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**TASK FORCE ON THE DEVELOPMENT OF  
REGULATIONS FOR NON-DEPOSIT TAKING SACCOS**

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**FRAMEWORK STATEMENTS**

APRIL 10<sup>TH</sup> 2019

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## 1.0 INTRODUCTION

The framework statements explains the legal basis and policy rationale informing the making of the regulations for non-deposit taking Saccos. Section one explains the legal powers to make these regulations and the establishment of the taskforce to develop the regulations

Section three provides a summary of the prudential and operational standards proposed for the specified non-deposit taking Saccos.

This includes the task force understanding of the Sacco business and the scope of work required under this appointment. The part ends with the limitations to the completion of this task within the stipulated timeline.

### ***1.1 Power to Make Regulations under Section 3(1)(b) of the Sacco Societies Act***

By way of a *Gazette Notice 12771 dated 2<sup>nd</sup> December, 2018* and published in the Kenya Gazette Issue No. Vol. CXX – No. 152, the Cabinet Secretary for Industry, Trade and Cooperatives issued a notice of intention to make regulations under the provisions of Section 3(1)(b) of the Sacco Societies Act (SSA) as read with Section 68(1) thereof.

Section 3(1)(b) of the SSA inter alia provides that, the Cabinet Secretary *may make regulations*: -

- a) specifying the non-deposit taking business to which the SSA applies; and
- b) prescribing measures for the conduct of the specified business.

Section 68(1) of the SSA on the other hand provides that the Cabinet Secretary shall, *in consultation with the Authority, make regulations generally for the better carrying out of the provisions of the SSA.*

From the foregoing, it is clear that the Cabinet Secretary, in consultation with the Sacco Societies Regulatory Authority (Authority); is empowered by Section 3(1)(b) and 68(1) of the SSA to make regulations specifying the non-deposit taking business to which the SSA shall apply; and also prescribe the measures

for the conduct of such business, as well as any other matter for the better carrying out of the provisions of the SSA.

### ***1.2 Establishment of the task force to formulate the draft Regulations***

By way of the same Gazette Notice, the Cabinet Secretary appointed a task force to draft the subject regulations. The task force is composed of ten (10) persons representing different key institutions drawn from the Sacco industry. The members of task force and the institutions they represent are listed in

## ***2.0 Understanding the Terms of Reference***

This section explains in detail the legal context for the regulations and the task force understanding of the non-deposit taking Sacco business.

### ***2.1 The Contextual Legal Analysis***

The *Savings and Credit Cooperative societies*, represented by the acronym SACCOs, are one of the most important and often visible typology of cooperatives in Kenya. Their distinguishing and unique character trait from other types of cooperatives is the object and purpose for which they are incorporated, which is to transact the *business of mobilization of savings, and advancement of credit facilities to their members*. This unique business undertaken by SACCOs in what is referred to, under the Sacco Societies Act as “Sacco business”<sup>1</sup>.

Sacco business has been defined under the SSA to mean “*financial intermediation and any other activity by a Sacco society based on co-operative principles and in accordance with this Act, or in compliance with Islamic law by way of:*

- a) receipt of withdraw-able deposits, domestic money transfer services, loans, finance advances and credit facilities; or*
- b) receipt of non-withdraw-able deposits from members and which deposits are not available for withdrawal for the duration of the membership of a member in a Sacco society and may be used as collateral against borrowings providing finance and domestic money transfer services;*

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<sup>1</sup> . See Section 2 of the SSA

Consequently, the SSA recognizes two types of business that together comprise “*Sacco business*”. These are the *deposit-taking business*; and the *non-deposit taking business*<sup>2</sup>. It is therefore easy to note from the foregoing provisions of the SSA that the distinguishing factor or characteristics between the two types of *Sacco business*, is the nature of deposits that are involved.

In the first case are the *deposit-taking business*, which is defined under the SSA as:

- a) *a Sacco business in which the person conducting the business holds himself out as accepting deposits on a day-to-day basis; and*
- b) *any other activity of the Sacco business which is financed, wholly or to a material extent, by lending or extending credit for the account and at the risk of the person accepting the deposit, including the provision of short-term loans or funding or in compliance with the Islamic law.*

On the other hand, the *non-deposit-taking business* is defined under the SSA in the negative terminology of “*Sacco business, other than deposit-taking business*”.

Consequently, the key restriction that distinguishes the two businesses is the fact that under the non-deposit taking business; the component of *receipt of withdraw-able deposits*” is absent. Consequently and in conclusion, the Sacco business in respect of which Regulations to be made under Section 3(1)(b) of the SSA, must be understood to mean “**SACCO business as defined in SSA, BUT which excludes the receipt of withdrawable deposits**”, and it is on this basis that the task force proceeds.

But what is “**withdrawable deposits?**” As shown above in Section 2 of the SSA above, two types of deposits are identified and defined. The key distinguishing factor however is the purpose of the deposits received and the point in time when each is withdrawable.

In the first instance are the **withdrawable deposits**. These deposits can be accessed by a member of the SACCO Society at any time and on demand, without the member losing his or her membership in the SACCO. They are like the usual

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<sup>2</sup> . See section 2 of the SSA

savings made with commercial banking institutions, except that in this instance, the savers are members of the SACCO and not just customers. They are popularly called FOSA savings within the SACCO practice lingo.

On the other hand are the ***non-withdrawable deposits***. These deposits are periodically received by the SACCO Society from the members, purposely to be used as collateral for any loan or credit facility that the member may obtain from the SACCO. These deposits are therefore not withdrawable. They are only refundable, upon the member exiting the membership of the SACCO less any outstanding loan or credit facility that the member may have obtained from the SACCO during the term of membership. Additionally, a substantial notice of 60 days must be given by the member of the intention to withdraw from the membership and be refunded the deposits.

## ***2.2 The Non-Deposit Taking Business in Common Parlance***

***Firstly***, it is important to note that the provision of savings and credit to members is a financial services business and hence an integral part of the financial services sector. Consequently, SACCOs are also often referred to as financial cooperatives, and are clustered as such together with other financial intermediating cooperatives like investments and housing cooperatives in some jurisdiction like Malawi.

SACCOs in Kenya are thus a distinct and separate subset of Financial Cooperatives, whose supervision and regulation is prescribed in the SSA. The SSA does not and cannot extend its application to the other financial cooperatives like investment and housing cooperative, unless it is amended. Its application at the moment is thus to Sacco societies only.

***Secondly***, unlike other jurisdictions, the Kenyan SACCO subsector was by way of practice divided in to two segments; principally defined or differentiated by the nature of savings and deposits that the SACCOs mobilize from their membership. The first segment consisted of the *deposit-taking SACCOs* (DT-SACCOs), while the second segment consists of the *non-deposit-taking SACCOs* (*non-DT-SACCOs*). In the common parlance and practice, the first segment are known as FOSA SACCOs, while the second segment are known as the BOSA only SACCOs,

Upon the enactment of the SSA in 2008, these two segments of SACCOs which started as a way of practice found legal definitions, with the BOSA only deposits becoming the “*non-withdraw-able deposits*” and the FOSA deposits becoming the “*withdraw-able deposits*” In this legal definition, the SSA provided that SACCOs that undertake both the BOSA and FOSA deposits, would be deemed to undertake “deposit-taking Sacco business”. But SACCOs that undertook “BOSA deposits only, without the FOSA deposits would be deemed to undertake “*non-deposit taking business*.”

***In conclusion therefore, the Regulations anticipated under Section 3(1)(b) of the SSA would relate to SACCOs that take “BOSA deposits only”.***

### **3.0 SPECIFYING THE NON-DEPOSIT TAKING BUSINESS**

This section of the report contains a comprehensive report on the considerations and justifications of the task force with regard to the criteria for specifying the non-deposit taking Sacco business.

#### ***3.1 General Overview***

Section 3(1)(b) of the SSA as read with subsection (2)(a) thereof requires that the Cabinet Secretary, shall first and foremost specify the *non-deposit taking business* to which the SSA applies.

Having defined what constitute “*non-deposit taking business*”, and there being consensus that in common parlance, it is that business conducted by SACCOs that receive “BOSA only” deposits, it is easy to conclude that all SACCOs, that do not undertake FOSA deposits or deposit taking Sacco business, are legally classified as undertaking “*non-deposit taking business*”. Thus all the SACCOs that receive BOSA only deposits are thus technically qualified to be specified as undertaking “*non-deposit taking business*”.

#### ***3.2 Justification for Specifying” Non-deposit Taking Business***

**Firstly**, the fact that Section 3 of the SSA as drafted requires that there be a specification of the non-deposit taking business in respect of which the SSA



applies technically means that the law as drafted did not anticipate that all BOSA only SACCOs would be brought under the purview of SSA. If that were so, Section 3 of the SSA would not have required any “**specification**”, but would have simply provided that “it would apply to all non-deposit taking businesses”.

Comparatively, it is important to observe that the drafting language of Section 3 of the SSA is the same as the drafting of Section 3 Microfinance Act<sup>3</sup> which also distinguishes between the deposit-taking business and the non-deposit taking business in respect of which a Microfinance Institution can engage in. From a policy and legal perspective, Section 3 of the Microfinance Act is thus important as a statute in *pari materia*, which is useful for comparative studies. This is particularly significant with regard to the public policy rationale or justification for regulating financial institutions.

**Secondly**, the fact that Section 3 of the SSA requires the Cabinet Secretary to specify the non-deposit taking business to which the SSA applies; means that there must be a **definitive criteria** for making such specification. Such criteria must equally find favour with the public policy rationale and justification for regulating financial institutions. This is particularly important for those financial institutions which are classified as not taking deposits from the public such as financial cooperatives.

**Thirdly**, the fact that the registration and incorporation of SACCO Societies is domiciled under the jurisdiction of the Commissioner for Cooperative Development (CCD) and not the Authority, technically means that Parliament did not intend that the Authority shall supervise and regulate all BOSA only SACCOs. If the intention was to have all SACCOs, including all BOSA only SACCOs under the framework of SSA and the Authority; then as a precursor to the same, Parliament would have vested the Authority with powers over the registration and incorporation process as well.

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<sup>3</sup> .Microfinance Act No. 19 of 2006. It is interesting that notwithstanding the fact that the Microfinance Act came into effect sometimes in 2008, the Regulations applicable to the non-deposit taking microfinance business have never been made. Those MFIs that undertake non-deposit taking microfinance business therefore remain unregulated, ostensibly because they do not pose any risk of loss of public deposits as they are credit only. Apart from a conduct regulation perspective, there is no reason why public funds need to be utilized to regulate these MFIs.

As a legal and policy proposition therefore, it is not practical for CCD to register and incorporate all SACCOs, and thereafter hand them over to the Authority under the SSA. If that is to happen, then as a policy and legal proposition the Authority must first and foremost have a say before any SACCO Society is incorporated, which is presently not the case. By way of analogy with the prevailing policy and legal framework in the domestic financial sector; no insurance company; and no commercial banking institution can be incorporated by the Registrar of Companies at the State Law Office without the written consent of the Insurance Regulatory Authority and the Central Bank of Kenya respectively.

The rationale for these policy and legal position, is that like “Sacco business”, insurance and banking, are financial businesses; whose operators must meet certain specified entry criteria. Upon, entry, the operators must maintain these minimum operating, governance and prudential criteria at all times, in order to protect and preserve public interest in a safe and stable financial institutions and therefore national financial system. In case of failure to maintain the criteria, the operators must be made to exit the market in a manner that protects and safeguards the public interest (depositors). It is for these reasons that the regulator ought to have a say on the entry and exit. In the absence of such a say, as with the current SACCO registration regime, then there must be a definitive criteria by which the regulator decides those that qualifies for entry into its legal jurisdiction, and the manner of their exit.

For this reason too, there must be developed a definitive criteria by which BOSA only SACCOs enters the regulatory framework of SSA, as well as a criteria for exit. Not all BOSA only SACCOs can fit that criteria, unless that criteria is made as the minimum registration and incorporation requirement.

**Fourthly**, the promulgation of the Constitution, 2010 brought with it new dynamics in the supervision and regulation of SACCOs as Cooperative enterprises. The Constitution of Kenya, (CoK) 2010 devolved the supervision of Cooperative Societies as a county government function. Whereas, there is no dispute that regulation and supervision of deposit-taking financial institution is a national government function for obvious reasons; the regulation and

supervision of which BOSA only SACCOs, may not be said to be a national government function without contravening the CoK, 2010.

Recognizing the principle of mutual respect and cooperation between the two levels of government; and appreciating the fact that the operations of certain cadres of BOSA only SACCOs transcends the limits of any single geographical and jurisdictional limits of any single county; it is necessary to prescribe a definitive criteria for the regulation and supervision of such BOSA only SACCOs. Such criteria will also respect the role of county governments in supervision of those BOSA only SACCOs whose operations are restricted within the geographical jurisdictions of the counties.

### ***3.3 Definitive Criteria for Specifying the Non-Deposit Taking Business***

In developing a suitable definitive criteria for specifying the non-deposit taking business to which the SSA ought to apply, it is necessary to take into account several policy and public interest considerations. These include:

- a) The prevailing situational analysis of the BOSA only SACCOs;
- b) The comparative analysis of similar jurisdictional frameworks;
- c) The risk that the BOSA only business present to the public to warrant governmental intervention by way of direct regulation and supervision;
- d) The level of risk exposure to the government in taking the supervision and regulation of BOSA only SACCOs;
- e) The ability of the BOSA only SACCOs to bear the regulatory and supervisory burdens associated with prudential and or conduct regulation;

These policy and public interests considerations do not operate in isolation, but the totality of the same must be assessed when coming up with a definitive criteria. Below is a discussion of these factors as a basis for the criteria for specifying the non-deposit taking Saccos.

### 3.3.1 Situational Analysis of Non-Deposit Taking Sacco Societies

The State Department of Cooperatives, SDC availed data on 2884 Sacco societies covering the period 2015 to 2017. Data fields included total assets, member deposits, CS number and membership. After data clean-up, a total of 1683 Saccos were used to analyze a representative situation of the non-DTSs in Kenya. The table below represent a summary of the key findings.

*Table A: Performance of the Non-Deposit Taking Saccos, 31<sup>st</sup> December 2017*

DepositCluster	No of saccos	Deposits	Loans	Total Assets	Members
OverKsh. 1Billion	6	11,046,483,449	10,139,335,505	12,468,118,790	28,150
Between Ksh.500Mn-1Bn	13	8,962,015,276	9,143,308,086	16,757,326,314	119,567
Between Ksh.200Mn-500Bn	31	8,193,104,880	8,959,459,720	12,308,224,006	52,220
Between Ksh.100Mn-200Mn	60	8,306,913,313	8,239,405,015	12,540,267,646	97,070
Between Kshs.20Mn-100Mn	365	14,766,141,167	14,433,677,945	19,279,991,675	177,928
Below Kshs. 20Mn	1,208	7,453,953,926	7,531,560,511	11,741,088,218	984,238
<b>TOTAL</b>	<b>1,683</b>	<b>58,728,612,011</b>	<b>58,446,746,782</b>	<b>85,095,016,650</b>	<b>1,459,173</b>

- 1208 of the 1683 Saccos analyzed have deposits under Ksh.20 million and account for less than 15 per cent of the deposits and assets of the non-deposit taking Saccos. A Sacco in this category serves on average 800 members.
- Saccos with deposits exceeding Ksh.200million number fifty and account for 42 per cent and 48 per cent in deposits and assets respectively. Combined the 50 Saccos served about 200,000 members as at December 2017.
- The 1683 Saccos were spread across forty-three Counties with total of 1070 found in Nairobi (841), Mombasa (124) and Kiambu (105).
- Four Counties namely Garissa, Marsabit, Wajir and Samburu did not have any reporting, an unusual situation given that Samburu and Marsabit have a DTS each.

*The large number of non-DTSs with deposits under Ksh.100 million point to the obtaining policy of registering Saccos where like non-financial cooperatives a minimum of ten promoters is required.*

### ***3.3.2 The Comparative Analysis of Similar Jurisdictional Frameworks***

The primary consideration for the jurisdictions discussed in this section is the presence of a tiered regulatory framework for Saccos, financial cooperatives and/or credit unions. The goal is to identify possible criteria that can be applied in specifying the non-DT Saccos. Developed Sacco markets such as India, US and Canada were found not suitable for this as the Saccos are highly integrated to the financial system.

Consequently, Malawi, South Africa and Rwanda were studied and below is a summary of key findings.

#### **a) Malawi**

Reserve Bank of Malawi is responsible for all Saccos under the Financial Cooperatives Act of 2011. However, it has taken regulation of large Saccos (exceeding USD.100,000 in total assets) while delegating the small ones (Below USD.100,000 in total assets) to the Industry Association (i.e with Malawi Union of Savings and Credit Cooperatives, MUSCCO) under a memorandum of understanding.

All SACCOs are required to maintain a minimum capital adequacy ratio by way of institutional capital of not less than **10 per cent of total assets.**

The delegation arrangement is currently under review.

#### **b) Rwanda**

The National Bank of Rwanda (BNR) is responsible for regulating, licensing and supervising banks, and Microfinance Institutions including SACCOs. The enabling law tiers the microfinance including SACCOs by level of deposits collected. Small SACCOs with less than Rwf 20 million (approximately USD.20,000) are restricted to one point of service. Those SACCOs collecting deposits from the general public and whose deposits exceed Rwf 20 million are required to observe all rules of management and prudential norms defined in the microfinance law and its applicable regulations.

#### **c) South Africa**

The Saccos, referred to as Cooperative Financial Institutions, CFIs in the republic of South Africa are very small segment of the financial sector accounting for less

than one per cent in total deposits as at December 2017. The CFIs are registered under the Cooperatives Act of 2005 but regulated under the Cooperatives Bank Act of 2007.

A CFI should have a minimum of 200 members and a capital of about USD.7,700 to be registered. A CFI must apply for license under the Cooperative Bank Act when its deposits exceed USD.3.8million. Such a CFI must have a minimum of 6 per cent in capital besides the licensing requirements.

#### **d) Kenya Deposit Taking Saccos**

The prudential performance of the DT Saccos by deposit or asset size provide some useful insights that may inform how the non-DTS can be tiered and supervised. Table B below is a summary of the DTSS market share based on deposits.

*Table B: Deposit Clustering for the Deposit taking Saccos*

Depositor_Cluster		2018		2017		2016		2015
Above Ksh. 5Billion	16	181,737,034,278	13	147,817,596,320	11	123,014,491,472	8	94,864,390,861
Between Kshs. 1Bn & 5Bn	53	126,012,342,099	54	124,041,049,571	51	114,076,013,379	48	105,241,289,179
Below Kshs. 1Billion	105	34,546,509,793	107	33,445,961,012	113	35,488,097,235	121	37,706,661,271
<b>Total</b>	<b>174</b>	<b>342,295,886,171</b>	<b>174</b>	<b>305,304,606,903</b>	<b>175</b>	<b>272,578,602,087</b>	<b>177</b>	<b>237,812,341,311</b>
		<b>2018</b>		<b>2017</b>		<b>2016</b>		<b>2015</b>
Above Ksh. 5Billion		53.1%		48.4%		45.1%		39.9%
Between Kshs. 1Bn & 5Bn		36.8%		40.6%		41.9%		44.3%
Below Kshs. 1Billion		10.1%		11.0%		13.0%		15.9%

This analysis shows the deposit market share for small DTSS declining over the four year period to 2018 in favor of the medium and large DTSS. SASRA notes that the small DTSS experience most challenges in terms of financial, human and technological resources and this adversely impacts on the regulatory compliance and competitiveness. Small Saccos lack the economies of scope and scale necessary in investing heavily in human and technological capacities.

*The criteria for the specified non-DTSS should consider the balance between anticipated business benefits and costs of regulating such Saccos.*

#### **3.3.3 Business Risks in Non-Deposit Taking Saccos**

By design business risks inherent in non-DTSS are contained within the membership and redress mechanisms exist for the members to hold leaders to

account including voting them out and electing new ones. This is a risk control mechanism as leaders know every year they will be accountable to the members through a special or annual general meeting.

However, in the recent past, there has been growing concern over non-deposit taking Saccos' failure to honor contractual obligations with members in terms of availing credit facilities and/or refund of non-withdrawable deposits upon exit.

Below are a number of incidences supporting the policy concerns.

- a) In 2015, SASRA put out public notices the SASRA warning the public against conducting deposit taking business with unauthorized (October of 2015);
- b) In 2017, a joint public notice was issued by Central Bank of Kenya and SASRA warning the public against transacting with unlicensed deposit taking entities;
- c) Collapse of non-DTSs with huge losses to members;
- d) Questions over some of the non-DT business conducted by some of the registered Saccos and potential risks to member deposits;
- e) Regulatory concerns over newly registered non-DT Saccos with open membership using digital channels (mobile financial services) to mobilize savings from Kenyans with inadequate member accountability mechanisms;
- f) Increasing use of mobile financial channels to receive deposits and pay members, narrowing the difference between deposit taking business and non-deposit taking business amongst Saccos; and
- g) Frequency of financial cooperatives engaged in Ponzi type schemes.

*A closer review over the most quoted financial cooperative scandals reveals that:*

- They have an open bond of membership spread across several Counties within a short span of time.

- These financial cooperatives defy the slow and lengthy organic growth path by aggressively marketing themselves via social, electronic and print media. Roadshows and fast branch expansion are common features for these cooperatives, quite unlike the traditional Sacco or cooperative.
- They lack appropriate governance structures to ensure effective member participation in decision making and accountability.

*The above observations and incidences underscore a need for change in the regulatory regime for non-deposit taking Saccos.*

#### **3.3.4 Resolutions on Criteria for the Specified Non-Deposit Taking Saccos**

The task force after due consideration of the foregoing factors resolved the criteria to specify the non-deposit taking Saccos pursuant to section 3(2) as below.

- a) Sacco societies with deposit liabilities of Ksh.100 million and above. This group of Saccos while few in number from the data available, account for about 60 per cent of the deposit liabilities of the non-deposit taking Saccos.
  - *A high deposit thresh-hold also minimizes the risks of regulatory agency being overwhelmed by thousands of small Sacco societies at the expense of larger Saccos that require intense supervision due to the risks they present to the Sacco subsector and financial sector in general.*
  - *This threshold ensures the right balance in terms of effective regulatory oversight by the Authority, regulatory burden on the Saccos and the expected public benefit for the members and Sacco industry.*
- b) All Sacco societies that elect to register and conduct business virtually through social media, mobile phones, internet or computer software. Such Saccos lack a definitive common bond and collect deposits primarily through mobile phones and other electronic channels.



- *This specification seeks to address the risk presented by Saccos which upon registration recruit members and receive monies electronically but fail to honor their obligations to the members.*
  - *These Saccos generally lack appropriate governance structure for members to participate in decision making and destiny of the business.*
  - *These Saccos exhibit faster growth in membership increasing financial and operational risks on the business.*
- c) Sacco societies registered in Kenya but membership is persons resident in foreign country, commonly referred to as diaspora Sacco societies. Like virtual Saccos, these Saccos present higher risks due to:
- *Complexities associated with multiple and cross border remittances.*
  - *Open bond membership hence challenges in participation of members in decision making.*
  - *Increased reliance on technology to serve and govern due to the geographical spread of membership including officials.*

The criteria will define the specified non-deposit taking Sacco business and can be said to constitute tier two Saccos.

### ***3.3.5 Tier three Non-Deposit Taking Saccos***

The task force recognizes that the Sacco societies falling outside the above criteria hence tier three are the majority in number but small in business volume. Thus subjecting them to prudential supervision as envisaged in the Sacco Societies Act will not be beneficial to them. The resource demand to oversee large number of Saccos spread in every sub county and ward will be too much compared to the potential risks and/or public benefits.

Consequently, a different model of supervision is required especially through the County Governments. This can be facilitated nationally with review of registration and standardized regulatory policy which should be adopted by all Counties. Such a policy will create predictability and certainty in the Sacco subsector while giving responsibility appropriately.

A tier three Sacco that attains member deposits volume of Ksh.200 million must within one year apply for authorization and transition to SASRA as a specified non-Deposit Taking Sacco.

#### **4. MEASURES OF CONDUCT FOR SPECIFIED NON-DEPOSITING TAKING BUSINESS**

These are the proposed regulations stipulating the financial, governance and operational standards expected of the Specified Non-deposit Taking business. These standards and requirements are already provided in the Sacco Societies Act, Cap 490B and the task force is required to apply its judgment in formulating regulations appropriate for the specified non-deposit taking business undertaken by the Sacco societies.

For the purposes of this report, this section will therefore include the findings and recommendations of the task force in respect to the regulations.

##### ***4.1 Citation and Commencement***

The task force proposes that these regulations shall come into operation at such a day that shall be published in the Kenya gazette by the Cabinet Secretary in consultation with the Authority.

##### ***4.2 Authorization/Licensing***

- a) This is the entry point for the specified non-deposit taking to the proposed regulatory framework. Section 5(a) of the SSA provides for licensing of Sacco societies to undertake deposit taking business. Thus licensing cannot apply to specified non-deposit taking Saccos and instead the task force proposes in these regulations authorization. For a Sacco to obtain authorization for specified non-deposit taking business, it has to submit an application in a prescribed manner and satisfy the minimum prudential and operational standards.
- b) The application will cost Ksh.3000 while authorization certificate will be Ksh.50,000. These amounts are the same as license application and certificate fees for deposit taking Saccos as the resources and level of input required in assessing the application was considered the same.
- c) The Authorization shall be perpetual unless revoked, but subject to compliance with regulatory requirements and payment of applicable fees.

- d) The specified non-deposit taking Saccos will apply for authorization within six (6) months from the date of commencement of these regulations.
- e) Upon authorization, the Authority will publish the list of the authorized specified non-deposit taking Saccos within 60 days of such authorization.
- f) The specified non-deposit taking Saccos shall be required to display a copy of the authorization certificate in a conspicuous place in its head office as well as other places of business.

#### **4.3 Capital Adequacy Requirements**

- a) The regulations provide for core capital which comprise of paid up share member capital, retained surplus and donated capital. A Sacco being a financial service provider requires capital as a first protection for member deposits against normal business losses. Secondly it is capital (and not deposits) that is applied in fixed assets including business premises and infrastructure. Thirdly capital provides cash-flow that is not tied to loans which is the case for non-withdrawable deposits.
- b) The minimum core capital for deposit taking Saccos is Shillings ten million (10Million) while that for community based Microfinance banks is Shillings twenty million (20 million). The operational requirements for a new specified non-deposit taking Sacco are lower and less complex compared to those of a deposit taking Sacco business. This lower absolute amount for core capital is proposed but the same is compensated by capital adequacy ratios.
- c) Specifically, the taskforce the following minimum capital adequacy requirements:
  - i. Core capital of not less than Kenya shillings five million;
  - ii. Core capital of not less than eight percent of total Assets, provided that at least 50% of the core capital shall be composed of retained earnings and disclosed reserves; and
  - iii. Core capital of not less than 8% of total non-withdrawable deposits.

#### **4.4 Liquidity Management**

- a) This is meant to ensure the institution maintains sufficient cash and liquid assets to satisfy the demands for loans and non-withdrawable deposits and other day-to-day operational expenses.

- b) Liquidity is an important indicator of the financial stability in a Sacco Society since it shows the ability to meet obligations as they fall due. A Sacco Society should manage the demand and supply of liquidity in an appropriate manner in order to safely run their business, maintain good relations with the stakeholders and avoid liquidity problem.
- c) Specified non-deposit taking Saccos are encouraged to hold liquid reserves through investments in available liquid assets. A minimum liquidity reserve of five (5) per cent of non-withdrawable deposits is proposed.

#### **4.5 *Shares and Deposits***

- a) Regulations around member share capital and deposit are aimed enhancing integrity of the financial and member records maintained by the Sacco at all times.
- b) The regulations provide the minimum data and features that must be maintained and updated for a member in respect of the share register and non-withdrawable deposits.

#### **4.6 *Credit Risk Management***

- a) Specified non-deposit taking Saccos collect non-withdrawable deposits for lending to members. These deposits form the primary collateral or security for loans to members.
- b) The regulations provide for minimum and general credit risk management requirements, classification of loans by purposes, lending disclosures to borrowers, procedures for introduction of new products and reporting requirements.
- c) To enhance responsibility and accountability in the performance of loans portfolio the regulations provide for a technical management credit committee in addition to a board credit committee.
- d) Effective credit risk management practices are the foundation of a sound Sacco and authorized Saccos will be required to make quarterly on loans outstanding in their books and the sectors they have lend monies. This will enable aggregation and reporting at national level, thus availing the much needed data on contribution of Saccos to household credit in Kenya.

#### ***4.7 Risk Classification and Assets and Provisioning***

- a) The regulations under this part aim to ensure that loans which make on average 75 per cent of the Sacco assets are prudently managed and reported to members and the regulator.
- b) For standardization, classification of loan performance adopted in this regulations is the same applied by deposit taking Sacco businesses. The task force notes that a number of non-deposit taking Saccos already apply this classification.

#### ***4.8 Investments and Associated entities***

- a) The core business of Sacco business is to facilitate financial intermediation amongst a closed group of members. Thus the regulations on investments in such assets as land and property, equities of other institutions (subsidiaries, related entities) is restricted.
- b) In order to enhance independence and objectivity in decision making, the multiple directorship between the Sacco and the related entities is restricted to no more than two directors from the Sacco and chairperson must be independent.
- c) Transparency and accountability to members in identifying, deciding, financing and reporting of investments projects is central in enhancing governance in investments and related entities.
- d) Consolidation in the financial reporting is mandatory and a standard reporting template will be developed and provided to the Sacco societies.

#### ***4.9 Financial Performance Reporting***

- a) Unlike deposit taking Saccos which make regulatory returns on monthly cycles, the specified non-deposit taking Saccos will be reporting every quarter such that the regulatory returns are submitted by 15<sup>th</sup> of the month following the end of a quarter (i.e 15<sup>th</sup> April, 15<sup>th</sup> July, 15<sup>th</sup> October and 15<sup>th</sup> January).
- b) A functional management information system is at the core of effective management of Sacco business and reporting thereof.

#### ***4.10 Governance of Sacco Societies***

- a) This is largely provided in the Sacco Societies Act and the regulations dwell on defining the duties and responsibilities of the board of directors to enhance alignment with the lending business and associated risks.
- b) The regulations propose a maximum of three committees given the demands of a specified non-deposit taking business and the need to enhance effective and efficiency in board functioning. In this the credit and risk board committee is mandatory and the Board can establish the other two.
- c) The task force proposes to have the functions of the Audit committee performed by the supervisory committee to enhance efficiency and oversight by members.
- d) The regulations require the Sacco to establish internal audit function, either direct or by outsourcing to a third party. Where the internal audit function is outsourced, the Sacco shall seek approval of the Authority.

#### ***4.11 Consumer protection***

- a) The purpose of this regulation is to protect and empower the members as consumer of financial services provided by the Sacco. This will be achieved by requiring the Sacco provides adequate, timely, sufficient and informative disclosures in respects to shares, deposits and loan products to members.
- b) The Sacco should also ensure confidentiality, fair credit practices, accurate advertisement, fair debt collection practices, and redress of complaints.

#### ***4.12 Information, security, preservation and Business Continuity***

- a) This section of the regulations define the minimum features expected of management information systems for a non-specified deposit taking business.
- b) The regulations also provide measures required to ensure security and preservation of vital and critical information of the Sacco.

#### ***4.13 Regulation and Supervision***

This section deals with the supervisory powers and approach of the regulatory agency including inspections of Sacco Societies, enforcement actions, administrative sanctions, prohibitions and removal of officers.

#### ***4.14 Miscellaneous Provisions***

This section deals with amalgamations and transitional provisions.