The Supreme Court Holds that Banks and Financial Institutions are required to seek approval from the Cabinet Secretary responsible for Finance before increasing Interest Rates

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BACKGROUND

The Supreme Court has this morning delivered a decision in **Stanbic Bank Kenya Limited v Santowels Limited Supreme Court Petition No. E005 of 2023** on the question on the interest rates regime in the banking sector. The writers were involved in the matter before the Supreme Court.

The Court has found that interest rates on loans and facilities are subject to regulatory control under Section 44 of the Banking Act. Banks and financial institutions are therefore required to seek approval from the Cabinet Secretary for Treasury before increasing interest rates.

THE APPEAL

The Appeal concerned the correct statutory interpretation of sections 44 and 52 of the Banking Act which govern rate of banking and contractual rate of interest respectively.

The main ground of appeal was that the Court of Appeal and the High Court both failed to distinguish between the rate of banking and contractual rate of interest as governed by Sections 44 and 52 of the Banking Act respectively, which in effect illegally denied the bank the discretion to vary the rate of interest and deprived the petitioner of its right to property as guaranteed by article 40 of the Constitution of Kenya.

We argued that the majority of the High Court decisions on Section 44 of the Banking Act confirm that interest rates variation does not require ministerial consent. One key aspect we emphasized was that Section 52 of the Banking Act allows contractual freedom to financial institutions to contractually vary interest without ministerial authority.

Before the hearing of the Appeal, Kenya Bankers Association sought to be joined in the Appeal as interested parties. However, the Court dismissed the Application on grounds that the intended Interested Party did not raise a new perspective as its arguments were identical to those of the Appellant.

The Appellant also made an Application for joinder of the Cabinet Secretary for Finance & National Treasury to be joined as an Amicus Curiae to the Petition. In the Application, we argued that the input of the Cabinet Secretary for Treasury and Economic Planning was critical because the nature of the Appeal being a statutory interpretation of sections 44 and 52 of the Banking Act, has a substantial impact on public interest as it affects all lenders and borrowers. The Court in its ruling dismissed the Application for Joinder for reason that the Attorney General was not keen on participating in the Appeal since they had not sought to join the proceedings even after being served with the Petition. Soon after filing the petition, we served the same on the office of the Honorable Attorney General and requested his office to join in the petition before the Supreme Court.

COURT'S FINDINGS AND REASONING

The main issue for determination was limited to the interpretation of Sections 44 and 52 of the Banking Act in relation to the increase of interest rates on loans/facilities advanced by banks/financial institutions. The main question was whether the increase of interest rates required the approval of the Cabinet Secretary or if it was a matter of contractual freedom.

The Court examined the contradictory interpretations of the provisions by the lower courts. Some decisions held that banks/financial institutions needed the approval of the Cabinet Secretary under Section 44 of the Banking Act to increase interest rates, while others held that such approval was not required.

The Court analyzed the language and context of the provisions to determine their meaning. Section 44 of the Banking Act stated that no institution shall increase its rate of banking or other charges without the prior approval of the Minister. The term "rate of banking" was not defined in the Act, but the Court reasoned that it should be understood in the context of the definition of "banking business" in Section 2 of the Act. This definition included the acceptance of money on deposit, current accounts, and the lending of money, which encompassed loans and facilities advanced by banks. Therefore, the Court concluded that the term "rate of banking" included and covered interest rates charged by banks on loans/facilities.

The Court also considered Section 52 of the Banking Act, which stated that no contravention of the Act shall affect or invalidate any contractual obligation between an institution and any other person. The Court found that its interpretation of Section 44 did not impede on contractual freedom, as banks and customers could still negotiate and enter into mutual contracts regarding interest rates. However, the discretion of banks to vary interest rates was not absolute and subject to the regulatory process under Section 44.

The Court rejected the argument that the repeal of Section 39 of the Central Bank of Kenya (CBK) Act and Section 33B of the Banking Act had completely liberalized interest rates. It noted that the primary objective of the Banking Act was to regulate banking business, and the repeal of these sections did not remove the regulatory role of Section 44. The Court emphasized that the regulation of interest rates through capping had set parameters for negotiation between banks and customers, and the approval process under Section 44 provided oversight to prevent exploitation of consumers.

In conclusion, the Court declared that interest rates on loans and facilities advanced by banks/financial institutions were subject to the regulatory process under Section 44 of the Banking Act. Banks/financial institutions were required to seek the approval of the Cabinet Secretary prior to increasing interest rates. The Court dismissed the appeals and cross-appeals, and each party was ordered to bear their own costs.

Commentary

The decision has brought about uncertainty as it contradicts the historical deregulation of the interest rates regime by the government explained below.

a. The old section 39 of the Banking Act dealt specifically with "rates of interest", which section co-existed alongside section 44 of the Banking Act. With the repeal of section 39, interest rates were freed from control by the Minister for Finance, a position the courts have readily accepted. If section 44 was interpreted to include interest, it would contradict the Government's decision to deregulate interest rates chargeable by financial institutions.
b. Again, the introduction of the Central Bank of Kenya (Amendment) Act 2000 whose Section 39 was aimed at regulating interest rates is a clear indication that interest rates were not covered under Section 44 of the Banking Act. If this was the position, there would have been no need for that in the Act.
c. The Minister for Finance published the Banking (Increase of Rate of Banking And other Charges) Regulations, 2006 by Legal Notice No. 34 of 12th May 2006. Regulation 2 states that " an application for approval of increase in the rate of banking or other charges under section 44 of the Act, shall be in the form set out in the Schedule and shall be submitted to the Minister through the Governor of the Central Bank of Kenya".
   Rule 6 also states:
   "Every institution shall post, in a conspicuous position at every place of the institution's business in Kenya, the rates of banking and other charges levied on the products offered by the institution and shall submit a copy of the document so displayed to the Minister."
d. Based on the above observations on section 44, the regulations cannot apply to interest rates.
e. The regulations cannot override the provisions of section 52(1) of the Banking Act in cases where contractual charges are already in place.

It is important to note that the position taken by the courts so far has been that they would be reluctant to interfere with contractual provisions regarding interest, except in the cases of fraud. The overwhelming majority of the high court decisions correctly interpret Section 44 to exclude the application to interest rates and confirm the liberalization of the interest rate regime between 1991 and 2001.

Further, the court failed to consider that in National Bank Ltd v Cador Investment Ltd HCCC No. 2005 of 2000(unreported), it was held that the total effect of the revocation of Gazette Notice No. 1617 of 1990 by Gazette Notice No. 3348 of 1991 and subsequent repeal of SS. 39, 40 and 41 of the Central Bank of Kenya Act was firstly to:

a. free bank interest rates regime from control or regulation by the Minister for Finance through the Central Bank of Kenya, and
b. Removed the power of the Central Bank of Kenya to issue instructions under SS. 39-41 of the Act by the repeal of those sections.

This meant that specified banks and financial institutions were at liberty to negotiate interest rates with their borrowers.

IMPLICATIONS OF THE RULING

The Judgment has thrown the financial sector in disarray since the Court declared that any increase in interest rates must be preceded by the consent of the Cabinet Secretary for Treasury. As a result, this has the potential impact of making banking business too burdensome as all facilities will have to await the approval of the Cabinet Secretary, a process that may be too onerous and cumbersome.

Stakeholders such as the Kenya Bankers Association may consider lobbying parliament to consider legislative review to sections 44 and 52 of the Act.

Lastly, another avenue would be to pursue a review application of the Judgment of the Court on grounds of error apparent on the face of record and gross miscarriage of justice. However, past experience indicates that the Court is usually inclined towards dismissing Applications for review.

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