Financial Services Sector Report

Q4 2024

MMAN ADVOCATES

REPORT OF REGULATOR CIRCULARS, GUIDELINES, LEGAL NOTICES, POLICIES, PRACTICE NOTES AND REQUESTS FOR STAKEHOLDER COMMENTS OR PUBLIC PARTICIPATION FROM 1ST OCTOBER 2024 TO 31ST DECEMBER 2024

1. INVESTMENTS

On 14th October 2024, the Capital Markets Authority issued a Circular to all capital market licensees and market intermediaries requesting proposals for any amendments or improvements to the Capital Markets (Corporate Governance) (Market Intermediaries) Regulations 2011. Submission of feedback closed on 31st October 2024.

2. RETIREMENT BENEFITS

The Retirement Benefits Authority published a Communique to all Stakeholders of the Retirement Benefits Industry on the reforms introduced through the Tax Laws (Amendment Act) 2024, whose effective date was 27th December 2024. Some of the key provisions of the Act highlighted in the communique include:

a. Increase in the tax-deductible contribution limit by 50%; from KES 240,000 annually (i.e., KES 20,000 per month) to KES 360,000 annually (i.e., KES 30,000 per month).
b. A tax-deductible limit of up to KES 15,000 per month has been introduced, for contributions to post-retirement medical funds;
c. Pension benefits from registered schemes are now exempt from income tax for individuals who:
    - Have reached the retirement age as defined by their scheme
    - Withdraw before the retirement age due to ill health
    - Withdraw after at least 20 years of membership
d. Individual retirement funds, pension funds and provident funds are now required to register exclusively with the Retirement Benefits Authority, eliminating the previous dual registration requirement with the Kenya Revenue Authority.

ACTS PUBLISHED BETWEEN 1ST OCTOBER 2024 TO 31ST DECEMBER 2024

1. BANKING

The Business Laws (Amendment) Act, 2024 (**find the link here**) has amended several acts as follows:

The Banking Act, CAP 488

a. **Penalties for non-compliance**

Under the Act, the Central Bank of Kenya has the mandate to prescribe penalties for non-compliance with the Act, the Prudential Guidelines and its directions via regulations. With the amendment These penalties shall not exceed twenty million shillings in the case of banking institutions. With the amendment, the penalty for non-compliance by banking institutions shall not exceed the higher of twenty million shilling or three times the gross amount of monetary gain made or loss avoided by the failure or refusal to comply whichever is higher. This means that the financial consequences of non-compliance can be substantial as it can be directly tied to the benefit gained or losses avoided.

b. Minimum capital requirements

Prior to the gazettement of the (Amendment) Act, banks, financial institutions and mortgage refinance companies were required to at all times maintain a core capital of at least Kenya Shillings Two Hundred and Fifty Million. Under the Act, core capital includes permanent shareholders' equity from fully paid-up shares (for local banks), permanent shareholders' equity from assigned capital (for foreign banks), plus all disclosed reserves and minus goodwill or any other intangible assets. General provisions which are held against future and presently unidentified losses do not form core capital.

With the amendment, the minimum core capital requirement has been amended upwards to at least Kenya Shillings Ten Billion for banks and mortgage finance companies. Compliance with the capital requirement shall be subject to annual adjustments over a five-year period. Effective 31 December 2024, banks and mortgage refinance companies are required to have a minimum core capital of Kenya Shillings One Billion.

The Central Bank of Kenya Act, CAP 491

a. Regulation of non-deposit taking credit business

The Central Bank of Kenya Act has been amended to provide for regulation of non-deposit taking credit businesses by the Central Bank of Kenya. The Bill introduces defined terms such as buy now pay later", "credit provider "on-deposit taking credit business", "non-deposit taking credit provider", "peer to peer lending" and "specified credit guarantee business" with regards to consumer credit. Additionally, the Act has been amended to expand regulation to all non-deposit taking credit providers. This will ensure that all non-deposit taking credit providers which were previously unregulated, are regulated by the Central Bank.

The Act has also provided for the licensing and approval by the Central Bank of the conduct of a credit guarantee business (the business of providing a guarantee to a lender through an absorption of the lender's risk on a credit facility made to borrower in case of default). It also sets out the additional powers of the Central Bank regarding regulation of credit guarantee businesses.

The Microfinance Act, CAP 493C

a. Exemption on non-deposit taking business

The Microfinance Act has been amended to remove non-deposit taking microfinance business from the ambit of the Act. This is as a result of the amendments made to the Central Bank of Kenya Act which now provides for regulation of non-deposit taking business.

The Act has also been amended to now include provisions on the qualifications for carrying out of non-deposit taking microfinance business i.e. registration under the Companies Act and licensing under the Microfinance Act.

The Act sets out a six-month transitional period for non-deposit taking microfinance institutions to comply with the amendments resulting from the amendment Act.

2. FINTECH

The Tax Laws (Amendment) Act, 2024 (**find the link here**) has amended several acts as follows:

The Income Tax Act, CAP 470

a) **Taxation of income earned from a digital marketplace**

The Act has been amended to provide that income paid out by a resident or non-resident being the owner or operator of a digital marketplace or platform in respect of digital content monetization, goods shall be deemed to be income which accrued in Kenya and shall be subject to income tax. A digital platform or marketplace has been defined as a digital platform or website that facilitates the exchange of short-term engagement, freelance

or provision of a service between a service provider who is an independent contractor or freelancer, and a client or customer.

With this amendment, the withholding tax rates for owners and operators of digital marketplaces or platforms shall be 5% for payments made to residents and 20% for payments made to non-residents.

b) **Significant economic presence tax**

The Act introduces a new tax known as Significant Economic Presence tax to that is payable by a non-resident person whose income from the provision of services is derived from or accrues in Kenya through a business carried out over the digital marketplace. This amendment replaces what was previously the Digital Service Tax with Significant Economic Presence Tax. A non-resident person shall be considered to have significant economic presence where the user of its service is located in Kenya. There are certain exemptions to this tax such as:

(i) services offered by a non-resident person through a permanent establishment;
(ii) non-residents that generate an annual turnover of less than five million shillings;

The rate of tax in respect of significant economic presence tax shall be 30% of the deemed taxable profit. The taxable profit shall be deemed to be 10% of the gross turnover. This is a significant increase from the previous Digital Service Tax which was calculated at a rate of 1.5% of gross transaction value.

The Excise Duty Act, CAP 472

c) **Introduction of excise duty for digital lenders**

Excisable services offered in Kenya by a non-resident through a digital platform shall now be subjected to Excise Duty. This amendment had been introduced previously under the Finance Bill, 2022 but was challenged by the Digital Financial Services Association of Kenya. The Excise Duty shall be paid by the non-resident person offering the service.

The Excise Duty payable shall be calculated on the fees charged by digital lenders at a rate of 20%. The fees charged by digital lenders shall include any fees, charges or commissions charged by digital lenders relating to their licensed activities but does not include interest, pre-loan interest, post-loan interest, return on loan or any share of profit or an insurance premium or premium based or related commissions specified in the Insurance Act CAP 487 or its regulations.

3. INVESTMENTS

The Business Laws (Amendment) Act, 2024 (**find the link here**) has amended the Special Economic Zones Act, CAP 517A to address the visibility of benefits to be enjoyed by the investors within the Special Economic Zones for a given period of time.

Previously the Act was silent on the validity period of the incentives and tax benefits granted to a licensed special economic zone developer, operator or enterprise. This period has now been limited to a period not exceeding ten years from the date of issuance of the special economic zone licence.

Investors should be aware of the ten-year period. Once the same has lapsed, incentives and benefits such as stamp duty exemptions, business permit fees, exemption from certain operational licences and work permits will no longer apply.

HIGHLIGHTS OF THE RELEVANT HIGH COURT CASE LAW FOR THE FINANCIAL SERVICES SECTOR – Q4 [2024]

Prime Bank Limited v Jessa & 3 others (Commercial Case E721 of 2021) [2024] KEHC 13414 (KLR) (Commercial and Tax) (25 October 2024) (Judgment)[1]

BACKGROUND:

Prime Bank Limited ("**the Plaintiff**") commenced legal proceedings against Zulifkar Haiderali Jessa ("**1st Defendant**"), Nasir Jessa ("**2nd Defendant**"), Hands of Green Investments Limited ("**3rd Defendant**"), and WE Tilley (Muthaiga) Limited ("**4th Defendant**") seeking recovery of various loans facilities advanced to Value Pak Foods Limited ("**the Borrower**"), which had since been placed in liquidation.

The loan facilities were secured by (inter alia) personal guarantees from the 1st and 2nd Defendants, corporate guarantees from the 3rd and 4th Defendants, and legal charges over properties belonging to the 3rd Defendant.

The Borrower defaulted on servicing the loan facilities thus causing the Plaintiff to seek enforcements of the guarantees issued by the 1st, 2nd, 3rd and 4th Defendants and recover:

(a) EUR.2,249,620.92 with interest at the rate of 13% p.a.; and

(b) Kshs.3,556,359.53, with interest at the rate of 22% p.a.

PLAINTIFF'S CASE:

The Plaintiff's case was that it had advanced the loan facilities to the Borrower on the strength of the guarantees executed by the Defendants. Upon the Borrower's default, the Defendants, as guarantors, became liable to settle the outstanding loan balances. The Plaintiff argued that the Borrower's liquidation did not extinguish the liability of the guarantors, as the guarantees were explicit in stating their continued enforceability.

THE DEFENDANTS' CASE:

In opposing the claim, the Defendants contended that the guarantees sought to be enforced by the Plaintiff were rendered void following the Borrower's liquidation. They submitted that the Plaintiff ought to have participated in the Borrower's liquidation proceedings or joined existing suits involving the Borrower. Additionally, the Defendants sought solace on injunctive orders issued in a separate case, *Milimani HCCC No. 522 of 2015,* arguing that these orders had prevented them from servicing the loans due from the Borrower.

ISSUES FOR DETERMINATION:

The Honourable Court framed the following as the issues for determination:

1. Whether the failure to join the Borrower to the proceedings was fatal to the Plaintiff's suit.
2. Whether the guarantees executed by the Defendants were extinguished when the Borrower was placed in liquidation.
3. Whether the Plaintiff had proved its case to the required standard.

HELD:

Non-joinder of the Borrower did not Render the Plaintiff's Suit fatal

The Defendants had failed to raise this issue in their pleadings or witness statements. Thus, the Honourable Court rejected the argument and emphasized that the Defendants were bound by the facts pleaded in the Statements of Defence.

[1] Available at https://new.kenyalaw.org/akn/ke/judgment/kehc/2024/13414/eng@2024-10-25 accessed on 17 December 2024.

The Guarantees were not Extinguished by Borrower's Liquidation

The Honourable Court found that the guarantees explicitly provided that they would remain valid and enforceable even in the event of the Borrower's liquidation or insolvency. As guarantors, the Defendants could not escape liability by invoking the Borrower's liquidation as defence. Further, the Honourable Court noted, guarantees are binding commercial contracts, and guarantors are obligated to honor their commitments made therein unless proven otherwise.

The Plaintiff had proved it case to the Required Standard

After evaluating the evidence, the Honourable Court held that the Plaintiff had proved its case on a balance of probabilities. In the court's mind, the evidence adduced sufficiently demonstrated that the Borrower defaulted, and the Defendants, as guarantors of the loan facilities, were liable to settle the Borrower's outstanding liabilities.

Thus, the Honourable Court entered judgment in favor of the Plaintiff as follows:

1. EUR.2,249,620.92 with interest at the rate of 13% p.a.; and
2. Kshs.3,556,359.53, with interest at the rate of 22% p.a.
3. Costs of the suit plus interest at court rates.

RATIO OF THE CASE:

The decision reinforces the following principles:

(a) Guarantees are binding contracts, and guarantors remain liable for a borrower's obligations, even in the event of insolvency or liquidation, if the terms of the guarantee explicitly provide for such continuity.

(b) A creditor has the right to pursue guarantors directly without first exhausting claims against the principal borrower or participating in liquidation proceedings.

(c) Guarantor liability is independent of the status of the borrower.

CONCLUSION & IMPLICATION:

This decision is significant for players in the financial services sector in the following ways:

(a) It reaffirms the enforceability of guarantees, ensuring that guarantors cannot evade liability by relying on the insolvency or liquidation of a borrower.

(b) It reinforces that lenders have the discretion to pursue guarantors directly without participating in liquidation proceedings or exhausting remedies against the borrower.

(c) It underscores the importance of having well-drafted guarantees that explicitly outline the guarantors' obligations, including their continued liability in the event of borrower insolvency or liquidation.

For finance institutions, this decision provides certainty on the enforcement of guarantees, which are critical instruments in mitigating credit risk. It also serves as a reminder on the importance of ensuring that guarantee clauses are clear and robust to withstand legal challenges, particularly in borrower insolvency or liquidation scenarios.

RECOMMENDED ACTION:

We recommend that our clients review their existing contracts of guarantee to ensure they distinctly address guarantor liability in cases of borrower insolvency or liquidation. This proactive step will help protect against potential challenges and bolster recovery efforts against guarantors.

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