

the bank facilitated a loan to the company, which loan was guaranteed by the late *Joseph Muiruri Gachoka* and his wife, *Margaret Njeri Muiruri*, using their lands and one house in Nairobi. After the death of the husband, and due to the difficulties in business, the borrower was unable to repay the loans. As a result of the default, the two properties belonging to the company were disposed of by the respondent.

After her husband's death, the appellant approached the respondent to renegotiate the terms of the loan. As at the time of taking out the mortgage facility, the loan amount advanced was Kshs.6 million, and the rate of interest was agreed at 14%. The bank had raised the interest payable to 45% on the outstanding balance, and so the amount owing to the respondent continued to grow. The appellant paid about 12 million to the respondent. The respondent however took the position that since the repayments made by the appellant were so few and far between, and that since interest continued to accrue on the mortgage account, the debt owed had built up to the amount of Kshs.200 million. As a result of the failure of the appellant to repay the amount, the respondent moved to realise the Eastleigh property. The bank changed the interest rate without informing the bank customer. This made the amount owed to the bank to grow and even exceeded the previous loan that the company had already paid almost two thirds.

The bank did not give the bank customer information about the proceeds they got from disposing the two lands and when they changed the interest rates of the loan.

The court termed the contract as unfair contract. It was fraudulent in nature and took advantage of the fact the appellant was in a lower position of bargaining power. The fact that the appellant came to request to the bank to renegotiate the terms of the loan but they refused amounted to an unfair banking practice. The court gave an order to stop the bank from taking the house and to renegotiate the terms of the loan. This shows how important it is for a bank to explain every single detail to the bank customer before it goes ahead to implement it. This protects a customer against unfair loan terms.

The bank should give an explanation especially where the bank knows that the contract has a provision that differs substantially from those that the customer could rightfully expect. In

such a case, the recognition of the obligation to provide an explanation also arises because of the gap in the parties' expectations.²¹⁶ The obligation explain should also be recognized where the bank is aware that the customer is not capable of reading the document, for example, due to language difficulties. This was elaborated in the case of *Israel Mortgage Bank Ltd. v. Hershko*.²¹⁷ *Hershko* dealt with a customer who received a loan from the bank.²¹⁸ As a result of various limitations, the loan was established through a complex arrangement.²¹⁹ The customer was not given a satisfactory explanation as to the essence of the transaction and therefore did not understand that the way the loan had been established would cause him huge losses.²²⁰ The Court found that the bank had breached its fiduciary duty by failing to provide the customer with the full explanation required, even though the customer had received personal advice from his attorney.²²¹

3.4.3 Duties of the bank to ensure customer protection

Due to the contract of the bank and the customer, there exists a relationship. This relationship brings into existence the duties and right to the parties of the contract. The bank has a role to play to ensure that the bank customer is protected from being taken advantage of or defrauded. This places a duty on the side of the bank to act in a manner that will not put the bank customer in a disadvantage. The bank has the following duties

3.4.3.1 The bank's duty of confidentiality

Institutions shall not disclose any information about a consumer to a third party except where: the institution is compelled by law to disclose the information; or the disclosure is made with the express consent of the consumer. The duty not to disclose any information about the consumer includes information relating to the consumer's accounts and any information about the relationship between the institution and the consumer²²²

²¹⁶ *supra* note 214..

²¹⁷ 29(2) PD 208.

²¹⁸ *Ibid*

²¹⁹ *Ibid*

²²⁰ [2004]58(3) PD 934

²²¹ (2011)2 QB.PG 74.

²²²The Central Bank of Kenya Prudential guidelines for institutions licensed under the Banking Act, On consumer protection CBK/PG/22/419. '(2006)210.

The banker-customer relationship is an agency contract and the element of privacy stems from this contract. Generally, an agent is under a duty of care and privacy to his principal.²²³ The bank's duty of confidentiality implies a legal obligation to maintain the customer's information securely. The case of *Tournier v National Provincial and Union Bank of England*,²²⁴ identified the principles of a bank's duty of confidentiality. In this case, the claimant had his account with the defendant bank and the latter made payment demands. It was agreed that the claimant would make payments in order to reduce his overdraft, but he failed to keep up the payment after the third instalment. The bank became aware of the claimant being the payee of a cheque to a third party and upon making enquiries the bank became aware that the endorsee of the cheque was bookmaker. The branch manager then telephoned the claimant's employers apparently to determine the private address of the claimant, but the branch manager divulged during the course of the conversation that the claimant's account was overdrawn and that he had dealings with bookmakers. As direct results of the conversation, the claimant employers decided not to renew his contract of employment. The court of Appeal found that the bank breached its duty of confidentiality. Atkin L.J noted that: The obligation extends to information was obtained arose out of the banking relations of the bank and its customers.

Hence, a bank 'duty is to treat information as secret'²²⁵ and this obligation is not only limited to information that a bank knew from the condition of the account of the customer, but extends to all information derived from the banking relationship between the bank and the customer.²²⁶

A bank's duty of confidentiality is not absolute, and is subject to four exceptions, *Tournier*:²²⁷ disclosure by compulsion of law; disclosure under duty to the public interest; disclosure under the bank's own interest and disclosure under the customer's approval.

The first two qualifications mean that the disclosure of a customer's privacy data may be required by law and in cases where the public interest prevails, as the bank has no power to avoid the rules of law and will be liable if the revelation does not occur. Disclosure under the bank's own interest is the third exception to the bank's duty of confidentiality identified by *Tournier*. The fourth

²²³ [1942] 1 All ER 378; Boardman v Phipps [1967] 2 AC 46.

²²⁴ [1924] 1 K.B. 461 at 427.

²²⁵ Hudson Alastair 'The law of finance' (First Edition, Sweet & Maxwell (2009) pg 777.

²²⁶ Doctor Charles, 'The law and practice of international banking' (Oxford University Press 2010) pg 678.

²²⁷ [1924] 1 K.B. 461 at 427

qualification in *Tournier* is the customer's consent, which may be either explicit or implicit. In *Tournier*, the court held that the best instance of a customer's implicit approval for the revelation of confidential information is where he/she authorises the bank to provide a reference.²²⁸

The bank has to notify its customer about any reference before it is transmitted and is moreover, required to obtain the customer's written consent before any action is taken with regard to the reference. Overall, it is fair practice to obtain the customer's express consent before passing any confidential information to another party and if the bank fails to do so it will be liable for breach of a duty of confidentiality.²²⁹ The duty of Secrecy in banking is provided for in the case of *Standard Chartered Bank Kenya Ltd v Intercorn Services Ltd*²³⁰ the respondents were customers of the appellant at Westlands branch, Nairobi while the fifth respondent was the Managing Director of each of the four respondents. It is pleaded in that plaint that on or about 25th May, 1985, the first respondent deposited a cheque for Ksh17,007,568/25 into its account and the same was credited to its account at the Westlands branch of the appellant. The respondents claimed in the plaint further, that despite the express contractual understanding between the appellant and the respondents that strict fiduciary mutuality and confidentiality would be maintained, the agents and/or servants of the appellant namely Amos Yiesel and Hutton Ayodi in breach of the same fiduciary relationship informed the police that they suspected that the same cheque was unlawfully obtained, as a result of which the fifth respondent in his official capacity as the Managing Director of each of the respondents, was charged and prosecuted in Criminal Case No1716 of 1985 thereby causing the respondents' business inoperative and all the respondents suffered damages as the respondents' accounts were also frozen and that resulted in the closure of their business.

The court explained the bank had breached on the duty of confidentiality. In order to protect a bank customer the bank should keep all information relating to the bank customer as a secret. When the bank disclose the financial details of a bank customer, it tends to make the partners in business to lose trust in him. Where a business partner finds out that the person he is doing business with does not have enough money to perform the contract. This may lead to him losing

²²⁸ Sinai Deutch, 'Bank-Customer Relationship: Contractual and Consumer Aspects', (1996) pg 163, 183.

²²⁹ Ibid

²³⁰ Civil Appeal No. 37 2003

his contract.

The effect felt when financial information is disclosed, is different depending on how situation of the parties. Where the bank discloses that the bank customer has deposited a lot of money to the bank hence suspecting him of money laundering, then this will destroy the reputation of the bank customer. It can make the customer to lose his or her customer and eventually shut down the business. The market will no longer trust him as his reputation will have been spoilt. Hence the bank has a duty to keep all the financial information a secret so as to protect the back customer.

3.4.3.2. Banks reasonable care and skill

Regarding 'the bank's duty to exercise reasonable care and skill and the confidentiality of electronic fund transfer systems', banks must adopt highly sophisticated encryption system. This will prevent hackers from gaining access to its own and its customers' data. The bank is under strict liability to employ reasonable and secure software programs for executing its intended purposes and such liability does not depend on proof that the bank was negligent.²³¹

Azzouni (2003) considers encryption systems one of the most significant problems associated with electronic banking confidentiality. Such a problem can be solved by adopting a highly secret system to prevent any unauthorised access to the bank's electronic data. This was elaborated in the case of *Equity Bank Limited & Lucy Ndururi v Robert Chesang*²³² Where Mr. Robert Chasang had four accounts with equity bank, the accounts were all connected to the ATM card which he frequently used it to do most of his shopping. He went for shopping at the supermarket and shopped for goods worth 15, 000 Ksh, When he presented the card for payment, the counter explained the account does not exist. This made the supermarket manager to handle him like a fraudster, He was arrested and detained in the manager's office until he explained himself and later realised.

²³¹ G.P Tumwine Mikubwa & Others, *Essays in African Banking Law and Practice Uganda Law Watch*, 2009.

²³² civil appeal no. 571 of 2012.

On presenting his claim to the bank it was not well addressed. Mr Robert sued the bank for general damages because of the inconveniences he went through in the supermarket. And for special damages for the embarrassment, as the supermarket manager thought he was a fraudster. The learned Magistrates explained that a bank has a duty to handled the customer's account with care in order to avoid some lose. The bank was ordered to pay for general damages for the inconveniences the bank customer went through.

The duty of goes beyond just exercising care and skill in confidentiality, it goes to the level of handling the bank customer transaction in a way that will not expose him to any lose or fraud.

This was elaborated in the case of *Otieno-Omuga and Ouma Advocates v CTC Stanbic Bank Limited*,²³³ The plaintiff and the defendant had a customer bank relationship, the plaintiff claimed that his account had enough money at the time of the incidence. On the 2nd September the plaintiff after issuing a cheque to the defendant bank received one of the cheques back on the grounds that there was no sufficient funds. Mr, Otieno claimed that the account had enough money to enable the bank to honour all the three cheques he had issued. Because of this a partner who was the payee threatened to report the plaintiff to the advocates complaints commission and law society of Kenya for misconduct and to the police for issuing a dishonoured cheque and further to circulate an advisory to all the advocates in Kenya not to accept the plaintiff's professional undertaking and cheques.

The defendant bank on its defence explained that they did not honer one of the cheques because at the time they were issued , money was not enough in the account and a bank process was to be conducted to ensure due diligence.

Court held that due to the negligence and lack of care in handling the bank customer cheques, it led to wrongful dishonour of the cheques. The bank has a role to play, in ensuring that they honour the bank customer instructions and a duty of care should be put on account when doing some transaction on the customer's account.

²³³ Civil Suit civil suit No.75 of 2012.

Hence the bank has a duty to ensure that the customer's account is handled with care and skill. This will protect the bank customers reputation and business. In a situation where a cheque has to be drawn, the bank has to call the account holder so that he can confirm his or her consent. This shows care and prevent fraudulent transactions from the bank customers account.

3.4.3.3. Advise a customer if some forgery suspected

Fraud and forgery have always been an issue for banks and customers especially in the transfer of money. Currently with the electronic transfer of money, the risks are even greater. With the widespread use of mobile and internet banking, there has been an increased focus on the need to mitigate the possibility of fraudulent activity in private banking transactions. This gives a duty of care placed on both a bank and its customers. Such duty of care has long been in existence, and laws have granted certain protections to banks. Also there are numerous cases establishing the obligations owed by each party, particularly in relation to the drawing of cheques.

(a)The extent to which a bank owe its customer a duty of care not to facilitate fraud.

According to the *Central Bank of Kenya Prudential Guidelines for institutions licensed under the Banking Act*, provides that the bank shall post updated security advice. This advice will be advertised on their branches, websites and all channels. This information will be available so as the customers will be aware of particular scam and fraud. Also so that the bank can protect the bank customer from fraudsters, the institution shall provide the consumer with a 24-hour telephone number. This will enable consumers to report a lost or stolen card, cheque book or passbook or a suspected scam or fraud. They are further encouraged that this line should be toll-free²³⁴

Banks are expected to comply strictly with their customer's payment orders, issuing corresponding payment orders that precisely match that of their customer's. There are limited circumstances in which a bank is able to refuse a payment order, and in the case that it does,

²³⁴The Central Bank of Kenya Prudential guidelines for institutions licensed under the Banking Act, On consumer protection CBK/PG/22/419 Section 3.3.3

the bank must inform the customer at the earliest opportunity that it is doing so and, where possible, provide an explanation. In *Bank of New South Wales v Laing*²³⁵ it was held that there was an obligation on a bank to comply with their customer's payment order so long as the account was in credit. Banks are also entitled to reject a payment order where the customer has breached the agreed terms and conditions governing the account, for example by not providing two signatures for a joint account payment, or where making the payment would be considered unlawful.

However, the duty to obey a customer's payment order can conflict with a bank's duty to exercise reasonable care and skill, in protecting its customer from the fraud of agents such as directors and partners in issuing a payment order. A conflict can occur where a bank is provided with what may appear to be an authorised payment order, but in fact was made as a result of fraudulent activity, raising questions as to the extent of the duty of care a bank owes to its customer in confirming the validity of the payment order instruction.

Clause 40 of *Payment Services Regulations*, where they apply, address the issue of the misuse of a payment instrument. They direct that a bank will only have the authority to make a payment or debit a customer's account if it can show that consent has been obtained from the customer. The form and procedure for giving consent to the execution of a transaction must be set out in the information given to a customer before a transaction is concluded.²³⁶ If a bank cannot show that consent has been obtained the transaction must be regarded as unauthorised. As a result, if a third party were to gain access to a customer's electronic payment device or were able to bypass it altogether and send payment instructions to a bank, the obligation on the bank to assess whether it had the consent to process the transaction would be dependent on the terms of the contract between the parties.

In situations where incorrect payment instructions are given to a bank as a result of fraud and banking acts in accordance with those instructions, case law has sought to restrict the liability of a bank. In *Tidal Energy Ltd v Bank of Scotland PLC*²³⁷ it was held that a customer's bank will not be liable for facilitating the defrauding of its customers, so long as it follows established banking practice. In this particular circumstance, the customer had provided the

²³⁵ [1954] AC 135.

²³⁶ Payment service regulation 2014, Section 40.

²³⁷ [2014] EWCA Civ 1107.

bank with the correct name but incorrect account number and sort code, having been subject to fraud. The bank complied with the payment order to the fraudulent third party and the payment was withdrawn from the account. It was held that as established banking practice did not require that a bank should match names to account numbers and sort codes, the bank was not under a duty of care to do so.

International Standard banking practice ²³⁸requires that in order to confirm a payment instruction, a bank must provide to its customer details of transactions made from their account, including the date of the transaction, the amount of the transaction, the name of the payee or payer and a reference so that the payment can be easily identified. More stringent requirements have been proposed in the form of a Fourth Money Laundering Directive and revised Wire Transfer Regulations.

In the event that there has been a misdirection of payment, the Code of Best Practice which is published by Payment Council Board of Kenya²³⁹ provides guidance on payments made via real time payment system. It directs that both the sending and receiving banks would be expected to investigate the misdirected payment. The receiving bank will also be expected to inform the sending bank of the progress and outcome of any error recovery request.

With this crucial steps put , in the international banking practice. It put across the limit to which the commercial bank should scrutinize to ensure that the banks protect the bank customer internet theft of money and fraudsters. The practice has kept several authentication process of the person who is receiving the money. This protects the bank customers from fraudsters.

3.4.3.4. Responsibilities of bank customers in prevention of fraud

Exercise reasonable care in drawing cheques to prevent fraud, forgery, and not to mislead the bank. "A Customer of a bank owes a duty of care in drawing a cheque to take reasonable and ordinary precautions against forgery."The leading authority for this proposition is the case of *London Joint Stock Bank Ltd v. Macmillan*, ²⁴⁰A firm who were customers of a bank entrusted the duty of filling out their cheques to a clerk whose integrity they had no reason to

²³⁸ International Standard banking practice 2013.

²³⁹ Council board of Kenya "Code"(2012 Pub)pg 82.

²⁴⁰ (1918) A.C. 777.

doubt. The clerk presented to one of the partners for signature a cheque drawn in favour of the firm or bearer. With no sum on words written on the cheque in the space provided and there were the figures in the space intended for the figures. The partner signed the cheque. The clerk subsequently tampered with the cheque by adding the words one hundred and twenty pounds in the space that had been left. The clerk then presented that cheque for payment at the firm's bank and received a hundred and twenty pounds out of the firm's account. The question was whether the bank would then be liable to the firm for that loss that was perpetrated by their own clerk.

The House of Lords held that the firm had been guilty of a breach of duty arising out of the relation of a banker and customer to take care in the mode of drawing the cheque and that the alteration of the cheque by the clerk was a direct result of that breach of duty. And accordingly the bank was entitled to debit the customer's account with the amount of that cheque.

Lord Finley further explained as:

...the relationship between a banker and a customer is that of debtor and creditor with a super added obligation on the part of the banker to honour the customers cheques if the account is in credit. A cheque drawn by a customer is in points of law a mandate to the banker to pay the amount according to the tenor of the cheque. It is beyond dispute that the customer is bound to exercise reasonable care in drawing the cheque to prevent the banker being misled. If he draws the cheque in a manner which facilitates fraud, he is guilty of a breach of duty as between himself and the banker and he will be responsible to the banker for any loss sustained by the banker as a natural and direct consequence of this breach of duty...

The above case explains that the duty to protect the bank customer, is not only on the part of the bank. The bank customer also plays a role in ensuring the he or she does not give a chance for theft of fraud to take place. Sections 3 and 4 of the *Cheques Act* s. 3 (2) that where a banker in good faith and without negligence and in the ordinary course of business receives

payment for a customer of a prescribed instrument to which the customer has no title or defective title Protection is essentially being proffered to protect the bank²⁴¹

The duty placed on the bank customer, towards protecting himself against fraud does not go beyond care . The bank customer should not be negligent to give a chance a person to change the amount or even names on the cheque. Hence where the bank customer was not negligent, yet a cheques has been forged and money withdrawn from his account. Then the bank will be liable for the lose. Section 24 of the *Bills of Exchange Act* which provides that where a signature on a bill is forged, or placed thereon without the authority of the person whose signature it purports to be, the forged or the authorised signature is wholly inoperative. In other words if the bank honours a forged cheque and it subsequently turns out the cheque was forged, then the banker bears the loss.²⁴²

In *Tai Hing Cotton Mills Ltd v. Liu Chong Hing Bank Ltd*,²⁴³ a company was a customer of a bank and maintained accounts with that bank. The bank honoured cheques 300 of them totalling approximately 5.5 million Hong Kong dollars. The cheques on the face of them appeared to have been drawn by the company and appeared to bear the signature of the Managing Director of the Company who was one of the authorised signatories and so the bank honoured these cheques. It later transpired that those cheques were not in fact the company's cheques, they were in fact forgeries and the forgeries had been perpetrated by the company's own accounts clerk and the question was whether that loss should fall on the company or on the bank.

The holding of the Privy Council was as follows: in the absence of express agreement to the contrary the duty of care owed by a customer to his bank in the operation of a current account was limited to a duty to refrain from drawing a cheque in such manner as to facilitate fraud or forgery and that a customer had a duty to inform the bank of any unauthorised cheques purportedly drawn on the account as soon as the customer became aware of it. And on the question whether there was an obligation on the part of the customer to screen statements

²⁴¹Cheques Act No2 of 2002.

²⁴² Bill of exchange Act Cap 27.

²⁴³ P.C 1985 2 947.

which is what the bank had advocated or argued, the court held, that the customer was not under a duty to take reasonable precautions in the management of his business with the Bank to prevent forged cheques being presented for payments nor was he under a duty to check his periodic bank statements so as to enable him to notify the bank of any unauthorised debit items because such wide a duty was not a necessary incident of the Banker/Customer relationship since the business of Banking was not the business of the customer but the business of the bank and forgery of cheques was a risk of the service which the bank offered.

It had been suggested in this case that there was a duty owed to the bank by the customer but the Privy Council stated that the customer was under no duty to scrutinise statements to check if they are erroneous.

This protects the bank customer gist bearing the loss of money that has occurred from fraudulent transactions. The bank plays a role in ensuring the, it communicates to the bank customer before they honour a cheque. They can do this by calling the bank customer to find out if he has signed that cheque, and if they should honour it.

The *Payment Service Regulations* provide that a bank's customer would be liable for all losses arising from the unauthorised use of a 'payment instrument' if he or she has intentionally or with 'gross negligence' failed to comply with his statutory obligations, for example by not complying with the terms and conditions of the use of the payment instrument, failing to notify the bank without 'undue delay' of its loss, theft, misappropriation or unauthorised use, or failing to take reasonable steps to keep the personalised security features of the payment instrument safe.

Both banks and their customers have a duty not to facilitate fraud on the customer's account and care must be taken by both parties to ensure they meet their legal obligations. Where a private bank is dealing with individuals it needs to ensure that it complies with all its internal procedures as well as standard banking practice, otherwise it could find that, in the event of

fraud, a court would not allow it to rely on any exclusion of liability clause in its standard terms and conditions.²⁴⁴

3.4 Comparison with other jurisdiction.

3.4.1. Protection of bank customers in Uganda

In Uganda the protection of bank customers is provided for under the *Bank of Uganda Financial Consumer Protection Guidelines*.²⁴⁵ The guideline gives the commercial banks in Uganda duties to ensure bank customer protection. A financial services provider shall act fairly and reasonably in all its dealings with a consumer.

Section 6 (1) provides that;

A financial services provider shall not: engage in unfair, deceptive or aggressive practices such as threatening, intimidating, being violent towards, abusing, or humiliating a consumer; offer, accept or ask for bribes or other 'gifts' or unfair inducements; discriminate against any consumer on the grounds of sex, race, colour, ethnic origin, tribe, birth, creed or religion, social standing, political opinion or disability; take advantage of a consumer whether or not he or she is able to fully understand the character or nature of a proposed transaction; include an unconscionable term in an agreement; exert undue influence or duress on a consumer to enter into a transaction; disguise, diminish, obscure or conceal a material fact or warning through, among others, use of print whose font size is less than 10 point, describing the material fact or warning in complex language, use of voluminous or omitting a

²⁴⁴ Fieldfisher, 'Duties not to facilitate fraud' (03/2015) <[www..com/publications/duties-not-to-facilitate-fraud#sthash.lrfLkXVE.dpuf](http://www.fieldfisher.com/publications/duties-not-to-facilitate-fraud#sthash.lrfLkXVE.dpuf)> accessed 3rd 3 2017.

²⁴⁵ Bank of Uganda Financial Consumer Protection Guidelines, 2011, Part ii section 6 (1).

*material fact or warning; mislead the consumer; or(ix) lend recklessly.*²⁴⁶

The protection of bank customer in Uganda is elaborated from different legislations and case law. The Constitution of Uganda provides that the bank customer has a right to having of his or her bank information not to be made public. The constitution of Uganda provides the right of the privacy that no one should subject to interference with the privacy, which includes observing his bank secrecy.²⁴⁷

Bank secrecy was explained in the case of *Asiimwe Ndyomugenyi v Asiimwe*²⁴⁸, where the case was brought against the widow of the late Dr Tumwesigye, who had applied for the letter of administration for the late husband's estate. A caveat was lodge on Mrs Tumwesigye petition for letters if Administration on grounds that the late doctor had children with the immaculate. She claimed that the widow had not disclosed all the assets of the late doctors. She petitioned the court to order the widow to bring the bank statement and the balance in the accounts. This will enable her to know how much the late doctor had in his account. The court held that the widow has no power to disclose the late doctors account . This is because the bank had a fiduciary duty not to disclose the account statement of the doctor. The bank has a duty to protect the bank customer against all fraudulent parties, by keeping a secret of the bank details of the bank customer. Unless given an order by court of law. Which the above application the bank customer is protected against all fraudulent parties. The court was the only one who can declare the right person to administer the estate of the late doctor.

All the members of the board of the bank and officers and employees to keep all the customers information confidential even after termination of their employment unless he/she is compelled to give evidence by the court of competent jurisdiction or to fulfil other obligations imposed by the law.²⁴⁹

²⁴⁶ Ibid.

²⁴⁷ Article 27 The Uganda Constitution. of the 1995

²⁴⁸ Civil Suit No. 104 of 2013.

²⁴⁹ Bank of Uganda Act. S 45,

The offence is stipulated in section²⁵⁰ that the offender is liable to imprisonment for five years or to fine not exceeding five hundred thousand shilling or to both. Disclosure to the Central bank, explain, the audited annual financial statements shall at least disclose the range of interest rates and performance status of such insides loans during the reporting period.²⁵¹

In Uganda the bank has a duty to provide information and give advice to a customer. Prior to a consumer choosing a product or service, a financial services provider shall, explain clearly in plain language. The bank should explain the key features of the range of products and services that the consumer is interested. This will enable the consumer to arrive at an informed decision about these products and services. The explain about any charges and fees which would be incurred The bank has to request the consumer to provide all the information needed to verify whether or not the consumer is eligible for a product .Where a consumer has chosen a product ,a financial services provider shall before the consumer buys the product , provide the consumer with a key facts document for the product or service. The bank should give the consumer a copy of the terms and conditions for the consumer's agreement ,also inform the consumer of the applicable charges, fees or additional interest the consumer will bear should the consumer decide on an early termination of any contract.²⁵²

3.4.2. Nature of the bank customer relationship in Singapore

In Singapore, the relationship between banker and the customer is largely governed by the common law. However, in certain matters, the most notable of which is banking secrecy, the *Banking Act*²⁵³ applies the establishment of a banker and customer relationship is significant as it gives rise to the rights and duties of a banker. To illustrate the banker's duty of care in carrying out the customer's mandate. In the most common scenario, the banker and customer relationship is establishes upon the opening of an account by the customer with the bank.²⁵⁴

²⁵⁰ 45(4)cap 51.

²⁵¹ Uganda Financial Institution Act no 2 2004. Section 49(d).

²⁵² Bank of Uganda Financial Consumer Protection Guidelines, 2011.part ii section 6(2)

²⁵³ Cap 19, 2008 ev Ed.

²⁵⁴ Singaporelaw,'Banking and finance'(03/2010)> [http://www.singaporelaw.sg /content/banking and finance.htm](http://www.singaporelaw.sg/content/banking%20and%20finance.htm)< accessed on 1st March,2017.

Whether the customer is depositing money with the bank, other bank, or the bank is extending a loan or other banking facilities to the customer, the nature of the relationship between banker and customer is essentially one of the contracts. However, where the bank is holding the customers' deposits, it is a special feature of the contractual relationship that the bank is able to use the money received from the customer for the banks purposes, subject to its undertaking to repay the money to the customer(with or without interest) either on demand or at a pre-determined time.²⁵⁵ Licensed banks in Singapore are subject to statutory obligations of secrecy with respect to information relating to its customers and their accounts.²⁵⁶

In 2001, the *Banking (Amendment) Act*²⁵⁷ repealed section 47 and re-enacted it in a substantially different form. The legislative move marked a policy change it in a substantially different form. The legislative move marked a policy change in Singapore's regulatory approach to banking secrecy, the Monetary Authority of Singapore(the MAS) having recognized that the previous provision had impeded banks seeking to take advantage of potential operational benefits and savings. For instance, under the previous regime, the banks had encountered difficulty in securitizing mortgage loans or outsourcing data processing to third parties. The current section 47 extends the circumstances under which banks may disclose customer information.

Section 47 provides that customer information shall not, in anyway, be disclosed by a bank as defined in *Banking Act*.²⁵⁸ That is a bank incorporated in Singapore or the branches and offices located within Singapore of a bank incorporated outside Singapore) or any of it officers, to any other person except expressly provided in the *banking Act*(Cap 19, 2008 (and elaborated on in the third schedule thereof). Consequently, the confidentiality obligation under Section 47, extends to the bank as well as its officers. An officer, is defined ²⁵⁹to include a director, secretary, employee receiver, manager, and liquidator.

²⁵⁵ Ibid.

²⁵⁶ Banking Act (Cap 19,2008Rev Ed). Section 47.

²⁵⁷ Ibid.

²⁵⁸ Cap 19, 2008 Rev Ed.

²⁵⁹ Banking Act Cap 19 2008 Rev Ed) Section 2(1) .

In the case of *United States Ghidon*²⁶⁰ It increasingly sensitive issue in federal criminal procedure; the use of “compelled consent” to produce foreign banking and professional relationship record.²⁶¹

3.5 Conclusion

The state of bank customer protection in Kenya is not at it's very best. The financial sector has experienced new technology and different products that are introduces to the bank customer. These products come along with advantages and disadvantages. Though customers are enjoying different bank products, on the other hand they have been exposed to unfair term loan terms with the banks. The bank customer protection has not been adhered to , hence bank customer are rendered vulnerable. Kenya is in need of proper law and bodies that will regulate the financial institutions. This will supervise the commercial banks and ensure that they adhere to bank customer protection laws.

²⁶⁰ 732f 2d 814(1984)

²⁶¹ 1st Circuit Reject compelled consent”NAIL LJ Apr 20,1987, at (cool; Second says Access to Bank Records Violates Constitutional.

CHAPTER FOUR

CUSTOMER PROTECTION UNDER BANK GUARANTEE TRANSACTION

4.1 Introduction

Guarantees are some of the earliest forms of contractual obligations to be introduced under English law. A guarantee can be defined as a promise made by one party who is known as the surety or guarantor, that will be answerable for that particular performance of the legal obligation and any other that may arise out of that promise to take responsibilities in case of default of another person who is known as the principal debtor, Legal obligation of another party known as the principal debtor. A guarantee may relate to the performance of an obligation, the discharge of a legal liability, or the payment of an outstanding debt.

Guarantee is well explained in the *Banking Act* ²⁶² as the simplest form of security, that a banker may take. It is the commonest in banking. In this type of security it's very easy as it has no formalities required apart from getting the guarantor's consent which is expressed using his signature on the bankers' standard form of guarantee.²⁶³

A guarantee is not a particularly safe form of security, depending as it depends on the guarantor's willingness and ability to pay when called upon to do so. Unless a charge is taken over some form of property, a loan secured by a guarantee should be considered by the bank as an unsecured loan.²⁶⁴ The validity of a bank guarantee in a situation where a security has been provided was explained in the Kenyan case of *Koileken Ole Kipolonka Orumoi V Mellech Engineering & Others*²⁶⁵ The Plaintiff is the registered owner of all that parcel which the Defendant known as Mr. Gerald Wamalwa requested the Plaintiff to guarantee financial facilities. The Plaintiff accepted the 1st Defendant's request on condition to only use his property as security for a period of three years only and only an amount not exceeding Kshs 150,000.00 to be paid for every month during the three years. The Plaintiff contended that he learned from the demand letter dated 24th April, 2014 that the financial facilities secured by a charge on his property had been converted into a term loan of Kshs 30,325,476.66. Also the

²⁶² The Banking Act Cap 448.

²⁶³ Sheldon and Fidler, *"practice and law of banking,"* (2009) 7th edition wlbs.

²⁶⁴ Ibid.

²⁶⁵ Civil suit no 545 of 2014.

2nd Defendant arranged to have two more parcels of land belonging to a Mr. Moses Lonkisa Ole Nkuya charged to secure the said term loan without the Plaintiff. The Plaintiff confessed that he is illiterate, he cannot read or write in English and the contents of the charge were not explained to him. He contended that, all he can recall is that he was called by the 1st defendant's Advocate, one Ms. Winnie Wambui to go and execute documents whose content was not explained to him. The Plaintiff stated that he did not get independent legal advice on the matter because Ms Winnie Wambui advocate all along acted for the 1st Defendant.

The court explained that for guarantee to be valid, the guarantor should have all the information disclosed to him. The bank should ensure that the guarantor has got all the information required from an independent advisor. In this situation the bank had no right to dispose the parcels of land that had been used to guarantee. This is because the plaintiff was not aware of the intentions of the plaintiff and her lawyer. Hence the guarantor was protected on the grounds that he signed a document that had different agreement from the one he had been told by the defendant lawyer.

4.2 The role of guarantees in contemporary commerce

The importance of guarantees has not waned despite their longstanding role in contract law. Historically, banks and creditors would lend not based on collateral but based on guarantees or endorsements of bills of exchange, typically from the commercial entity or person that operated the business to which a loan was made.²⁶⁶ By contrast, for example where creditors and bankers would lend money to customer on securities, they would only do so in exchange for hard collateral, often in the form of government bonds or real estate mortgages.²⁶⁷ As we stand today the words economy highly relies on the availability of credit to loan business personnel so that they could do their business.

As Walter William Fell explained,

The universal adoption of a system of credit in all mercantile transactions, and the prodigious extent to which that system is

²⁶⁶ McGuinness, *supra* note 2 at 18.

²⁶⁷ *Ibid.*

*at present carried, has introduced, or at least very much increased, the practice of requiring counter securities against such credit or some other species of guarantee, for the performance of engagements entered into. The subject of mercantile guarantees may, therefore, be considered of first consequence both to the commercial world and the profession of law*²⁶⁸

The significance is also felt in Kenya, this was elaborate in the case of *Barclays Bank of Kenya V. Kenya Farmers Association and Kepha Nyabera*²⁶⁹, In this case the learned Judge explained that the nature of guarantee plays a very significant role in the current business active Kenya. This is one of the ways that business people can easy get credit from a financial institution, within a short time and without a lot of technicalities involved. The fact that one can give surety on behalf on another person, so that when the principal debtor failed to pay the amount borrowed, then he will be liable. This processes enables the economies of the country grow faster. Hence the parties involved in this guarantee transaction should be protected to enable the long existence and significance of this product.

4.3 The nature of guarantee obligations

A guarantee can be well defined as a promise made by one person known as the guarantor or surety to be answerable for the due performance of the obligation of another person known as the principal or debtor should the principal fail to perform the obligation as required.²⁷⁰ Part VIII of *Contract Act*²⁷¹ defines a contract of guarantee, as a to perform or discharge the liability of a third party in case of default of that third party. In a similar way, the common law defines a contract of guarantee as “a contract whereby one person promises another person to be answerable in the event of a third person who is the principal debtor, making default in respect of a liability incurred or to be incurred by such third person to the

²⁶⁸ Walter William Fell, *A Treatise on the Law of Mercantile Guarantees and of Principal and Surety in General* (London: J Butterworth, 1811).

²⁶⁹ ,Civil appeal No.169of 2007.

²⁷⁰ Kevin McGuinness, *The Law of Guarantee*, (Markham: LexisNexis Canada Inc, 2013) 3d ed at 1.

²⁷¹ Of 2012

promise.”²⁷² This is distinct from other common forms of security such as mortgages or pledges because it only provides creditors with a promise of performance, rather than property, to which a creditor may seek recourse in the event of a default.

The nature of guarantee obligation is well elaborated in the case of *Lalji Karsan Rabadia and others v Commercial Bank of Africa Limited* ²⁷³

A contract of guarantee is an accessory contract, by which the surety undertakes to ensure that the principal performs the principal obligations. It has been described as a contract to indemnify the creditor upon the happening of a contingency namely the default of the principal to perform the principal obligation.

4.4 Capacity to give a guarantee

Any person other than a minor or mentally disordered person or an undercharged bankrupt may give a guarantee. A minor or a bankrupt may give a guarantee when acting as an agent for someone else. *Section 12 of the Contract Act*, provides that a person has a capacity to enter into a contract of guarantee where the person is eighteen years or above of sound mind and not disqualified from contracting by any law to which he or she is subject to.²⁷⁴

Giving of a guarantee by a minor was explained in the case of *Ottoman v Mawani & Ors.*²⁷⁵, in this case a minor was guarantor in a bank contract, where the father had taken a loan. The plaintiff's bank extended a loan to business owned by the defendant's father and the defendant guaranteed the amount. The fathers business was unable to pay the loan and the bank sued to enforce the guarantee, evidence of the defendant was that he under the control of the father. He worked at the fathers firm and had no independent source of income. It was held that he was not liable on the guarantee as it was voidable at his option for the fathers

²⁷² E Jenks, *Jenks' Digest of English Civil Law*, (London: Butterworths, 1921) 2d ed at para 652.
Civil Appeal No. 63 of 2012.

²⁷⁴ Contract Act 2012, S 12.

²⁷⁵ (1965)EA464.

undue influence. A minor cannot be guarantor as he is not in a position to understand the duty he or she undertakes when guaranteeing.

This was elaborated in the case of *Mohamed Gulamhussein Farzal Karmaland others v C.F.C. Bank Limited and another*²⁷⁶ where the second plaintiff claimed that she did not consent to giving the house as a security to the bank. But due to the pressure from the husband, she agreed to give her house as security. Because of the bank's bigger bargaining power coerced the husband to concede to charge the house to them due to the representation that Hyundai Motors (K) Limited was heavily indebted and the bank threatened to pursue the company itself by either winding it up, or appoint a receiver or in any other way exercise its contractual rights to recover the said money. Court held that this does not fall under the case of capacity as the parties were not minors and at the time she signed she was not mentally disordered. Though the security documents were signed under duress from the bank and the first plaintiff.

The bank would have advised the second plaintiff who is the bank to seek for an independent advice before giving the house as security. Hence this security contract was considered to be voidable due to the factor of husband and wife.

4.5 Liability of the guarantor

Unless the guarantee provides otherwise the liability of the guarantor arises when the principal debt becomes due. The guarantor will be liable from that date even if the banker does not inform him that the principal debt has become due and does not demand payment under guarantee.²⁷⁷ *Section 72 of Contract Act* provides that the liability of a guarantor shall be to the extent to which a principal debtor is liable, unless otherwise provided by a contract. The liability of a guarantor takes effect upon default by the principal debtor.²⁷⁸

The guarantor can only be liable to the amount that was borrowed by the principal debtor. Also where the principal debtor has fully paid for the amount borrowed, but still there is

²⁷⁶ Nairobi (Milimani Commercial Courts) Civil Case 3 of 2006.

²⁷⁷ Sheldon and Fidler, *practice and law of banking*, (2009) 7th edition wlbs

²⁷⁸ Contract Act 2012, Section 72.

another overdraft that he took gain. Then the guarantor shall not be held liable for the overdraft. Unless he consented to guarantee for the overdraft. Banks sometimes tend to be unfair to the guarantor, especially in loan overdrafts. This was elaborated in the case of *Ranjikantkhetshi Shah v Habib Bank A.G. Zurich*²⁷⁹ Where the bank demanded payment of money that had been borrowed but the principal debtor as an overdraft of the previous loan he had borrowed. The court held that the guarantor was only liable to the previous amount the guarantor had signed. The guarantor was only going to pay for the amount in the first contact. The fact the he had not guaranteed the overdraft the bank had no right to presume that the first guarantee contract covered the overdraft.

A person who gives a bank guarantee today usually guarantees all the liabilities of the principal debtor to the banker, including any liabilities in respect of any joint account or partnership account. If the guarantor wishes to confine his guarantee to any particular account of the principal debtor, he should ensure that the guarantee is worded accordingly. The banker should, however, be cautious about agreeing to any such suggestion and care should be taken over any necessary amendment to the standard wording. If any such amendment is agreed, the banker should ensure that the principal debtor's account is conducted in the manner contemplated by the guarantee, or he may find that the guarantor is discharged from his guarantee.²⁸⁰

So many financial institution take advantage of the fact that most guarantors do not know their rights. Hence they give them a larger liability that what the law provides. Hence the guarantor should know that he can guarantee the debt to a particular extend. As long there is proper wording in the contract of guarantee.

4.6 Rights of the guarantor

By becoming a guarantor, you become liable to pay if the borrower or lessee defaults on its repayments. This means that the creditor may, once the borrower has defaulted, require the full repayment of all the money that still owed on the loan agreement. Hence it is of great importance for the guarantor to know their rights, so as they cannot be cheated by neither the bank or the principal debtor.

²⁷⁹ Civil Case No.246 Of 2011.

²⁸⁰ Sheldon and Fidler,s "*practice and law of banking,*" (2009) 7th edition wlbs

4.6.1 Rights of the guarantor to get information about the guarantee contract

From the very moment when the guarantee is entered into, the guarantor has certain rights against the banker.

In order to protect the bank customer, against unfair terms of contract of guarantee. The bank should ensure that the guarantor is given enough information about the guarantee contract. The bank should explain in details the terms of the contract, the extent to which the guarantor is guaranteeing the principal debt. This helps the guarantor to enter the contract knowing the consequences of the default of payment of the principal debtor. *Contract Act Section 81*²⁸¹ provides that a guarantor is discharged where the eventual remedy of the guarantor against a principal debtor is impaired, because a creditor does any act which is inconsistent with the right of the guarantor or omits to do any act which his or her duty to the guarantor requires him or her to do. Hence the guarantee contract will be rendered voidable where the bank does not disclose all the relevant information. Also where the bank gives wrong information to the guarantor, that leads him or her to enter into the guarantee contract. Then the contract will be voidable. Section 85²⁸² provides that A guarantee which is obtained by a misrepresentation made by a creditor or with the knowledge and assent of a creditor, concerning a material part of the transaction, is void.

This provision protects the guarantor against the banks that do not explain, to them about their rights. And also removes the guarantor from liability in situations where there is misrepresentation.

4.6.2. Right of the guarantor to get independent advice

The guarantor has the right to get independent advice of the guarantee contract before he or she signs the contract. As much as the bank will disclose all the information required, the bank should allow the customer to get independent advice. This enables the bank customer to understand the guarantee contract without being influenced by the bank. This was explained in the case of *koileken ole kipolonka orumoi V Mellech engineering & others*²⁸³ The Plaintiff

²⁸¹ Contract Act, 2012, S 81.

²⁸² Ibid Section 85.

²⁸³ Nairobi, civil Suit No 545 Of 2014.

is the registered owner of all that parcel which the Defendant known as Mr. Gerald Wamalwa requested the Plaintiff to guarantee financial facilities. The plaintiff was not given full information about the guaranteed contract. The defendant misrepresented the terms of the guarantee. He made the plaintiff to sign for his two lands mean while he explained that he needed just one land. The Plaintiff confessed that he is illiterate, he cannot read or write in English and the contents of the charge were not explained to him. He contended that, all he can recall is that he was called by the 1st defendant's Advocate, one Ms. Winnie Wambui to go and execute documents whose content was not explained to him. The Plaintiff stated that he did not get independent legal advice on the matter because Ms Winnie Wambui advocate all along acted for the 1st defendant.

The court explained that for guarantee to be valid, the guarantor should have all the information disclosed to him. The bank should ensure that the guarantor has got all the information required from an independent advisor. In this situation the bank had no right to dispose the parcels of land that had been used to guarantee. This is because the plaintiff was not aware of the intentions of the plaintiff and her lawyer. Hence the guarantor was protected on the grounds that he signed a document that had different agreement from the one he had been told by the defendant lawyer.

The guarantor has a right when the guarantee contract is still going on to request for information from the banker. The information that may be requested include a full disclosure of the extend of liability he has towards the guarantee contract. The information that may be given does not include the amount earned or the money in the account of the principal debtor. This is because all this is covered for under the principal of bank secrecy.²⁸⁴ but he may tell the guarantor how much he would have to pay if the guarantee were to called off immediately

4.6.3 Right to recover from a principal debtor

The guarantor's right of indemnity entitles him to recover from the principal debtor the full amount he has laid together with interest and he has also entitled to recover damages for any other loss.²⁸⁵ Section 86²⁸⁶ provides that, a guarantor is entitled to recover from a principal

²⁸⁴ .See Chapter Four.

²⁸⁵ (1886) 34 Ch .D. 536.

debtor any sum the guarantor rightfully paid under the guarantee on the contract. Where the principal debtor is a company in liquidation or on bankrupt, the guarantor is entitled to interest only up to the commencement of the winding up or the date of the receiving order, irrespective of when he made his payment under the guarantee, even then the usual restriction on the maximum rate of interest on which dividends will be paid will apply.²⁸⁷ This enables the guarantor to be able to recover the amount of money they have spent in paying for the principal debtor.

Section 84 of the *Contract Act* provides that, a guarantor is entitled to the benefit of every security which a creditor has against a principal debtor at the time a contract of guarantorship is entered into, whether the guarantor knows of the existence of the security or not.²⁸⁸ This protect the guarantor against fraudulent principal debtor. They will not be able to escape from payment of their debt to the principal debtor. For the principal debtor to be able to get the security then he or she has to pay the guarantor.

4.6.4 Right to call upon the principal debtor to make payments

The guarantor has a right to call upon the principal debtor to make payments for the debt, Where the principal debt has become due, the guarantor need not to wait until the banker demands payment from him;²⁸⁹ he is entitled to call upon the principal debtor to pay the guaranteed debt, so as to relieve the guarantor from his obligation.²⁹⁰ This relief is not generally available until the debt is due, so that the guarantor cannot require the principal debtor to take provision for payments to the banker before the debt is due.

4.7. Scenario that the guarantor will be protected

Contracts of guarantee are being signed in situations where the guarantors have little or no information or are misinformed about important aspects of the transaction. The misinformation may include such as the borrower's loan or the financial soundness of the business they are supporting. Such guarantees are therefore given with an inadequate

²⁸⁶ Contract Act 2012,s 86.

²⁸⁷ Bankruptcy Act 1914,s. 66. See Chapters Twenty-nine and thirty.

²⁸⁸ Contract Act 2012, S84(2).

²⁸⁹ (1909) 2 Ch . 401.

²⁹⁰ (1983) 1 Vern .189 at p.190;Antrobus v Davidson (1817) 3 Mer .569 at p.579;Berchervaise v lewis(1872) L.R.7 C.P.372 at p. 377

understanding of crucial aspects of the transaction, which in general terms would relate to the financial viability of the business secured and the nature and extent of the liability.²⁹¹

The protection of the bank customer against unfair demands from the banks was explained in the case of *Ebony Development Co. Ltd v Standard Chartered Bank Ltd*²⁹² The court explained about joint liability in guarantee. The bank should hold the guarantors liable to the extent of the guarantee they have offered in the contract. In case of default of one guarantor, the banks should not make the remaining guarantor pay for him.

If however, the guarantor does not make inquiries of the banker with reference to matters which the banker does not have a duty to disclose, the banker must then give a straight forward reply and not one capable of being misconstrued, and give the information honestly and to the best of his ability. While the banker is not bound to disclose all that he knows about the principal debtor's dealing, he must not conceal from the guarantor any fact materially affecting the transaction between the banker and the guarantor.

This was explained in the case of *Koileken Ole Kipolonka Orumoi V Mellech Engineering & Others*²⁹³ the avoidance of a contract of guarantee by the non disclosure of material facts depends in each case upon whether, having regard to the material fact whether having regard to the nature of the transaction, and the relations of the parties, the fact non disclosure is impliedly represented not exist', and very little said which ought not have been said and very little omitted which ought to have been said will suffice to avoid the contract."

4.8. Protection of old people as guarantors

The age of the guarantor is be significant in ensuring that the he or she understands the nature of the guarantee. Exploitation of the guarantor is rampant to old people. This is because the bank knows they don't understand the nature of the guarantee. And also they may entirely depend on the bank and the person they are guaranteeing for advice. The protection of a guarantor goes to the extent of looking at the situation of how the guarantee agreement was

²⁹¹ Trade Practices Commission: *Guarantors: Problems and Perspectives*, Discussion Paper ,Australia, way back, 1990-1991.

²⁹² [2008] Eklr.

²⁹³ civil Suit No 545 Of 2014.

entered. If the guarantor agrees to guarantee but, it is done in such a way that, he does not independently decide, then it will be aground for the contract to be voidable.

In a situation where the guarantor has given the guarantee but it was given out of undue influence, then that will stand as ground, to make the guarantee contract to be voidable. A guarantor may be discharged if he can show that he was induced to enter into the guarantee by reasons of undue influence. There is a likelihood of undue influence in a situation where the guarantor has been convinced by a person he trusts and is very close, and where the banker knew that this was so. This was explained in the case of *In the case of Lloyds Bank v. Bundy*²⁹⁴. The guarantor was an old man in a poor health. He had already given two guarantees to the bank in respect of an overdraft to his son, and had mortgaged a farm, which had been in the family for generations and was his only asset, in support of the guarantees. He had been advised by his solicitor not to commit his assets beyond the figure of 6,500, the amount for which he was liable after signing the second guarantee. The assistant bank advised that he would only continue the facilities if the father gave a third guarantee and increased the mortgage on the farm. The father had relied on the financial advice of the bank manager for a long time.

The law has always recognised that there are some cases of “in-equity of bargaining power” where the intervention of the courts is required. These include cases of “undue influence”, where the stronger party gains from the relationship with the weaker some gift or advantage for himself.²⁹⁵ In some cases there is a presumption of undue influence from the relationship of the parties such as parent over child, solicitor over a client; in other cases a relation of confidence must be proved to exist.

In the case of *Bundy* the relation of confidence was found to exist because of the age of Mr. Bundy and their long relationship between the family and the bank. The bank conceded that a relation of confidentiality could arise between a banker and a customer, and the father conceded that in the normal course of transactions by which a customer guaranteed third party obligations the relationship did not arise. However, it was held that this was a case which cried out for independence advice “and in such cases the stronger party must not be allowed

²⁹⁴ (1975) Q.B.326.

²⁹⁵ (1887) 36 Ch.D.145.

to retain any benefit from the transaction unless the other person can show to have formed an independent and informed judgement.

Sachs LJ pointed out that nothing in his judgement affected the duties of the bank in the normal case where it was obtaining a guarantee and in accordance with standard practice the banker explained the legal effect and the sums involved. When the bank, as in this case, went further and advised on the wisdom of the transaction, it might then have to examine all the facts to see if the line had been crossed.²⁹⁶

Exploitation of the bank customer, as the guarantor in Kenya was explained in the case of *Gimalu Estates Ltd & 4 others v International Finance Corporation & another*²⁹⁷, Where the plaintiff was advised by the financial institution, that for the company to get financial product, then he was to give his land as security. The plaintiff was the guarantor of the company. The money that the plaintiff required for the company, was little compared to the value of the land. On the demand of the bank for payments of the loan, the plaintiff paid the amount. The bank wanted to take over the land so that they could sell it to recover the interests of the loan. The plaintiff claimed that the guarantee he had given was exactly for the money offered. The bank had not disclosed the interest that would be incurred for that financial product. He explained the bank was focused on taking the land to dispose it at a lower value. The guarantee agreement was unfair and exploitative in nature, because the bank customer was not told all the terms of the loan. The bank kept on adding on the interest until the amount became unreasonable. He was not given full disclosure of the vital information about the loan. The bank had a higher bargaining power as the plaintiff at that particular time was really in need of that money.

The court held that, the bank had a duty to allow the bank customer to seek independent advice towards the loan. And also they were supposed to disclose all the information that will facilitate the plaintiff to make a free decision on the loan. Hence the contract was unfair and though it was not arrived under undue influence, but the terms took advantage of the bank customer. The court ordered the bank not to dispose the land and also revisit the terms of the guarantee contract.

²⁹⁶ (1975) Q.B.326.

²⁹⁷ [2006] EKLK

4.8.2 Husband and wife

There is no presumption of undue influence in case of husband and wife,²⁹⁸ and the burden of proving undue influence lies on those who allege it.²⁹⁹ This was elaborated in the case of *Bank of Montreal V Stuart*³⁰⁰ here the same solicitor acted on behalf of the bank, the husband and the wife. The husband had already given the bank a guarantee in respect of the company which was the principal debtor. The solicitor was also a director, secretary and shareholder of the debtors company. The wife was a confirmed invalid, who acted throughout in passive obedience to her husband's directions, and had no means of forming an independent judgement. In a series of transactions spread over eight years she changed all her extensive real and personal estate to the bank as security for the liabilities of the company for which the husband had already exhausted his own assets. The court found that these transactions could not stand, as the wife was under the husband's influence and the solicitor was in a position in which he could not advise fairly. The lawyer ought to have endeavoured to advise the wife and place her position and the consequences of what he was doing fully and plainly before her. Probably, if not certainly, she would have rejected his interventions. And then he ought to have gone to the husband and insisted on the wife being separately advised, and if that was an impossibility owing to the implicit confidence which Mr Stuart reposed in her husband, he ought to have retired from the business altogether and told the bank why he did so.³⁰¹

This was elaborated in the case of *Mohamed Gulamhussein Farzal Karmaland others v C.F.C. Bank Limited and another*³⁰² The plaintiff claimed that she did not consent to giving the house as a security to the bank. But due to the pressure given by the husband about the company however due to the banks bigger bargaining power coerced the 1st plaintiff and myself to concede to charge the house to them due to the representation that Hyundai Motors (K) Limited was heavily indebted and the bank threatened to pursue the company itself by either winding it up, or appoint a receiver or in any other way exercise its contractual rights to recover the said money. Court held that this does not fall under the case of capacity as the

²⁹⁸ (1934) A.C. 468.

²⁹⁹ (1852) 5 De G.&Sm.377

³⁰⁰ (1910) ukpc 53,(1911)AC120

³⁰¹ (1910) ukpc 53,(1911)AC120

³⁰² Nairobi (Milimani Commercial Courts) Civil Case 3 Of 2006.

parties were not minors and at the time she signed she was not mentally disordered. Though the security documents were signed under duress from the bank and the first plaintiff.

The bank would have advised the second plaintiff who is the bank to seek for an independent advise before giving the house as security. Hence this security contract was considered to voidable due to the factor of husband and wife.

It is very important in protection of a bank customer to ensure that when it come to a guarantee contract between the spouses, the bank must ensure that they are independently advised. This will enable them to make their decisions independently. This will protect the bank customers from making decisions that will that in reality when left for him or herself he wouldn't have.

In all cases where independent advice is sought at the request of the bank, it would be wise to have the signature on the guarantee witnessed by the solicitor. In such cases the solicitor should, either on the guarantee which he witnesses or in a separate letter, acknowledge that he explained the nature and effect of the document and the signing , and what obligations he or she was undertaking , before he or she signed the guarantee.

The relationship between a husband and wife is unfair to bank customers. For a customer to be protected and make independent decision, he or she is not supposed to be under any pressure. Undue influence that is generated from husband and wife relationship, affects the independence of the contract. In most of the relationships, the wife always respect the decision of the husband. When she is told to be a guarantor to a loan that has been taken by the husband, the bank should ensure that the spouse is independently advised. The wife should get all relevant information required for that loan. She should get advice from a lawyer alone so as to get legal advice. If not advised this will render the contract voidable as, the guarantor will have entered the guarantee contract under undue influence.

4.8.3 Avoidance by reason of mistake

A guarantee contact that has been signed by a bank customer, may be voidable when he can prove that there was misrepresentation. This occurs when a the guarantor does not know how to read or blind. Where the fact explains differs from what is contained in the document then the guarantee contract will be invalid. This was elaborated in the case of

This was elaborated in the case of *Koileken Ole Kipolonka Orumoi V Mellech Engineering & Others*³⁰³ where the court explained that

...if a blind man or one who cannot read , or one who for some reason forbears to read, has a written contract falsely read over to him. The reader misreading to such a degree that the written contract is of a nature altogether different from the contract pretended to be read from the paper which the blind or illiterate man afterwards signs. Then at least if there be no negligence, the signature so obtained is of no force .And it is invalid not merely on the ground of fraud, where fraud exists, but on the ground that the mind of the signer did not accompany the signature. In other words, that he never intended to sign, and therefore in contemplation of law never did sign, the contract to which his name is appended.

This was elaborated further in another Kenyan case of *Peter Njuguna Njenga ,Njenga Kabunyi and Others v Equity Bank Limited*³⁰⁴, Court held that the contract was voidable due to mistake, hence protecting the guarantor from being defrauded. The facts of the case are as follows, the plaintiff was advised by the one Mr Njenga to give out his land to be used as a security to get a sum of nine hundred thousand Kenyan shilling, But in reality that was not the situation, but instead he was given by Mr. Njengas lawyer an entirely different contract to sign, where he was allowing Mr Njenga to use his land to secure twelve million from the bank. The plaintiff used the plea of *non est factum* as a defence. *The court held that the contract was voidable as he was not aware of some particular cause of the contract.*

³⁰³ Nairobi Civil Suit No 545 of 2014.

³⁰⁴ ELC NO. 886 OF 2012.

In *Saunders v. Anglia Building Society*,³⁰⁵ the house of Lords decided that where a person signed a document, the plea of non est factum can only succeed if he can show that the document which he signed was not the document he intended to sign and that when he signed the document he was not acting carelessly.³⁰⁶ By proving that the plea of non est factum shall succeed to protect the bank customer.

4.9 Conclusion

A guarantee contract makes a third party to give his or her assets to the bank as security for a loan that is given to a borrower. Most of the time guarantor is exploited by the bank by not being given full information about the product. The banks do not explain to the guarantor the nature of the product, the rates that will accumulate in case of default. And the consequence of both the principal debtor and the guarantor failure to pay the loan. This puts the guarantor in an unfair position. As they can easily lose their assets because of the unfair terms in the guarantee contracts.

Using the Kenyan *contract Act* 2012, helps the bank customer to be protected against fraudulent financial institution. It provides for instances that the bank customer will not be liable, when the principal debtor has failed to pay the loan, hence protecting the bank customer. In Kenya, though not fully implemented, in the banks. But the courts have made several decisions in favour of the guarantor. Hence protecting the bank customers against unfair banking contracts.

³⁰⁵ (1970)3 All E.R. 961 (affirming *Gallie v. Lee* [1969]1 All E.R.1062); see also *Lyonnais v. P. T. Bernard & Associates* [1976]1 Lloyd's Rep. 557.

³⁰⁶ *Ibid.*

CHAPTER FIVE

FINDINGS AND RECOMMENDATIONS

5.1 Introduction

This chapter presents the findings and recommendations and conclusion of the study. The conclusion goes hand in hand with the objectives of the study, they include; to study the existing banking laws in Kenya and explain how effective they have protected the customer in Kenya .An analysis of the implementation of the existing laws banking laws, and how the existing bodies and financial institutions abide by them. To give recommendations on the steps to be taken to bring improvement in bank customer protection in Kenya.

An efficient financial system facilitates the optimal allocation of resources. When financial institutions and financial markets are efficient, capital is allocated to the most promising projects which are expected to offer the highest, risk-adjusted returns. In addition, a wide array of financial instruments allows savers and investors to achieve their preferred trade off between risk and return. Confidence in the financial system encourages investors to allocate their savings through financial markets and institutions rather than to invest in non-productive assets in order to hedge against inflation or the risk of financial collapse. As noted above such confidence requires not only some regulation, but also sufficient flexibility to adapt to market needs and opportunities.

5.2 Study findings

Though there laws that exist, in relation to banking and how the banking business is conducted in Kenya,still Kenya as a country lacks enough regulations that will enable fully protect the bank consumers. A good elaboration as explained in Chapter Two above; where they provide for protection of bank customer protection, like the *Banking Act* the provides for how banks should work and how they should offer their services,³⁰⁷ Also the *Central Bank of Kenya Prudential Guidelines for institutions licensed under the Banking Act*, has provisions on transparency, where the bank has a duty towards the bank customer to disclose

³⁰⁷ The Banking Act Cap 448.

all the information that is necessary for him or her make her decision in relation to the financial product. Also on loan recovery where the banks are bared to take advantage of the bank customer in case of failure to make repayments of his loan. Even though the bank is allowed to come and make demands, they are not allowed to give unnecessary expenses and also to take the bank customer properties in a manner that will leave him or her without the basic necessities of life.³⁰⁸As much as all this regulation exists, the law that is related to customer protection are not fully covered. Kenya lacks one particular statute that will have all laws that protect a consumer in financial services.

The consumer participation has been absent in many of the financial institutions in the country. The fact that the bank customer cannot participate through giving complains, hinders the bank customer protection. When the bank customers participate in financial institution, it will enable the service providers to get there complaints or suggestions and be able to make improvements in ensuring they get quality services. Lack of participation is attributed financial illiteracy. This is because the financial consumer do not know that they have a right to participate in issues concerning the institutions they save money institution. Lack of information makes them venerable and can easy be taken advantage of. That is the reason, the banks create websites that will enable them to write and post their suggestions and complaints.

Uncertainty about available options for recourse, and the legal basis in the consumer financial services. The bank customers do not know where and how they can get recourse in case they have been deprived of their rights. The recourse systems in place are not friendly or timely, redress requires hiring of a lawyer. They are very expensive and it takes a lot of time before the case has been settled. This makes the financial consumer to suffer.³⁰⁹

Financial consumers are often confronted with the problems of ‘Hidden fees and rates. Most of the banks do not give a detailed explanation about the fines a customer may incur in case of failure to pay. The banks take advantage of defaulting clients and bring fines that were not explained at the time of entering into the contract. The bank start introducing fines and excess

³⁰⁸ Central Bank Prudential Guidelines for institutions licensed under the Banking Act.S 4.

³⁰⁹ Mr. Daniel Asher , consumer protection conference ‘(3rd annual Africa dialogue for Abuja ,Nigeria sept 13th – 15th 2011 ,).

interests hence making it difficult for the bank customers to repay the loans. On-standardized terms of financial services making financial products difficult to evaluate for rational consumer choices and Lack of a pre-defined standard of recourse.³¹⁰

5.3 Recommendations

The recommendations based on the findings of the study, the researcher recommends the following. If this recommendations are applied by the legislature, the financial institution and the independent bodies that are responsible for ensuring implementation, then the bank customers will enjoy protection.

5.3.1. Financial literacy

Bank Consumers have suffered from the unfair and unreasonable terms of the banks . Such service providers, when offering a product, end to put terms that compromise the safety of the property offered as security. The banks introduce new terms and conditions on the bank customer that makes it difficult for them to repay their loans. The unfair terms includes change of the payment time, change of the interest rates charged and extra charges that occur as fines of services that are offer to the customer.

Because of the impossible task of monitoring all financial services providers especially the informal ones, it is recommended that financial literacy is the key. A financially literate person, it is assumed, is able to evaluate financial products and services and avoid those which are costly, exploitative, unnecessary or even fraudulent. Financial literacy is the sure safeguard and the best financial protection measure. The only problem is how financial education can easily reach the poor to help them in literacy and build their financial capability.³¹¹

In providing for education about banking, the financial services providers cannot be expected to provide bank customer education. Though there is a global campaign to design financial products and services with consumer welfare in mind complete with full disclosure of adverse or cautionary element that consumers need to know. In Kenya, the insurance industry is calling for self regulation and there is a consumer protection law in the pipeline to tame

³¹⁰ Supra Note 309.

³¹¹ Ibid.

financial services providers who ignore the welfare of consumers by capitalizing on their ignorance.

The next necessary step is that financial literacy should be taken to the next level. Currently, in Kenya, Financial Education and Consumer Protection Partnership (FEPP) funded by the government. It is championed by the Central Bank of Kenya with Financial Sector Deepening (FSD) providing research support. FEPP's mandate is to promote financial education and consumer protection ensuring that the necessary laws supporting the two areas are legislated and strategies of reaching the poor with financial education designed and executed.

5.3.2 Disclosure of information

It recommended that the banks should give full disclosure of information in guarantee contracts. This is meant to protect the bank customer against unfair credit provides. Before a guarantee is signed by the guarantor, the credit provider must give to the prospective guarantor, a copy of the contract document of the credit contract or proposed credit contract; and a document in the form prescribed by the regulations explaining the rights and obligations of a guarantor.

This being a condition that will determine whether the guarantee contract is valid or not, will give protection to the bank customers. The bank customers understand the if information has not been given to them, that renders the contract void. This recommendation gives the banks conditions the touch the validity of the guarantee contract. Hence by applying the provisions, the bank customer will be able to make a decision about being a guarantor, when he or she has enough information. A guarantee is not enforceable unless the bank disclosed to the guarantor all the necessary information.

If this proposal be used it coming up with An act that is meant to protect the bank customer against the credit providers. The bank customers will be protected, and this will encourage economic growth in Kenya.

5.3.3 Need for enforcement agency and faster handling of customers complaints

Kenya needs an enforcement agency with a market-wide protection mandate to protect all financial consumers .A separate market conduct regulator should be established within the

Central Bank. This body should be given a responsibility to supervise and regulate the conduct of all financial institutions and their dealings with customers.

In order to implement on the protection of the bank customer. The parliament should pass a new law that comes up with roles and duties of the regulator. There would be need to lobby to get the support of the government because such a venture would require financial support from the government.

The market conduct regulator should also be responsible for training both financial institutions and the consumers such that there is increased financial literacy. The enforcement agency will be, responsible for increasing the awareness of financial consumers about product characteristics and risks pertaining to the financial products to increase consumers' ability to make informed decisions.

The financial enforcement agency should also provide a platform through which customers can lodge complaints against providers of financial services who have failed to comply with consumer protection guidelines. The enforcement agency can archive this through establishing the office of the ombudsman who receives complaints from consumers and investigates financial crimes at no cost to the consumer. They will be able to handle customers complaints faster and cheaply. This will ensure compliance of the credit provider.

By handling disputes between the bank and bank customer, there will be protection of the customer against unfair term in their contract.

The enforcement agency should also carry out regular surveys and inspections to guarantee continuous compliance after financial institutions have been licensed to operate. Where institutions are found to have fallen short of expected standards, the enforcement agency should be mandated to cause the institutions to compensate consumers for any loss arising from their failure to comply with consumer protection guidelines or to terminate their licenses.

5.3.4. Responsible lending

The Central Bank of Kenya should ensure there is responsible lending. It is proposed that the licensed bank should have a role to play in ensuring that there is responsible lending. It is recommended that there should be rules that apply to licensees that provide credit assistance

in relation to credit contracts. These rules should be aimed at better informing consumers and preventing them from being in unsuitable credit contracts.

This requires a licensee to give its credit guide to a consumer. The credit guide has information about the licensee and some of the licensee's obligations. There should be requirement of a licensee to give a quote before providing credit assistance to a consumer. The quote must set out the maximum amount the consumer will be required to pay to the licensee. The licensee must not charge more than that amount. Another requirement is a licensee, before providing credit assistance to a consumer in relation to a credit contract, to make a preliminary assessment as to whether the contract will be unsuitable for the consumer. To do this, the licensee must make inquiries and verifications about the consumer's requirements, objectives and financial situation. The licensee must give the consumer a copy of the assessment if requested.

When a licensee, is providing credit assistance to a consumer in relation to a credit contract, to give the consumer a document that discloses certain information ,for example, the commission the licensee is likely to receive. This will enable the bank customer to have a bargain when negotiating for the interest of the loan. In responsible lending there should be provision that prohibits the licensee from providing credit assistance to a consumer in relation to a credit contract if the contract will be unsuitable for the consumer. This give a responsibility to a credit provider to make n inquire about the customer. Hence protecting the against liabilities that they cannot pay.

5.3.5.Penalties to credit providers

It is proposed that there should be penalties for credit providers. The breach of a bank not providing information to the bank customer attracts a fine and punitive damages the will be given to the bank customer. It is proposed that a party to a credit contract or a guarantor may apply to the court for an order of penalty. Penalty may be imposed for contravention of key requirement .The court must, on an application being made, by order declare whether or not the credit provider has contravened a key requirement in connection with the credit contract or contracts concerned.

After asserting there was a key contravention of a key requirement in the contract, the court may make an order, requiring the credit provider to pay an amount as a penalty. The court may give compensation to the bank customer. It is proposed that there should be compensation of the Bank customer. The court may, on application by a debtor or a guarantor, order that the credit provider pay to the debtor or guarantor an amount by way of compensation for loss arising from the contravention of a key requirement. This is very significant in the protection of the bank customer. The bank will deal with customer with due diligence as a contravention of a key requirement will attract compensation to the bank customer.

The court may only order an amount to be paid by way of compensation if the debtor or guarantor satisfies the court that the debtor or guarantor has suffered a loss arising from the contravention. The amount of compensation is not to exceed the amount of the loss.

5.3.6. The role of banking Associations

It is proposed that the banking associations in Kenya should have a say in ensuring that a bank customer is protected. They should be given freedom to investigate the banks and look at how they provide their services to the bank customer. They should have the ability to point out a particular infringement of the bank customers rights, and even have the powers to give a penalty to the defaulting bank.

It is recommended that the banking association should be able to have meetings, like twice in year. This meetings or seminar will be aimed at bench marking and training the bank personnel. The association will be able to train the bankers on bank customer protection and interact with other banks from other countries that have a good bank customer protection laws. This will improve the state of bank customers in Kenya as exposure of the stuffs will, equip them with valuable skills and information.

5.3.10 The role of Consumer Protection Association of Kenya.

The consumer protection in Kenya plays a vital role in consumer protection. Its mission is to empower people to make informed choices on safe and suitable goods and services and protect the consumer against unfair practices in the market place. They ensure that individual and collective rights are secured and respected.

The role the association plays is generally all type of consumers. It is suggested that the association should have a division that deals with bank customer protection. Where the bank customer can bring in complains of the infringements being experienced. The association can assist in ensuring that the bank customer has provided legal help from an affordable lawyer. And justice is granted to the Bank customer. By doing this the bank customer will have confidence in the banking industry. As they will be guaranteed in case there id a breach of contract, of unfair term in a loan. Then the association will be able to assist.

5.4.Conclusion

Having looked at the laws available to protect the bank customers and how are they applied to ensure that the bank customer is protected in Kenya. Chapter three discussed on bank customer protection in Kenya, that is if the bank customers are protected in Kenya. The study showed that though there exists some regulation that cover for the protection of the bank customer. They are not detailed enough to ensure bank customer protection. On implementation of existing laws, the banks do to adhere by the existing law to the latter. In chapter four the study explained about bank customer protection in a particular bank product, guarantee in relation to bank customer protection. Here the study explained how the guarantor and the principle debtor are protected from the bank higher advantage of taking the available security or the demand from the guarantor in case of default of the principle debtor. The study explained the principal debtor is more protected by the fact that the guarantor give a surety that he will pay when the principal debtor fails to pay. This put the guarantor in a venerable state as the will hold him liable in case of any default by the principal debtor. The guarantor is well protected in relation to the laws available. But this protection is not practical, as the case law in Kenya shows many instances where the bank customer has been deprived by the banks on the virtue that they have guaranteed the principled debtor when he took a loan from the bank. With such weakness in the banking industry in Kenya, the has given recommendations that are meant to guide in making new laws and improving on the existing once. The recommendations are going to aid the bank customer to know there rights hence, they will not be taken advantage of by the banks. This is because, after being educated about the bank products in the best language they understand, they can be able to take choices of the bank products willingly. Bank customer protection will help to build confidence on the products they have taken because they have enough information about them.

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