A REPORT ON THE EMERGING TRENDS IN COMMERCIAL AND FINANCIAL LAW

BANKING LAW, CAPITAL MARKETS LAW AND CORPORATE GOVERNANCE

KCB LEADERSHIP CENTRE, KAREN, NAIROBI
9TH – 10TH JUNE 2011

Organized by the Financial and Legal Sector Technical Assistance Project of the Ministry of Finance and hosted by the University of Nairobi, School of Law.

TABLE OF CONTENTS

I. Executive Summary……………………………………………………..……..3
- 1.1 Introduction……………………………………………….……...3
- 1.2 Objectives………………………………………………..……3
- 1.3 Key Points from the Presentations…………………………….……3
  - 1.3.1 Day 1 Presentations……………………………………3
  - 1.3.2 Day 2 Presentations……………………………..…5

II. Background………………………………………………………..……6
- 2.1 The Banking Sector……………………………………..…6
- 2.2 The Capital Markets Authority…………………………..…7
- 2.3 Corporate Governance……………………………….……..8

III. Report of the Discussions……………………………………..……..9
- 3.1 Welcome and Opening Remarks…………………………………...9
- 3.2 Day 1
  - 3.2.1 M-Payments, E-Payments and the Future……………..9
  - 3.2.2 Need for Legal and Regulatory Framework for M-Payments and E-Payments……………………………..10
  - 3.2.3 Regulation of Banking Institutions……………………11
  - 3.2.4 Banking Law Reforms…………………………………11
  - 3.2.5 Recent Amendments to Banking Law………………..12

- 3.3 Day 2
  - 3.3.1 The Paradox in the Implementation Matrix of Capital Markets Reforms in Kenya……………………………..13
  - 3.3.2 Effectiveness of the Policy and Legislative Measures under the Proposed Amendments to the Capital Markets Legal and Regulatory Framework……………………..14
  - 3.3.3 International Best Practices in the Regulation of Capital Markets…………………………………………………..15
  - 3.3.4 The Companies Bill 2010: Challenges and Opportunities for Corporate Governance……………………………...16
  - 3.3.5 Horizontality and the New Bill of Rights: Towards a Clearer Definition of Parameters of Corporate Obligations and Complicity for Human Rights Violations…………………………………………..17

IV. Sector Specific Recommendations………….…………………………..…18

V. General Recommendations for the School of Law…………….….…19

VI. Conclusion…………………………………………………….………20

ANNEX I: Workshop Presentations

ANNEX II: Programme

ANNEX III: List of Participants

1.0 EXECUTIVE SUMMARY

1.1 Introduction

The two-day workshop on *Banking Law, Capital Markets Law and Corporate Governance*, dubbed the **Emerging Trends in Commercial and Financial Law** was organized by the Financial and Legal Sector Technical Assistance Project of the Ministry of Finance and hosted by the University of Nairobi, School of Law.

The conference drew a wide array of participants from the public, private, and business sectors. In all, 10 presentations were made, and discussion sessions were held at the workshop.

The first day of the workshop witnessed the opening ceremony with addresses by Dr. Kiarie Mwaura from the University of Nairobi and Christine A. Agimba, Project Manager from the Office of the Deputy Prime Minister and Ministry of Finance. Laila Abdullatif, Pupil at Okoth & Kiplagat Advocates was the rapporteur chosen for the workshop.

1.2 Objectives

The objectives of the workshop were:

a. To provide an interactive forum to engage in the discourse on emerging trends in commercial and financial law in Kenya and elsewhere;
b. To facilitate a better understanding of policy and legal problems that were to be identified during the discussions;
c. To create links between the School of Law and industry (particularly those working in the area of commercial law) so as to develop an environment for exchange of ideas and staff between academia and industry as well as to explore the possibility of student attachments;
d. To explore the possibility of undertaking collaborative research and teaching between the School of Law and industry players;
e. To enhance the quality of the curriculum on offer in the fields of commercial and financial law and to develop standard teaching materials/course packs in the areas of:
    i. Banking Law;
    ii. Capital Markets and Securities Regulation; and
    iii. Corporate Governance.

1.3 Key Points from the Discussions

1.3.1 Day 1 Presentations

After the opening session, five presentations were made on the first day. The first two presentations were on *M-Payments, E-Payments and the Future*, and on the *Need for Legal and Regulatory Framework for M-Payments and E-Payments.* These presentations addressed the emerging trends in Banking Law and called for collaborative research into these trends by both the School of Law and the

Banking Sector.

The first presentation by Stephen Mwaura, Head, National Payment System, Central Bank of Kenya, on the topic *M-Payments, E-Payments and the Future* noted that the growth of mobile telephony in Kenya in recent years has been phenomenal but marred by inefficiency. He recognized that the banking sector in the country has attracted the use of technology; his premise derived from the fact that there has been an increase in the usage of the ATMs and in use of the MPESA system to transfer money. Accordingly, his concern was on the issue of cyber crime, an area that has not been addressed by the law.

Presenting the second paper titled the *Need for Legal and Regulatory Framework for M-Payments and E-Payments,* Gladys Musuva, Lecturer at the Kenya School of Monetary Studies, noted that the purpose of a legal and regulatory framework for M-Payments and E-Payments is for safeguarding money, and to protect individuals. She stressed that mobile telephony has offered its subscribers with an opportunity to buy any product anywhere with the only requirement being the production of the Identification Card. The challenge therefore, she stressed, is the possibility of fraud in this area.

The next three presentations addressed the legal problems faced by the Banking sector.

Dr. David Gachuki from the University of Nairobi made a presentation on the *Regulation of Banking Institutions.* He noted that the Banking Act states that the Central Bank of Kenya has the ability to regulate the banking sector but it lacks the capacity to do so. This is because the Central Bank does not have the adequate human resource to do so. He also stated that the Central Bank of Kenya does not regulate the area of the contracts entered into; and the interest that is charged, by the banks. Concerning the Credit Reference Bureaus, Dr. Gachuki stated that their sole purpose is regulating the customers and not the banks.

He also cited the relevant sections of the Banking Act, Chapter 488 of the Laws of Kenya, which guaranteed the success of the Kenyan Banking Sector. He emphasized that the First Schedule to the Banking Act on the Criteria for Determining Professional and Moral Suitability of Directors and Senior Officers Proposed to Manage or Control Institutions is critical. He also underlined the principle of know your customer saying that the Basel Code of Conduct and Anti Money Laundering laws forces banks to know their customer. Accordingly, the principle of know your customer, according to him must be put in the Banking Act, and that this principle must become law.

Dr. Winnie Kamau from the Kenya School of Law took the participants through the *Banking Law Reforms.* She spoke on the role of the Central Bank of Kenya and enumerated on the reasons for reform in the banking and financial sector. According to Dr. Winnie Kamau, the challenge is coming up with regulations for Mobile and Electronic Banking, as well as addressing the concept of Islamic Banking that is becoming popular.

The last presentation of the day titled *Recent Amendments to Banking Law* was by Kyalo Mbobu from the University of Nairobi. He began by posing the following question:

"Do you change the law by changing a rule or regulation?"

Rules and regulations are subordinate to the main Act and therefore not effective to making change stated Mr. Mbobu. He then empathically demonstrated to the panel how the Kenyan Banks have refused to be regulated. He also showed how the Central Bank has been dormant in carrying out its duties.

1.3.2 Day 2 Presentations

Five presentations were made on the second day of the workshop. These presentations brought out the legal problems that the participants identified within the commercial and financial sector.

The morning session had the theme: *The Paradox in the Implementation Matrix of Capital Markets Reforms in Kenya.* Mr. Njambara Gichuki from the University of Nairobi explained to the panel the reforms that have been brought into the Capital Markets system and he also analyzed whether the intended reforms have achieved the intended result.

However, the panel discussion drew attention to the fact that most of the reforms have been on developing a regulatory market rather than the development of the market itself, that there has been an emphasis on regulation and not on the development of the market.

The second presentation of the morning session by Mr. George Oraro, Senior Partner at Oraro & Company Advocates on the *Effectiveness of the Policy and Legislative Measures under the Proposed Amendments to the Capital Markets Legal and Regulatory Framework* recognized that SMEs (Small and Medium Sized Enterprises) face unique challenges, which affect their growth and profitability and hence, diminish their ability to contribute effectively to sustainable development. Mr. Oraro then briefly discussed the following challenges: Lack of Managerial Training and Experience, Inadequate Education and Skills, Lack of Credit, National Policy and Regulatory Environment, Technological Change, Poor Infrastructure and Scanty Markets information.

Accordingly, he suggested that SMEs should be attracted into the market by the establishment of more venture funds to facilitate the SMEs working capital.

Dr. Jacob Gakeri from the University of Nairobi through his paper *International Best Practices in the Regulation of Capital Markets* discussed globalization in the context of the securities market. He gave three reasons for the regulation of the securities market. These are: to protect investors, to reduce risks and to bring in confidence in the markets. He emphasized that the market is not regulated and therefore, suggested an approach by which the market can be regulated. This approach is based on dealing with the tension between capital formation and investor protection. According to him African markets are small and struggling, therefore there is a need to have a regional stock exchange.

During the panel discussion it was agreed that security markets are considered elitist. This is from history where Africans were restricted from trading and economics. Education, therefore, is essential because financial illiteracy is the rule. Public education must be sustained. It was also noted that Kenya does not have a clear policy on financial services and her legal infrastructure is being reformed now.

It was further agreed that the Capital Markets Authority lacks autonomy.

The afternoon session of the second day of the workshop saw the presentation of two papers. The themes for the session were: *The Companies Bill 2010: Challenges and Opportunities for Corporate Governance* and *Horizontality and the New Bill of Rights: Towards a Clearer Definition of Parameters of Corporate Obligations and Complicity for Human Rights Violations.*

Presentations were made by Lewis Kamau, CEO, Institute of Directors and Dr. Kiarie Mwaura, University of Nairobi.

The session was dominated by discussions on the Companies Bill on corporate governance. Mr. Lewis Kamau argued that the role of the Board in corporate governance is extremely crucial and he looked at how it has been addressed in the Companies Bill. He identified the following legal issues that plague Kenya's corporate sector: Poor selection criteria for appointing directors; Lack of independence among directors; and Poor succession planning.

The last panel discussion of the workshop was on the presentation by Dr. Mwaura on *Horizontality and the New Bill of Rights: Towards a Clearer Definition of Parameters of Corporate Obligations and Complicity for Human Rights Violations.*

It was said that governance of corporations is as important as governing nations and hence there is a need to extend International Human Rights to corporations.

Dr. Mwaura concluded by stating that Kenya does not have a proper framework to control businesses and that is a challenge to the country.

2.0 BACKGROUND

2.1 The Banking Sector

The Companies Act, the Banking Act, the Central Bank of Kenya Act and the various prudential guidelines issued by the Central Bank of Kenya (CBK), governs the Banking industry in Kenya.

The banking sector was liberalized in 1995 and exchange controls lifted.

The CBK, which falls under the Minister for Finance docket, is responsible for formulating and implementing monetary policy and fostering the liquidity, solvency and proper functioning of the financial system.

As at December 2008 there were forty-six banking and non-bank institutions, fifteen micro finance institutions and one hundred and nine foreign exchange bureaus.

The banks have come together under the Kenya Bankers Association (KBA), which serves as a lobby for the banking sector's interests. The KBA serves a forum to address issues affecting members.

Players in this sector have experienced increased competition over the last few years resulting from increased innovations in the market, specifically from the emergence of M-Payments and E-Payments.

2.2 The Capital Markets Authority

The Capital Markets Authority (CMA) was established in 1989 as a body corporate with perpetual succession through an Act of Parliament to regulate and oversee the orderly development of Kenya's capital markets. The mission of the Capital Markets Authority is to promote the development of orderly, fair, efficient, secure, transparent and dynamic capital markets in Kenya within a framework which facilitates innovation through an effective but flexible system of regulation for the maintenance of investor confidence.

Pursuant to its mission, the CMA is guided by the following objectives:

a) Facilitate the creation of incentives for and the removal of impediments to long-term investments in productive activities.

b) Facilitate the existence of a market in which securities can be traded in an orderly, fair and efficient manner, and ensure participation of the general public.

c) Protect investors from financial loss arising from failure of a broker or dealer to meet his contractual obligations through a guarantee embodied in the compensation fund.

d) Develop a framework through which electronic commerce may be used for the development of capital markets in Kenya.

e) Develop new financial products to diversify the market and attract investors.

f) Facilitating the training and education of investors and other market participants.

g) Participate in the integration of the East African capital market.

h) Develop a legal and regulatory framework for the market. In this regard, the CMA has formulated the following rules and regulations:

a. Capital Markets (Licensing Requirements) (General) Regulations, 2002

b. Capital Markets (Securities) (Public Offers, Listing and Disclosure) Regulations, 2002

c. Capital Markets (Takeovers and Mergers) Regulations

d. Capital Markets Authority, Foreign Investor Regulations, 2002

e. Capital Markets Authority Fees Structure

f. Collective Investment Schemes Regulations, 2001

g. Corporate Governance Guidelines, 2002

h. Rating Agency Guidelines, 2001

2.3 Corporate Governance

Section 11 (3) and 12 of the Capital Markets Authority Act empower the Capital Markets Authority to make rules and regulations to govern capital markets in Kenya. Pursuant to this authority, the Capital Markets Authority developed guidelines on corporate governance practices by public companies in Kenya, in 2002 and incorporated them as a schedule in the Capital Markets Act.

The guidelines were developed in recognition of the role of good governance in corporate performance, capital formation, maximization of shareholders value and protection of investor's rights.

The main objective of these rules is to strengthen corporate governance practices in public listed companies in Kenya and to promote the standards of self-regulation so as to bring the level of governance in line with international standards.

The Authority has defined corporate governance as the process and structure used to direct and manage business affairs of the company towards enhancing prosperity and corporate accounting with the ultimate objective of realizing shareholders long-term value taking into account the interests of other stakeholders.

The Authority has also identified a number of principles as essential and critical foundations for good corporate governance practices. These are the minimum standards that public listed companies are expected to adhere to and they relate to directors, shareholders, auditors, public disclosure, chairman and chief executives.

3.0 REPORT ON THE DISCUSSIONS

3.1 Welcome and Opening Remarks

Dr. Kiarie Mwaura opened the workshop by welcoming the participants and asking them to introduce themselves. He also warmly thanked Christine A. Agimba for providing the opportunity and support to engage in discourse on the emerging trends in commercial and financial law.

Christine A. Agimba outlined the objectives of the workshop and called for a strong partnership between the School of Law and the commercial and financial sector to help make the recommendations following the presentations work.

3.2 Day 1

3.2.1 M-Payments, E-Payments and the Future

The Internet has elements of common standard; it makes us all belong to one platform and allows its users to connect easily through their phones and PCs. In 1977 there were 111 hosts whereas today 80% of the worlds population are Internet users. Africa alone accounts for over 110.9 million Internet users, and in Kenya 25% of the population has access to the Internet.

The Internet has made E-Commerce possible. E-Commerce makes everything accessible to us. It allows price comparison from different countries.

The Internet is attracting a lot of research, and it simplifies marketing as well.

The Republic of South Africa has a 60% access to finance; Namibia 45% whereas Kenya has a 23% access to finance. Banking has been with us for over 100 years then why is Kenya at 23%?

The answer lies in the challenges Kenya faces. These challenges are posed by the inefficiency in the infrastructure, transport, telecommunication, and power sectors. Shortages in fuel and food are also challenges that Kenya faces. However, despite the difficult terrain, illiteracy, and poverty, mobile technology has been adopted very fast in Kenya and Africa as well. Consequently, there is a need to look for solutions for the problems faced as a result of this technology.

The areas of concern are the element of storing money in a phone. 90% of Kenyans believe that their money is safe with MPESA. Mobile subscribers as at 2010 stand at 25million, thus over 60% of the Kenyan population has access to mobile phones. This in turn has resulted in the growth of MPESA; a system that needs to be regulated in order to curb the possibility of fraud. Accordingly, mobile banking and cyber crime as well are aspects of the law, which have not been addressed.

3.2.2 Need for Legal and Regulatory Framework for M-payments and E-payments

There is a need for a regulatory framework for M-payments and E-payments, and there is also a need to look into the role played by the regulatory bodies.

The issues to be considered under the legal framework are Debit cards, Credit cards, Smart cards, SWITCH, Truncation, and RTGS whose subscribers are offered with an opportunity to buy any product anywhere.

M-payments only require the Identification Card number. The challenge, therefore, is on the possibility of fraud in this area. Thus arises the need to protect Kenyans from unscrupulous people. Consequently, Banks carry out references for the purpose of vetting applicants before employing them. Is the same procedure also a requirement when it comes to employing agents in M-Payments?

M-Payments i.e., Mobile Payments is all about reaching out to the unbanked. Accordingly, we need to think about protecting the unbanked especially when it comes to withdrawal of MPESA money. The issue of information privacy is critical to prevent fraud.

The major users of this system are the rural people and the unbanked. M-Payments offer a wealth of opportunities to retailers and financiers. Despite this advantage there are a number of challenges to M-Payments as well as E-Payments.

These challenges are in the subletting of agencies and the difficulty of tracing fraudsters.

The issues that need to be considered in the development of a legal framework to combat these challenges are as follows:

a. Efficiency: we need to pass information to the subscribers and avail access to it. This is a permanent objective.
b. Consumer confidence: in withdrawal of money and confirmation on receipt.
c. Efficient payment methods and instruments.
d. Coming up with policy issues for Central Bank in retail payments: for example the BASEL prudential guidelines.
e. Security is a condition: there would not be any trust in this system without security. Insecurity needs to be reduced.
f. The issue of terrorism financing through the M-Payments: how much you can store and withdraw at any given time should be addressed.
g. Competition: access to market and level playing field is critical.
h. Customer protection at a high level: Article 151 of the European Treaty to be considered.
i. What to do when it comes to unauthorized payments and fraud. This is where we think about how to protect the unbanked.

3.2.3 Regulation of Banking Institutions

Section 3 of the Banking Act, Chapter 488 of the Laws of Kenya shows that Banks are regulated by way of licensing. Regulation is important and the Central Bank needs to come in to regulate the area of bank contracts and the interest that is charged by the Banks.

Auditing is also another way of regulating Banks. The Central Bank can appoint a qualified auditor where it feels that a Bank is not proceeding in the right way. Through auditing and giving directions to the Banks, the Central Bank can regulate the Banks.

Regulation also concerns the opening and closing of the Bank's branch. The Central Bank thinks that the closing down of a Bank's branch may not affect the customers. This presumption is not well founded. Opening of a Bank branch requires the approval of the Central Bank, whereas closing down the Bank's branch requires only a 6-month notice.

Furthermore there is also a need for regulation in the area of amalgamation and the transfer of a Bank's assets to another Bank in order to prevent the theft of money.

There is also a need to restrict the trading done by Banks. All banks today are multifunctional. The Banking Act does not take into account multifunctional banking. Banks operate as trustees, and as agents over property, and that has not been contemplated in the Banking Act.

It is not only through the law that Banks can be regulated. Economic policies can also be used as a way of regulation. Policy therefore can be a source of regulation.

3.2.4 Banking Law Reforms

The emerging issues of money laundering and terrorist financing have called for the need to regulate Banks.

The Central Bank of Kenya was established in 1966 and in 1984 there was a Banking crisis. As a result, the Banking Act was amended to provide for the Deposit Protection Fund, the question then is whether the amount provided per depositor is adequate or not [Kshs.100, 000 per depositor].

The factors that drove reform were based on the Banks:

a. Financial indiscipline;
b. Lending without security;
c. Need to respond to the rise of technology; and
d. The need to counter money laundering.

The initiatives that were taken were as follows:

a. Coming up with Prudential Regulations (concerning the supervision of banks, risk management, and to ensure security of depositors funds, in line with Basel 1.)
b. Amendments to the Banking Act to take into account the provisions of Basel 1.
c. Micro Finance Act and Regulations were passed. Object being to regulate the establishment of Micro Finance institutions and making them efficient.
d. Introduction of Agency Banking by way of the 2009 amendment to the Banking Act to include the word "agent".
e. Establishment of Credit Reference Institutions that collect personal financial information on customers for credit history-information sharing. The goal being to reduce fraud.

In conclusion the challenges that now remain are in the grey area concerning:

a. Bank insurance. This is not allowed but Banks indirectly practice it.
b. Lack of regulations concerning mobile and electronic banking.
c. Islamic Banks not having been addressed by the Banking Act.

3.2.5 Recent Amendments to Banking Law

When the Donde Act was introduced for the purpose of regulating the Banks, the Banks refused to accept the provisions of the Act. No Bank accepted it and neither did any bank comply with it yet Central Bank as the regulator was there! Thus it can be said that the Central Bank has been dormant. It has not being doing its work.

In 2004 the Donde Act was repealed.

The main concern with the Banking sector is that Banks are using their discretion to change the rate of interest on grounds that the customs and practices of the Banks allow them that latitude. Judges follow this argument. Section 39 of the Banking Act stipulates that a ministerial approval is required for the purpose of increasing the rate of interest. When Daima Bank breached this provision the Courts remained mum.

In fact no bank has ever applied for permission to apply for an increment. Parliament has established a regulator and the regulator is not following the written law. This gave rise to a debate that led the Minister to publish guidelines for the Banks on how to apply for the ministerial consent to raise bank charges.

Practice has shown that Banks avoid the statute. The *Duplum Rule* requires that Banks inform the borrower that the loan is non performing and then to state what the principal amount is and the interest as well and to give the borrower time to pay. Failure of which the Banks right to foreclosure arises.

Banks in practice do not follow the Duplum Rule.

Thus the Banking Industry needs to be controlled. Central Bank's supervision is very weak. The Bank needs to be intrusive even though the other banks do not like it. For the well being of the borrowing public the Central Bank needs to supervise the banking industry. The Duplum Rule must be enforced and obeyed.

3.3 Day 2

3.3.1 The Paradox in the Implementation Matrix of Capital Markets Reforms in Kenya

The Vision 2030 on capital markets recognizes the importance of financial development, the promotion of long-term investments, and the listing of more companies at the Nairobi Stock Exchange [NSE].

The Capital Markets Authority [CMA] is the main regulatory body in the financial sector and its principle objective is set out under Section 11 (1) of the Capital Markets Act, Chapter 485A of the Laws of Kenya.

Our main objective should be to let the markets self regulate, as we focus on the protection of investors through the Investor Protection Fund. However, our reforms are not helping us achieve this objective. Our capital market is urban. The CMA has limited capacity and its supervision of the markets therefore remains weak. The Authority was only established to regulate the NSE and that is a wrong intention. The intention should be focused on the development of the market.

Our reforms have been concentrated on developing a regulatory market rather than on the development of the markets. We need to promote integrity and confidence in the markets and that is where our reforms should be centered on.

Between 1954 and 1990 markets developed without regulation therefore we can say that it is not regulation that brings development in the markets. Conversely in 1990 four stockbrokers collapsed under the watch of the CMA.

Section 18 of the Capital Markets Act establishes the Investor Compensation Fund [ICF]. The ICF does not have officers, it's Board is non functional and this has an impact on investor confidence and on investment itself.

In 2010 the ICF had Kshs 424 million in its fund and it paid out Kshs 281,880,000 in compensation to Nyaga Stock Brokers. The ICF paid more than half of what it was holding. What would have happened if there were more investors who were to be compensated?

There is a need to develop the capital market, to educate people, to come up with concerted efforts to move towards self-regulation by the markets to a practical extent.

There is a need to make the ICF autonomous. Kshs 50,000 is the amount paid out for investor compensation, this should be increased and the investors need to be educated.

We do not need another Stock Exchange. SMEs are ignored completely. Our markets are small and if we establish a market in Mombasa it will be trading once. We do not have the capacity. Our capital market is connected to our economy. If the economy is not growing, neither will the markets. Instead of focusing on regulation, we need to focus on developing our markets.

Self-regulation was the result of the collapse of the four stockbrokers. Self-regulation has failed across the board. We have to share responsibilities. Our argument should be on how to the share responsibilities. Self-regulation is not sustainable. The NSE cannot police itself; it will not be serious in regulation since regulation will impact negatively on its operation. We need to protect consumers and self-regulation is not the way.

Investor education is an excellent way forward.

The ICF Board has the power to manage the money. Yet the ICF is only seen as a pay shop. Apart from compensating what else does it do? It does not have money-raising powers. Reform should take this into account.

It has been noted that Kenya does not have a culture of saving. Savings must be encouraged [for example the Smart Youth program]. This awareness must be created, and only then will we have more people participating in the market. We cannot talk of regulation when there is no participation in the market. Consumer confidence must be brought into the market. People must know of their rights and the rights of shareholders so that they understand investment and promote its growth.

The legal structure to take care of the minority in our corporate structure is dead. Shareholders rights are practically non-existent.

Therefore self-regulation is doubtful. The Banking Code itself is not about regulation it is about defending the banks, and how to fight with the customers.

3.3.2 Effectiveness of the Policy and Legislative Measures under the Proposed Amendments to the Capital Markets Legal and Regulatory Framework

The capital market is part of the financial system that provides funds for long-term development. This is a market that brings together lenders (investors) of capital and borrowers (companies that sell securities to the public) of capital.

In January 2004, the Financial Sector Reform and Strengthening (FIRST) Initiative launched a "*Strategy for Development Finance and Increasing Access to Financial Services*" project for Kenya, which was completed in February 2005. The aim of the project was to strengthen the financial sector in Kenya by reforming the Development Finance Institutions, and facilitating access to finance for rural and small-and-medium enterprise sectors.

In October 2004, the World Bank approved the Proposed Credit to Kenya for the Financial and Legal Sector Technical Assistance Project. According to the World

Bank website, the overall objective of the program was to "create a sound financial system and strengthen the legal framework and judicial capacity." One of the main components of the Project included the development of long-term securities and capital markets in Kenya.

The World Bank has stressed that the Capital Markets Authority has limited capacity and lacks operational independence, and that its enforcement of market rules and supervision of market participants is relatively weak.

Kenya's capital market is still at a nascent stage. The NSE, a self-regulatory organization under the supervision of the CMA, is the sole licensed trading exchange in the country. All applications for listing must be approved by the CMA, and are subject to NSE Rules and Regulations. The NSE is divided into three parts. The Main Investment Market is the dominant segment and favorable for "mature companies with strong dividend streams". The Alternative Investment Market is favorable for small and medium sized enterprises. The Fixed Income Securities Market "allows businesses, financial institutions, and governments and supranational authorities to raise capital through the issuance of debt securities".

There are two major Acts of Parliament governing Kenya's capital market. The Capital Markets Act and the Central Depositories Act, 2000.

Reform has been proposed by way of amendments to the Capital Markets (Licensing Requirements) (General) Regulations, 2002. These amendments are necessary to implement a demutualized stock exchange following the move towards demutualization which commenced with the amendment to the Capital Markets Act in the 2010 Finance Bill which converted the requirements for licensing a stock exchange from a company limited by guarantee to a company limited by shares.

There has also been a proposed amendment on private transfers. Consequently, private transactions will be made easier.

However there is a need to license market participants and control the persons applying for license. We also need to do away with the public and private dichotomy when it comes to listing at the stock exchange. We need to come up with reasonable thresholds for a company to go public. This way we can increase listings. This public-private dichotomy has worked against us. CMA and NSE are not proactive. They do not look for customers. They should inform Private companies of the benefit of listing. Kenya has listed in Tanzania and Uganda, why are serious Ugandan and Tanzanian companies not coming here. We need to encourage and entice those companies to come here.

3.3.3 International Best Practices in the Regulation of Capital Markets

What is international about the securities markets? Capital markets are becoming globalised through increased dealings in securities in different jurisdictions and the explosion of technological advances.

We do not have much on international capital market regulation. We only have principles that countries are encouraged to adopt. It is a soft law approach and it is voluntary, and these are the International Best Practices. We cannot have an international securities regulation based on soft law. Regulations can only be implemented through national law.

A capital market is not a physical building. It is all about the market participants, investors, shares and the stock exchange. Security exchange is the component of the capital market.

There are three main reasons for securities regulation. These are to protect investors, reduce risks and bring in confidence in the market.

In regulating the market we need to deal with the tension between capital formation and investor protection. We also need to consider Government protection and regulation.

The consideration when it comes to regulation is on what approach to take. Is regulation to be by way of enforcement or by rule making? That is the question. Rule making impacts the market. If the regulator enforces the law harshly investors will not come into that market. Whereas having a loose regulatory structure will force companies to list in other jurisdictions in order to get more credibility, and protection mechanisms.

In Kenya we have an institutional approach towards our sectors. We have the CMA for the financial sector. The institutional approach encourages the development of expertise in that area. Our industries are young and we need to develop the expertise and this approach encouraging.

Self-regulation must be responsive to the needs of the market. Unless it does this, it is not useful. Self-regulation must be seen in the context of state regulation.

Financial illiteracy is the rule here in Kenya therefore public education must be sustained. There is no clear policy on financial services. Our legal infrastructure is being reformed now. CMA lacks autonomy. Stockbrokers are persuasive. There is no clear policy on the enforcement philosophy of CMA. Some of these problems will be cured by time.

3.3.4 The Companies Bill 2010: Challenges and Opportunities for Corporate Governance

Corporate governance is about conducting businesses in a way to ensure fairness. Due to misconduct and failure of oversight on the part of directors, companies such Kenya Bus Services, Trust Bank, AT & H, Muhoroni Sugar, United Insurance have failed.

The areas that are rife for reform is between managers and shareholders. It has been noted that the controlling shareholders oppress the minority, there is skewed

access to information, and managers are likely to exploit shareholders wealth and we lack just courts that can be trusted to arbitrate. Fair treatment of all parties in the corporate is essential.

This fairness is part and parcel of the way the Board of Directors carries out its responsibilities. The role of the Board is central in corporate governance.

When it comes to regulation, other than the Companies Bill there is also the Corporate Governance Code for Listed Companies in Kenya (2002) that provides a guidance material on best practice, equitable treatment of shareholders, transparency and disclosure of information, clarification of the responsibility of the Board.

According to Price WaterHouse Coopers the way we select our directors is very poor, there is lack of independence among the directors, there is little controversy in boardrooms, and rarely are issues raised, there is poor succession planning, and conflict of interests are rampant.

What has been identified as a weakness in our Company Law is in how to appoint directors.

The way a company structures its Board of directors is significant to the quality of governance. There should be representation for the minority shareholders so that there would be confidence in the organization.

3.3.5 Horizontality and the New Bill of Rights: Towards a Clearer Definition of Parameters of Corporate Obligations and Complicity for Human Rights Violations

Governance of corporations is as important as governing nations. Hence there is the need to extend International Human Rights to corporations.

Article 20 (1) of the Kenyan Constitution states that the Bill of Rights applies to all laws and binds all State organs and all persons. The article does not define a person. The interpretation section of the Constitution defines a person as to include a company. Thus the banks today can be regulated by the new Constitution under the Chapter on the Bill of Rights.

The concern therefore is whether or not the Constitution should be used to regulate private persons.

Scholars say that the Constitutions were not made for private persons but for the regulation of governments and that regulating private persons through the Constitution will lead to a floodgate of cases and then the courts will not be able to apply the Constitution to the government.

We do not have a proper framework to control businesses and that is a challenge to us and for us. Especially where we have direct and indirect violations of human rights by companies. These parameters need to be drawn clearly. An

approach to realizing this objective is to have human rights auditors on an annual basis auditing a company's human rights practices. This will also create a new profession.

4.0 SECTOR SPECIFIC RECOMMENDATIONS

4.1 Banking Law

1. To create consumer awareness and confidence in mobile banking by disseminating the information to the rural and the unbanked population.
2. To regulate the M-Payments and E-Payments system in order to prevent fraud and unauthorized payments.
3. To put in place mechanisms to trace fraudsters or in the alternative to provide for adequate remedies.
4. To put in place measures for the regulation of:
   a. Bank contracts;
   b. Bank interest rates; and
   c. Amalgamation and transfer of the bank assets.
5. To restrict the trading done by banks or to amend the Banking Act to allow for banks to engage in activities in addition to banking.
6. To strengthen CBK's supervision of the banking sector.
7. To control persons applying for licenses.
8. To call for a specialized judiciary.

4.2 Capital Markets Law

1. To investigate measures that will develop the market.
2. To have the public invest in shares.
3. To list more companies at the NSE.
4. To protect investors and create investor confidence by giving the Investor Compensation Fund Board the powers to manage the money it holds.
5. To do away with financial illiteracy through public and investor education.
6. To come up with a clear policy on financial services.
7. To call for a specialized judiciary.

4.3 Corporate Governance

1. To come up with a selection criteria for appointing directors.
2. To assist in an organization's succession planning.
3. To ensure the minority shareholders are represented in a company.
4. To have human rights auditors on an annual basis auditing a company's human rights practices.
5. To call for a specialized judiciary.

5.0 GENERAL RECOMMENDATIONS FOR THE SCHOOL OF LAW

1. To identify legal challenges, issues and problems within the fields of commercial and financial law with the aim of engaging in collaborative research with the main players in these fields in order to come up with possible answers and solutions.
2. To comment on legislation addressing the emerging trends within these fields.
3. To facilitate and provide for the School of Law students a lecture forum and a question and answer session by the main players in these fields.
4. To link the School of Law students to these fields through student attachments.
5. To enhance the quality of the curriculum on offer in these fields.

6.0 CONCLUSION

The two-day workshop on *Banking Law, Capital Markets Law and Corporate Governance* provided an interactive forum to engage in the discourse on the emerging trends in commercial and financial law in Kenya.

A number of recommendations were advanced following the session presentations wherein a number of legal problems, challenges and issues were identified. The discussion sessions also facilitated a better understanding of the legal challenges and problems that Kenya is faced with.

The workshop ended with the suggestion that there has now arisen the need to undertake collaborative research and teaching between the University of Nairobi, School of Law and the industry players.