Regulatory Shifts in Interest Rate Adjustments in Kenya

Lessons from Santowels Ltd v. Stanbic Bank and Beyond

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The evolution of interest rate regulation has been shaped by a combination of legislative reforms, judicial clarifications, and institutional policy adjustments

Between 2023 and 2025, Kenya experienced significant regulatory shifts in the management of interest rates within its banking sector. These developments reflect a broader effort to balance consumer protection, financial sector stability, and market responsiveness.

The evolution of interest rate regulation has been shaped by a combination of legislative reforms, judicial clarifications, and institutional policy adjustments, with the most recent being the Supreme Court's landmark decision in Santowels Limited v. Stanbic Bank Kenya Limited[2024] KESC 31 (KLR) (the "Santowels" decision).

Key milestones in this journey include the enforcement of Section 44 of the Banking Act Cap 488 of the Laws of Kenya ('the "Banking Act"), the introduction and subsequent repeal of interest rate caps under Section 33B of the Banking Act, and the growing emphasis on legal compliance, transparency, and judicial oversight.

Collectively, these changes have reshaped the regulatory landscape and operational expectations for financial institutions in Kenya. We delve deeper into these changes and what they mean in this digest.

Repeal of Interest Rate Caps and Market-Based Pricing

To understand the current landscape, we need to rewind the clock to 2016 when Section 33B of the Banking Act was introduced. This section capped lending interest rates at no more than 4% above the Central Bank Rate ("CBR"). It aimed to protect consumers from predatory lending. However, the effects were mixed as credit to MSMEs shrank as banks became risk-averse, price signals were distorted, and the monetary policy transmission was weakened.

In 2019, Parliament repealed Section 33B of the Banking Act via the Finance Act, 2019, ushering in a return to market-based pricing.

While the Central Bank of Kenya ("CBK") and international actors like the International Monetary Fund (IMF) - who had long argued that interest rate controls distorted credit allocation and weakened monetary policy transmission - supported this move, the repeal left a gap: without the cap, how would lending rates be monitored or controlled?

In response, the CBK issued Circular No. 14 of 2019 on 7 November 2019 (the "Circular"), reaffirming that banks were still expected to comply with risk-based pricing principles outlined under Prudential Guideline No.3 ("PRG 3") on Credit Risk Management. The Circular emphasised that institutions must develop internal lending policies and pricing models that take into account borrower-specific risk factors and are transparent, auditable, and justifiable to supervisors.

Yet in practice, the repeal of Section 33B of the Banking Act created a regulatory grey area. Although Section 44 of the Banking Act continued to require prior approval for increases in banking charges by Cabinet Secretary, enforcement had historically been limited. In this context banks leaned heavily on contractual clauses in loan agreements that allowed them to adjust interest rates unilaterally, often pegged to internal base rates. This practice would soon face judicial scrutiny.

A landmark example is the Supreme Court's decision in the Santowels case. In this case, the bank had included a clause in its facility letter allowing it to vary interest rates based on Central Bank Rates. The rate fluctuated between 19.5% and 29% based on the various changes. The borrower challenged the legality of these adjustments, arguing that they were made without the required approval under Section 44 of the Banking Act. Notably, the case brought into question how Section 44 of the Banking Act- originally intended to prevent exploitative rate increases- interacts with modern contract law principles around freedom of contract and commercial certainty.

The Supreme Court ruled that: "Interest rates on loans and facilities advanced by banks/financial institutions are subject to the regulatory process under Section 44 of the Banking Act… such banks/ financial institutions are required to seek the Cabinet Secretary's1 approval prior to increasing interest

rates”. This decision clarified that even where contracts grant banks discretion, such discretion must still operate within the bounds of statutory oversight. It effectively invalidated the long-standing industry practice of relying solely on internal contractual mechanisms to adjust rates without regulatory approval.

The ruling has since prompted a wave of contractual reviews, regulatory consultations, and potential litigation by borrowers seeking redress for historical rate increases made without the approval of the Cabinet Secretary in line with the ruling.

CBK Monetary Policy Adjustments (2023–2025)

The Santowels decision introduced legal clarity - but also operational friction - particularly in the context of Kenya’s evolving monetary policy environment

In response to global economic shocks and domestic fiscal pressures, the CBK had begun to adopt an accommodative monetary policy stance between 2023 and 2025. The Central Bank Rate (“CBR”) was progressively lowered to stimulate borrowing and investment. Ordinarily, such policy shifts would be expected to translate into reduced lending rates across the banking sector.

From December 2024, commercial banks began adjusting their lending rates downward in alignment with the CBK’s policy direction. However, the 2024 Santowels ruling introduced a new layer of complexity: are banks now required to seek regulatory approval before implementing such rate changes, even if they were downward adjustments? This is likely to create operational delays and raise questions about how monetary policy would be transmitted effectively under the new compliance regime.

Enhanced Supervisory and Compliance Measures

In parallel with the legal developments stemming from Santowels, the CBK began tightening supervisory expectations around interest rate management - effectively translating judicial standards into day-to-day regulatory practice. The 2023 Financial Sector Stability Report2 had underscored a shift toward risk-based supervision. Regulators, particularly the CBK, began scrutinising how banks justified interest rate changes. Institutions were required to demonstrate that rate adjustments were based on borrower risk profiles, market conditions, and transparent methodologies.

This shift was driven not only by the evolving legal framework following Santowels, but also by the need to restore public trust in the banking sector following years of opaque pricing practices. It also reflected a broader trend toward data-driven regulation, where banks are expected to maintain robust documentation and audit trails for all pricing decisions.

Additionally, there is growing public concern that banks and financial institutions continue to report substantial profits, often perceived to be at the expense of customers who are facing financial hardship.

Push for Transparency and Consumer Protection

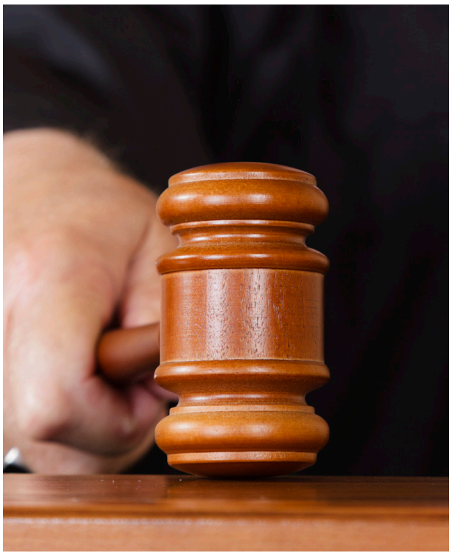
As regulatory expectations around interest rate management continue to evolve, there has been a growing push to enhance transparency in how those interest rates are communicated to borrowers. In light of supervisory practices and judicial developments, banks are now expected to clearly articulate rate adjustment mechanisms in loan agreements, provide reasonable advance notice to borrowers before implementing changes and educate customers on how interest rates are determined and what factors influence them.

This emphasis on financial literacy and borrower education is aimed at reducing disputes and fostering a more informed credit market. It also aligns with Kenya's broader financial inclusion agenda, which seeks to empower consumers through access to clear, actionable financial information.

Implications of the Santowels Decision

The Supreme Court's ruling in Santowels has ushered in a new era of regulatory accountability and legal scrutiny for Kenya's financial sector. Its implications are both immediate and far-reaching, touching on compliance, operations, legal risk, and contractual certainty.

First, the decision reinforces the **mandatory nature of regulatory compliance** under Section 44 of the Banking Act. Banks are now unequivocally required to obtain **prior approval from the Cabinet Secretary for the National Treasury** before implementing any upward adjustments to interest rates or related charges. This requirement applies even where loan agreements



contain clauses granting the bank discretion to vary rates, meaning that statutory oversight takes priority over contractual autonomy.

As a result, financial institutions must undertake comprehensive contractual reviews. Existing loan agreements need to be examined and, where necessary, amended to ensure they align with the Supreme Court's interpretation. Clauses that previously permitted unilateral rate adjustments without approval are now legally vulnerable and may expose banks to regulatory sanctions or judicial invalidation.

Operationally, the ruling introduces a new layer of procedural complexity. The requirement to seek formal approval before adjusting rates could lead to delays in responding to market dynamics, particularly in volatile economic environments where agility is critical. Banks will need to develop internal protocols and timelines to manage this approval process efficiently without compromising compliance.

Perhaps most significantly, the decision opens the door to increased litigation exposure. Borrowers may challenge historical rate adjustments made without the requisite approvals, seeking refunds, damages, or contract nullification - particularly where those adjustments fall within the legal limitation period for contractual claims. While the success of such challenges may depend on the specific terms, circumstances and timing of each case, the ruling has clearly opened the door to retrospective scrutiny. Going forward, any deviation from the prescribed regulatory process could trigger legal action, reputational damage, and financial liability.

In summary, the Santowels decision is not merely a judicial clarification, it is a regulatory turning point. It compels banks to rethink their pricing strategies, strengthen their compliance frameworks, and engage more proactively with regulators and legal advisors to navigate the evolving landscape.

What next?

In light of the Santowels decision and the evolving regulatory landscape, it is imperative for financial institutions to adopt a proactive and structured approach to compliance and risk management. We anticipate the need for the following strategic interventions:

Proactive Contract Review: Banks should initiate a comprehensive audit of existing loan agreements to identify clauses that may conflict with the Supreme Court's interpretation of Section 44 of the Banking Act. Particular attention should be paid to provisions granting unilateral discretion to vary interest rates. These clauses should be revised or supplemented with compliance safeguards to ensure enforceability and regulatory alignment.

Regulatory Engagement: Institutions must develop clear internal protocols for seeking and documenting approvals from the Cabinet Secretary for the National Treasury. In parallel, there is a need for sustained engagement with regulators to advocate for clarified guidelines, standardised approval processes, and reasonable timelines that balance compliance with operational efficiency.

Dispute Resolution Preparedness: Given the heightened risk of litigation, banks should prepare for potential legal challenges by building robust legal arguments and evidence frameworks. This includes maintaining detailed records of all rate adjustments, approval requests, and borrower communications. Institutions should also explore alternative dispute resolution (ADR) mechanisms to manage claims efficiently and preserve customer relationships.

Risk Mitigation Frameworks: To prevent future non-compliance, banks should implement internal controls that flag unauthorised rate changes and ensure all pricing decisions are reviewed by legal and compliance teams.

Regular training programs should be introduced to equip staff with the knowledge and tools to navigate the new regulatory environment confidently.

To navigate this new landscape effectively, banks must lean on the expertise of their legal and compliance teams. These professionals are uniquely positioned to provide:

- **Strategic Legal Advise:** Offering tailored guidance on how to align internal policies and loan documentation with evolving legal standards and regulatory expectations.
- **Compliance Risk Mitigation:** Designing and implementing frameworks to identify, assess, and manage compliance risks related to interest rate adjustments and other charges.

1. **Regulatory Engagement: Acting as liaisons with the Cabinet Secretary for the National Treasury and other regulatory bodies to ensure timely approvals and clarify ambiguities in the law.**

- **Training and Capacity Building:** Equipping frontline staff, credit officers, and relationship managers with the knowledge and tools to comply with the new requirements confidently and consistently.

By investing in these capabilities, banks can transform regulatory compliance from a reactive obligation into a proactive strategic advantage.

How PwC Can Support

At PwC Kenya, we recognise that the Santowels decision marks a critical inflection point for the financial sector. We are equipped to support financial institutions in responding proactively and strategically through:

1. **Legal Advisory & Regulatory Engagement**

- We provide legal guidance on interpreting and implementing Section 44 of the Banking Act in light of the Santowels decision.
- Our team can act as liaison with the regulatory authorities on approval protocols, transitional concerns, and guidance clarity.
- We support Board and executive decision-making with regulatory intelligence and legal risk assessment.

2. **Contractual Risk Reviews**

- We conduct focused reviews of lending contracts, particularly interest rate variation clauses, to identify terms that may be ambiguous, outdated, or inconsistent with current regulatory and judicial expectations.
- Our recommendations are aligned with CBK guidance, recent case law, and global best practices, ensuring your loan agreements are clear, compliant, and enforceable.
- We support redrafting efforts to future-proof your documentation, fostering transparency and minimising the risk of borrower challenges or regulatory scrutiny.

3. **Litigation Support & Dispute Resolution**

- We help financial institutions evaluate their historical exposure to claims arising from past rate adjustments, especially those implemented without adequate contractual clarity or proper borrower notification. To support this, our Data Analytics team has created a solution that allows for quick and consistent loan re-computations.
- Where disputes arise, we provide practical guidance on structured settlements and mediation strategies that preserve long-term client relationships while avoiding costly litigation.

4. **Compliance Risk Mitigation Frameworks**

- We assist in developing or updating internal legal and compliance frameworks to ensure that interest rate adjustments are legally defensible and procedurally sound.
- This includes escalation protocols, legal sign-offs, documentation standards, and governance structures.
- We also help institutions prepare for legal audit, regulatory inspection, and court scrutiny.

5. **Training and Capacity Building**

- We deliver bespoke training for legal, credit, relationship, and risk teams on the implications of Santowels, Section 44 compliance, and evolving pricing standards.
- Our sessions empower frontline teams to engage confidently with borrowers, manage rate adjustments legally, and document compliance effectively.

Now more than ever, institutions must strike a balance between commercial flexibility and legal certainty. Our multidisciplinary team, spanning legal, risk, and financial services advisory, works collaboratively to help you respond to judicial developments without disrupting your business model.

Contact PwC Kenya today to explore how we can support your institution in managing contractual exposures, mitigating litigation risks, and building resilient lending practices in this evolving environment.

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