

PAPER NO. CS 52

SECTION FIVE

CERTIFIED SECRETARIES (CS)

FINANCIAL MARKETS LAW

STUDY NOTES

KASNEB SYLLABUS

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CHAPTER ONE

REGULATION OF FINANCIAL SERVICES

Financial regulations are form of regulation or supervision, which subjects financial institutions to certain requirements, restrictions and guidelines, aiming to maintain the integrity of the financial system. This may be handled by either a government or non-government organization.

The subject of regulation has been one of the most contentious, with critics arguing that regulations interfere with the efficiency of the market, and advocates arguing that well designed regulations not only make markets more efficient but also help ensure that market outcomes are more equitable.

Reasons/Aims of regulation

Only under certain ideal circumstances individuals, acting on their own, obtain “pareto efficient” outcomes, that is, situations in which one can be made better off without making another worse off. These individuals involved must be rational and well informed, and must operate in competitive market.

Places that encompass a full range of insurance and credit markets, thus the theory of self regulation. In the absence of these ideal circumstances, there exist government interventions that can potentially increase societal efficiency and/or equity. Some of the major elements of these interventions are by now well accepted:

1. Antitrust laws, to prevent the creation of monopoly power and /or its abuse;
2. Consumer protection legislation, designed especially to address potential problems of exploitation arising from information asymmetries;
3. And regulations to ensure the safety and soundness of the banking system, which are made necessary by systemic externalities (spillover effects of economic transactions affecting many people who were not parties to the transactions) that can arise when a “systemically” important institution fails, or is allowed to fail.

The current economic crisis e.g., in Kenya, the Nyaga stock brokers, Discount securities limited, Pyramid schemes, collapsing Banks and economies, has highlighted the need for government intervention in the event of the failure of a systematically important institution.

But the need for massive intervention implies, in turn, the need to take actions to prevent the occurrence of such failures in the first place. Sometimes the damage done by actions that have adverse effects on others can be compensated for after the fact, but in the cases at hand, this is in general not possible. Policy intervention should be designed to make less likely the occurrence of actions that generate significant negative spillovers, or externalities.

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But these are not the only reasons for government interventions. Markets fail to produce efficient outcomes for a variety of other reasons that economists have explored over the last twenty-five years. Markets are plagued by problems of information asymmetries, and there are incentives for market participants both to exploit and to increase these information asymmetries. For a variety of reasons key markets (such risks that individuals and firms face) are missing.

Even when markets are efficient, they may fail to produce socially desirable outcomes. The wealthy and powerful may “exploit” others in an “efficient” way: the gains to one are offset by the losses to others, and in traditional economic parlance, so long as that is the case, markets are efficient. No one can make better off without making someone else worse off.

But some outcomes are socially unjust, and unacceptable. Governments impose regulations to prevent such exploitation and to pursue a number of other social goals.

In financial markets, interventions include:

- i. Disclosure of information
- ii. Restriction on incentive schemes (including conflict of interest)
- iii. Restriction on ownership
- iv. Restriction on particular behaviours
- v. Taxes designed to induce appropriate behaviours
- vi. Intervention to ensure competition

One of the big failures that the recent global financial crisis has exposed is that we allowed financial institutions to grow “too big to fail.” Not only may such large institutions be able to exploit market power, but they also pose systemic risk to the economy and have perverse incentives that encourage such behaviour. Institutions that grow too big to fail to pick inevitably know that if they undertake high-risk activities and fail, government will pick up the pieces, but if they succeed, they walk away with the gains. An example is the recent failure of pyramid schemes, networking businesses and the two or so stock brokerage firms who went down unchecked.

While regulation has typically focused on preventing “harmful” behaviours, there are some regulations that encourage “constructive” behaviours. These include lending requirements, designed to ensure that there is a certain flow of credit to underserved communities.

Some interventions combine traditional equity concerns with market failures:

Government may encourage private provision of retirement insurance (recognizing the social consequences of old age poverty), but also recognize the abuses that may arise, unless there are restrictions to ensure that ordinary workers are treated symmetrically with management.

Again, this crisis has exposed a regulatory failure: regulations failed to prevent the exploitation of poor and poorly educated borrowers by lenders. These people were not able to ascertain well

the risks associated with various lending provisions. The result is a massive social and economic disaster: people are losing their life savings.

By its nature, a regulation restricts an individual or firm from doing what it otherwise would have done. Those whose behaviour is so restricted may complain about, say, their loss of profits and potential adverse effects on innovation. But the purpose of government intervention is to address potential consequences that go beyond the parties directly involved, in situations in which private profit is not a good measure of social impact. Appropriate regulations may even advance welfare-enhancing innovations.

In short, regulations is necessary because social and private costs and benefits, and hence incentives, are misaligned. Such misalignment leads to problems not only in the short run but also in the long run.

Incentives to innovate are distorted. Kenya's financial system has been highly innovative, but to a great degree innovation has recently been directed at circumventing laws and regulations designed to ensure the efficiency, equity, and stability of the financial sector.

Brokerages, banks, and insurance companies, among others have engaged, in effect, in accounting, tax, and regulatory arbitrage. But our financial system did not innovate in truly important ways that would have enabled Kenyans to better manage the risks they face.

The designs of regulatory structures and systems have to take into account:

- a) Asymmetries of information, since the regulator is often at an informational disadvantage relative to the regulated
- b) Moral hazard, since there are often problems in ensuring that a regulator's behaviour is consistent with social welfare (for example, that he/she is not beholden to those whom he/she is supposed to be regulating
- c) Human fallibility, since mistakes are inevitable and we need to minimize the costs of such mistakes.

Well-designed regulations take into account the limitations of implementation and enforcement. While no regulatory system is perfect, economies with well-designed regulations can performed far better than those with inadequate regulation. Regulations can both enhance and protect those who might otherwise suffer in unregulated markets.

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There are theories which explain the need for regulation in financial markets. These are:-

1. Public Interest theory of regulation
2. Capture theory of regulation
3. Economic interest theories of regulation
4. Special Interest Theory and Group Competition
5. public choice theory

Public Interest theory of regulation

Public interest theory is an economic theory first developed by Arthur Cecil Pigou that holds that regulation is supplied in response to the demand of the public for the correction of inefficient or inequitable market practices. Regulation is assumed initially to benefit society as a whole rather than particular vested interest. The regulatory body is considered to represent the interest of the society in which it operates rather than the private interests of the regulators

Assumptions

This theory assumes that economic markets are extremely fragile and apt to operate very inefficiently (or inequitably) if left alone. The government is assumed to be a neutral arbiter.

The public interest view holds that governments regulate financial institutions to facilitate the efficient functioning of financial institutions by ameliorating market failures, for the benefit of broader civil society. In financial institutions, the public interest would be served if the financial institutions system allocated resources in a socially efficient manner (i.e. “maximizing output and minimizing variance”) and performed well other functions of finance.

Criticisms

Public interest theory is usually contrasted with public choice theory that is more cynical about government behaviour and motives, and sees regulation as being socially inefficient. Moreover according to Stigler, regulation can be captured by incumbent firms to protect the market from the entry of competitors. Critics believe this will only occur when the public demands a better allocative efficiency. This "theory" has no verified predictions or outcomes; therefore it is not viewed as a valid theory.

Capture Theory and Monopoly Control

The public-spirited vision of the public interest theory of regulation began to be challenged systematically in the early 1970s when researchers suggested that the individual regulatory agencies of government did not work for the public interest at all. Instead, they worked for private interests who actually demanded to be regulated as way of enhancing profits. Going further, some even argued that each individual government agency was "captured" by the leading organized interest (a company or business association) in the industry over which a particular agency operated (Stigler 1971).

This view rests on the understanding that the political actors most interested in the regulation of a particular industry are the companies in that very industry. In Texas, for instance, the oil and natural gas industry is thought to be the single party most interested in the types of regulation that the Texas Railroad Commission promulgates, and the Texas Farm Bureau is the most interested party with regard to state agricultural policy.

Because of this tightly focused interest orientation among economic actors, it is thought that each regulating agency has been isolated and essentially taken over by a single powerful interest or interest association representing the very industry under regulation. Furthermore, it is believed that powerful interests in one industry generally do not interfere with the regulating activities in other industries. In other words, the Farm Bureau doesn't mess with the Railroad Commission and the oil and gas industry doesn't mess with the Texas Department of Agriculture.

This line of analysis implies that there is little or even no competition over control of public policy among economic interests. Within each industry a single company or industry association dominates, and each industry minds its own business being careful not to interfere with other industries and their particular public agencies.

Citizens, meanwhile, are thought to be largely absent from the processes of economic regulation. This exclusion of citizens is thought to result from two things: the issues and processes involved are complex and arcane, and the impact of regulation on any individual citizen is relatively light compared to the impact on the businesses under regulation. A citizen paying a few dollars more per month for electricity is relatively insignificant compared to the millions of dollars at stake for an electric utility company.

In short, regulation exists not because citizens need it, but because the regulated industry wants it!

The capture theory of economic regulation provides some of the theoretical foundation for the concept of "iron triangles" (also known as policy sub-governments), which depict a three-way

relationship between a government agency, the industry over which it has responsibility and the relevant legislative committees. For more information on sub-governments, please see section 5.4 in the chapter on interest groups.

Economic interest theories of regulation

The theory assumes that everybody acts in their own self-interest, including regulators and those people that are regulated.

Rational: ‘Regulators will only propose and support regulation which leads to favorable outcomes for themselves, perhaps in terms of their re-election.

Special Interest Theory and Group Competition

This approach to understanding regulation developed as a response to the capture theory. Some researchers reject the capture theory's emphasis on monopoly control of individual agencies by one narrow group of powerful interests. Instead, they propose that multiple groups actually compete for control of an agency's activities

The average citizen is not a major factor in this model either. Instead, powerful groups fight among themselves to use the coercive authority of the government to makes rules and regulations that would help their particular businesses. Such rules might help one industry or company, but hurt others.

As in the capture theory government regulation is not regarded by the regulated industries as an inherently bad thing. Instead, the regulated industries or companies actually demand regulation. The key difference between the capture theory and the special interest theory is that the latter holds that competition among special interests can be both widespread and intense.

Public choice theory

Public choice or **public choice theory** has been described as "the use of economic tools to deal with traditional problems of political science". Its content includes the study of political behavior. In political science, it is the subset of positive political theory that models voters, politicians, and bureaucrats as mainly self-interested. In particular; it studies such agents and their interactions in the social system either as such or under alternative constitutional rules. These can be represented in a number of ways, including standard constrained utility maximization, game theory, or decision theory.

Public choice analysis has roots in positive analysis ("what is") but is often used for normative purposes ("what ought to be"), to identify a problem or suggest how a system could be improved by changes in constitutional rules, the subject of constitutional economics.

The specific aims/reasons of both local and international financial markets' regulation are usually:

- i. To enforce applicable laws
- ii. To prosecute cases of market misconduct, such as insider trading
- iii. To licence providers of financial services
- iv. To protect clients, and investigate complaints
- v. To maintain confidence in the financial system
- vi. Market confidence: maintaining confidence in the financial system
- vii. Public awareness: promoting public understanding of the financial system
- viii. Consumer protection: securing the appropriate degree of protection for consumers
- ix. The reduction of financial crime: reducing the extent to which it is possible for a business to be used for a purpose connected with financial crime.

RETIREMENT BENEFIT AUTHORITY

It's established under section 3 of the retirement benefits Act. i.e. (RB Act) of 1997 with its headquarters in Nairobi. The RBA shall be a corporate body with;

- a) Perpetual succession
- b) Common seal

Characteristics

1. The retirement Benefit Authority shall in its corporate name be capable of suing and being sued
2. Taking, purchasing or otherwise acquiring, holding, charging or disposing of movable and immovable property;
3. Borrowing and mortgage its assets for credit purposes
4. lending money: and
5. Doing or performing all other things or acts for the furtherance of the requirement of Retirement Benefits Act.

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Objects and functions of the authority

The object and functions of the Authority shall be to:

- i. Regulate and supervise the establishment and management of retirement benefits schemes:
- ii. Protect the interests of members and sponsors of retirement benefits schemes:
- iii. Promote the development of the retirement benefits sector:
- iv. Advise the Minister on the national policy to be followed with regard to retirement benefits schemes and to implement all Government policies relating thereto: and
- v. Perform such other functions as are conferred on it by this Act or by any other written law.

Management of the Authority

The management of the Authority shall vest in a Board of Directors of the Authority which shall comprise:

1. A chairman to be appointed by the Minister from amongst the 5 members appointed by the minister by virtue of their expertise.
2. The Chief Executive Officer appointed under by the board in consultation with the minister
3. The Permanent Secretary in the Ministry for the time being responsible for matters relating to finance or his representative;
4. The Commissioner of Insurance;
5. The Chief Executive of the Capital Markets Authority; and
6. Five members, not being public officers, appointed by the Minister by virtue of their knowledge or experience in matters relating to the administration of scheme funds, banking, insurance, law or actuarial studies.

Powers of the Board

The Board shall have all powers necessary for the performance of its functions under section 7 of the retirement Benefit Act. The Board shall have power to:-

- a) Control, supervise and administer the assets of the Authority in such manner and for such purposes as best promote the purpose for which the Authority is established;
- b) Determine the provisions to be made for capital and recurrent expenditure and for reserves of the Authority;

- c) Receive any grants, gifts, donations or endowments on behalf of the Authority and make legitimate disbursements.
- d) Enter into association with other bodies or organizations within or outside Kenya as the Board may consider desirable or appropriate and in furtherance of the purpose for which the Authority is established;
- e) Open a banking account or banking accounts for the funds of the Authority; and
- f) Invest the funds of the Authority not currently required for its purposes in the manner provided under RBA

Conduct of business and affairs of the Board

The conduct and regulation of the business and affairs of the Board shall be as provided in the Schedule but subject thereto, the Board shall regulate its own procedure.

Delegation by the Board

The Board may, by resolution either generally or in any particular case, delegate to any committee of the Board or to any member, officer, employee or agent of the Authority, the exercise of any of the powers or the performance of any of the functions or duties of the Authority under this Act or under any other written law.

Remuneration of Board members

The Authority, in consultation with the Minister, shall pay members of the Board such remuneration, fees or allowances for expenses as it may determine.

The Chief Executive Officer

1. There shall be a Chief Executive Officer who shall be appointed by the Board in consultation with the Minister and whose terms and conditions of service shall be determined by the Board in the instrument of appointment or otherwise in writing from time to time.
2. No person shall be appointed under this section unless he has at least ten years experience in a managerial capacity in the retirement benefits, accounting, finance, insurance or the banking sectors.

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3. The Chief Executive Officer shall be an ex officio member of the Board but shall have no right to vote at any meeting of the Board.
4. The Chief Executive Officer shall, subject to the directions of the Board, be responsible for the day to day management of the affairs of the Authority.

Staff of the Authority

- a. The Board shall appoint a secretary to the Board on such terms and conditions of service as the Board may determine.
- b. The Board may appoint such officers or servants as are necessary for the proper discharge of the functions of the Authority under this Act or any other written law, upon such terms and conditions of service as the Board may determine.

The common seal of the Authority

- i. The common seal of the Authority shall be kept in such custody as the Board may direct and shall not be used except on the order of the Board.
- ii. The common seal of the Authority when affixed to a document and duly authenticated shall be judicially and officially noticed and unless and until the contrary is proved, any necessary order or authorization by the Board under this section shall be presumed to have been duly given.

Protection from personal liability

No matter or thing done by a member of the Board or any officer, employee or agent of the Authority shall, if the matter or thing is done bona fide for executing the functions, powers or duties of the Authority, render the member, officer, employee or agent or any person acting on their directions personally liable to any action, claim or demand whatsoever.

Liability of the Authority for damages

The provisions of this Act shall not relieve the Authority of the liability to pay compensation or damages to any person for any injury to him, his property or any of his interests caused by the exercise of any power conferred by this Act or any other written law or by the failure, whether wholly or partially, of any works.

The Retirement Benefits Levy

1. The Minister may, in consultation with the Board, by order published in the Gazette, impose a levy to be known as the Retirement Benefits Levy on the contributions made to scheme funds, or on the assets of such funds, or on such other base as he may determine.
2. A levy imposed under this section shall be payable at such rate as may be specified in the order.
3. An order under this section may contain provisions as to the time at which any amount payable by way of the levy shall become due.
4. All moneys received in respect of the levy shall be paid into the Fund and if not paid on or before the date prescribed by the order, the amount due and any sum payable under shall be a civil debt recoverable summarily by the Authority.
5. If a person fails to pay any amount payable by him by way of the levy on or before the date prescribed by the order, a sum equal to five per centum of the amount shall be added to the amount due for each month or part thereof during which the amount due remains unpaid.

The Retirement Benefits Plan Authority Fund/ Retirement Benefits Authority Fund

It is established under section 17 of the Retirement Benefits Authority Act and shall vest in the Authority.

Sources of funds

- i. All proceeds of the levy established by section 16;
- ii. Such moneys or assets as may accrue to or vest in the Authority in the course of the exercise of its powers or the performance of its functions under this Act;
- iii. Such sums as may be payable to the Authority as provided under the Retirement Benefit Act or any other written law, or being any gift or trust;
- iv. Such sums as may be granted to the Authority by the Minister as may be provided by parliament, grants towards expenditure incurred by the board for all purposes.
- v. All moneys from any other source provided for or donated or lent to the Authority.

Investment of funds of the Authority

The Authority may invest any of its funds in securities which for the time being trustees may by law invest trust funds, or in any other securities which the Treasury may, from time to time, approve.

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The Authority may place on deposit with such bank or banks as it may determine, any moneys not immediately required for the purposes of the Authority.

Annual estimates

Before the commencement of each financial year, the Board shall cause to be prepared estimates of revenue and expenditure of the Authority for that year.

The annual estimates shall make provision for all the estimated expenditure of the Authority for the financial year and in particular, the estimates shall provide for:

- i. The payment of the salaries, allowances and other charges in respect of the staff of the Authority;
- ii. The payment of pensions, gratuities and other charges in respect of the retirement benefits which are payable out of the funds of the Authority;
- iii. The proper maintenance of the buildings and grounds of the Authority;
- iv. The maintenance, repair and replacement of the equipment and other property of the Authority;
- v. The creation of such reserve funds to meet future or contingent liabilities in respect of retirement benefits, insurance or replacement of buildings or equipment, or in respect of such other matter as the Board may deem appropriate.

The annual estimates shall be prepared at least three months before commencement of the financial year to which they relate and shall be submitted to the Board for approval and after such approval, the Authority shall not increase the annual estimates without the consent of the Minister.

No expenditure shall be incurred for the purposes of the Board except in accordance with the annual estimates approved under this section or in pursuance of an authorization of the Authority given with the prior approval of the Minister.

Registration of retirement benefits schemes

Retirement benefits schemes shall be established in accordance with provisions of Retirement Benefit Act. No persons shall act as a manager, custodian or administrator unless such a person is duly registered and holds a valid certificate of registration. This doesn't apply to natural persons who are employees of the scheme.

RBA shall publish a list of all registered managers, custodians and administrators at least once in every current year. The publication by the authority shall be in consultation with the minister. Shall publication be by notice in the gazette and public advertisement in at least one daily newspaper of wide circulation

A person who establishes a RB scheme or acts a manager, custodian or administrator contrary to the provisions of RBA, committee of an offence that if convicted is punishable by affine not exceeding Ksh.500, 000 or imprisonment for a term not exceeding two years or both.

Registration of the body

Under section 23(1) of the RBA provides that A person proposing to establish a retirement benefits scheme or to manage a scheme fund shall, before establishing the scheme or commencing management of the fund, apply to the Authority for registration.

Application for registration

An application shall be:

- a. Addressed to the Chief Executive Officer;
- b. In the prescribed form; and
- c. Accompanied by the prescribed fee.

The Authority may request the applicant to supply such additional information as it considers necessary in determining the application.

The Authority may, subject to the provisions of this Act and on payment of the prescribed fee, register the applicant and issue to the applicant a certificate of registration in the prescribed form, authorizing the applicant to establish a retirement benefits scheme, or to manage a scheme fund, as the case may be.

A certificate issued under this section shall be subject to such conditions as the Minister may, in consultation with the Authority, impose.

Requirements for registration of schemes

No scheme, other than a scheme established by a written law shall be registered under this Act unless:

- i. It is proposed to be established under an irrevocable trust; and
- ii. The proposed scheme rules adequately protect the rights and interests of the sponsors and members thereof.

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Requirements with regard to trustees

The trustee must certify the requirement specified under section 26 of the RBA.

The requirements include;

1. The person must not have been sentenced to imprisonment by a court of competent jurisdiction for a period of 6 months or more;
2. The person must not have been adjudged bankrupt;
3. The person must not have been previously involved in the management or administration of a scheme which was deregistered for any failure on the part of the management or the administration thereof;
4. The person must not have been disqualified under any other written law, or his holding office as such is deemed by the Authority as being, in any way, detrimental to the scheme.

Requirements for registration of managers

No applicant for registration as a manager shall be registered unless such applicant:

- i. Applicants must be a limited liability company incorporated under the Companies Act whose liability is limited by shares and whose main objective is to manage scheme funds;
- ii. Applicants must have a minimum paid up share capital as may be prescribed;
- iii. The applicant must be capable of meeting the obligations to members and sponsors specified in the scheme rules;
- iv. Applicants must have professional capacity to manage scheme funds;
- v. Applicant must be one whose never been involved in the management of the scheme fund of any scheme which was deregistered due to any failure on the part of the management;.
- vi. The applicant must meet such additional requirements as may be prescribed.

Roles of a manager

1. Advise the scheme or pooled fund on the asset classes which are available for investment
2. Assist the scheme or pooled fund to formulate a prudent investment policy on the investment of scheme funds or pooled funds
3. Invest capital moneys which form part of the scheme or pooled fund subject to the adopted investment policy
4. Reinvest any income of the scheme fund or pooled fund which is not required by the trustees for any immediate payments

5. Submit to the scheme or pooled funds at least quarterly from the date of commencement of the financial year of the scheme or pooled funds.
6. Issue instructions on behalf of the trustee or the pooled funds to the custodian to transfer, exchange and or deliver in the required form and manner scheme or pooled fund assets held by such custodian
7. Sit in-attendance , in the case of a scheme whose funds are not invested in a pooled fund, at the meetings of the board of trustees whenever the trustees have an agenda item involving management of the scheme fund
8. Issue instructions on behalf of the trustee or pooled fund to the custodian to effect payment in respect of purchased securities or any other assets
9. Keep or cause to be kept such books, records and statements as may be necessary to give a complete record of the scheme fund and investment portfolio held by custodian

Requirement for Registration of a custodian

No applicants shall be registered unless such applicant is;

1. A limited liability company incorporated under the company's Act whose main object is to perform the functions of a custodian within the meaning as given under the Act.
2. Has professional and technical capacity and adequate operational systems to perform the said functions
3. Has never been a custodian of any scheme fund that was deregistered due to any fault either fully or partially of the custodian
4. Meets such additional requirements as it may be described

Roles of a manager

1. Receive and keep in safe custody the title documents, securities and cash of the scheme fund or pooled funds
2. Open a bank account with the bank duly registered under banking act on behalf of the scheme for the exclusive benefit of such scheme
3. Transfer, exchange or deliver in the prescribed form securities held by a custodian upon receipt of proper instructions from the manager
4. Keep or cause to be kept such books, records and statements as may be necessary to give a complete record of the entire scheme fund, investment portfolio held by a custodian and the transaction carried out by the custodian on behalf of the scheme.
5. Deliver to the scheme all the copies of all notices, proxies, proxy soliciting materials received by the custodian in relation to any of the securities held in the scheme or pooled fund account, all publicly available information, financial reports and stock holder communications as the custodian may receive from the issuer of securities and all

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information and custodian may receive from an offer relating to exchange or tender offers or other rights as may be agreed upon from time to time

6. Submit to the scheme a written report on specified dates listing all assets of the scheme, in the schemes account, notification of any transfers of property or securities to or from a scheme, a copy of the most recent audited financial statements of the custodian prepared together with such information regarding the policies and procedures of the custodian as the scheme may request in connection with the agreement or the duties of the custodian under the agreement.
7. Exercise subscription, purchase or other similar rights represented by the securities subject to receipt of proper instructions from the manager
8. Exercise the same standard of care that it would exercise over its own assets in holding, maintaining, servicing and disposing of property and in fulfilling any other obligation in the agreement: provided that the custodian shall exercise the degree of care expected of a prudent professional custodian for hire.

Requirements for registration of an Administrator

1. The applicants must be a limited liability company incorporated under the Company's Act whose liability is limited by shares and whose main objective is to lender administrative serves and skills
2. Must have such minimum paid up share capital as may from time to time be prescribed
3. Applicant must be capable of meeting obligations and sponsors as provided in the schemes rule
4. Applicant must be posses professional and technical capacity and adequate operation system to perform its functions
5. Must not have been administrator of any scheme fund that has been deregistered, wound-up or placed under an interim administrator due to any fault either fully or partially of the administrator

Refusal of registration

The Authority may refuse to register a scheme or a manager under section 23 if satisfied that:

1. The information contained in the application for registration is false or untrue in any material particular; or
2. The applicant does not meet the requirements for registration.
3. Where the Authority refuses to register a scheme or a manager, it shall forthwith notify the applicant in the prescribed form, specifying the reasons for such refusal.

Deregistration of managers, custodians or administrators

The Authority may deregister a scheme if:

- i. It discovers after registration that a statement was made in connection with the application which the applicant knew to be false or untrue in any material particular (misrepresentation).
- ii. any event occurs which renders the manager, custodian or administrator ineligible to manage or provide custodian services to a scheme fund as the case may be
- iii. The manager, custodian or administrators' business is wound up or is otherwise dissolved
- iv. The manager, custodian or administrator is in breach of any condition attached to the certificate of registration
- v. The manager, custodian or administrator does not comply with any of provisions of RBA Act, or with any regulations made or directions issued under the Act.

The Authority, before deregistering a manager, custodian or administrator must give them at least 28 days notice of its intention and shall consider any representations made to it in writing by the trustees, sponsors or members within that period before deregistering the scheme.

INSPECTION AND APPOINTMENT OF INTERIM ADMINISTRATOR

Inspection

The Chief Executive Officer may, at any time and from time to time, and shall, if so directed by the Board, cause an inspection to be made by an inspector authorized by him in writing, of any scheme or of the business of any manager registered under this Act, and of its books, accounts and records.

When an inspection is made, the manager of the scheme concerned and every officer, trustee or employee thereof shall make available to the inspector all the books, accounts records and other documents of the scheme and such correspondence, statements and information relating to the scheme as the inspector may require, within seven days or such longer period as the inspector may direct in writing.

Any failure to produce any books, accounts, records, documents, correspondence, statements, returns or other information within the period specified in the direction constitutes an offence:

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Provided that:

- a. The books, accounts and other documents shall not, in the course of inspection, be removed from the premises at which they are produced;
- b. The inspector may make copies of any books, accounts and other documents required for the purposes of his report; and
- c. All information obtained in the course of the inspection shall be treated as confidential and used solely for the purposes of this Act.

Powers of the inspector

An inspector may, by notice in writing, require any person who is or has at any time been a trustee or a manager of the scheme being inspected, or an officer, employee, agent, accountant, auditor or actuary appointed by such trustee or manager to:

- a. Give to the inspector all reasonable assistance in connection with the inspection; or
- b. Appear before the inspector for examination concerning matters relevant to the inspection; or
- c. Produce any books or documents relating to the affairs of the scheme being inspected.

A person who:

- a. Refuses or fails to comply with a requirement of an inspector which is applicable to him, to the extent to which he is able to comply with it; or
- b. Obstructs or hinders an inspector in the exercise of his powers under this Act; or
- c. Furnishes information or makes a false statement which he knows to be false or misleading in any material particular; or
- d. When appearing before an inspector for examination, makes a statement which he knows to be false or misleading in any material particular, commits an offence.

A person convicted of an offence under subsection (2) shall be liable to a fine not exceeding fifty thousand shillings, or, in the case of a natural person, to imprisonment for a term not exceeding three years, or to both.

Where an offence is a continuing offence, the person convicted shall, in addition to the penalty prescribed, be liable to a further fine of one thousand shillings for every day during which the offence continues.

Where the person convicted under this section is a body corporate, the Authority may, notwithstanding any other penalty imposed under this Act, apply to a court for the winding up of such body corporate.

Inspection report-An inspector appointed under this Part shall submit his report to the Chief Executive Officer and the report shall draw attention to any breach of the requirements of this Act and any regulations made thereunder, any mismanagement or lack of management skills in the manager and any other matter revealed or discovered in the course of the inspection warranting, in the opinion of the inspector, remedial action or further investigation.

Directions to manager-The Chief Executive Officer may, by notice in the prescribed form, require the trustees or the manager of a scheme inspected under this Part to comply, by such date or within such period as may be specified therein, with such directions as the Authority considers necessary in connection with any matter arising out of the report made.

Appointment of interim administrator

This section applies and the powers conferred may be exercised in the following circumstances:

- a. if the trustees of a scheme fail to submit to the Chief Executive Officer the annual accounts required under section 34 for over six months after the end of the financial year to which they relate;
- b. if the trustees are found to have submitted or provided any accounts, returns, statements, books, records, correspondence, documents or other information relating to the scheme fund which are false or misleading; or
- c. If the Chief Executive Officer, whether on inspection or otherwise, becomes aware of any fact or circumstance which, in his opinion, warrants the exercise of the relevant power in the interests of the sponsors and members of the scheme or in the public interest.

The Chief Executive Officer may, with the approval of the Authority:

- a. Appoint any person (in this Act referred to as "an interim administrator") to assume the management, control and conduct of the affairs and business of the trustees or the manager, as the case may be, to exercise all the powers of the trustees or the manager to the exclusion of such trustees or manager;
- b. Remove any officer or employee of the trustees or the manager who, in the opinion of the Chief Executive Officer, has caused or contributed to any contravention of the provisions of this Act or any regulations made thereunder or to any deterioration in the financial stability of the scheme or has been guilty of conduct detrimental to the interests of the members or sponsors of the scheme; or

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- c. By notice in the Gazette, revoke or cancel any existing power of attorney, mandate, appointment or other authority by the trustees or manager in favour of any officer, employee or any other person.

The appointment of an interim administrator shall be for such period, not exceeding twelve months, as the Chief Executive Officer may specify in the instrument of appointment but may be extended by the High Court, upon application by the Chief Executive Officer, if such extension appears justified.

An interim administrator shall, upon assuming the management, control and conduct of the affairs and business of the trustees or the manager, discharge his duties with diligence and in accordance with sound actuarial and financial principles and in particular, with due regard to the interests of the trustees, the manager, the members and sponsors of the scheme.

The responsibilities of the interim administrator shall be:

- a. Tracing, preserving and securing all the assets and property of the scheme;
- b. Recovering all debts and other sums of money due to and owing to the scheme;
- c. Evaluating the solvency and the liquidity of the scheme;
- d. Assessing the scheme's and the manager's compliance with the provisions of this Act and any regulations made thereunder;
- e. Determining the adequacy of the capital and reserves and the management of the scheme and recommending to the Chief Executive Officer any restructuring or reorganization which he considers necessary and which, subject to the provisions of any other law, may be implemented by him on behalf of the trustees or the manager; and
- f. Obtain from any former trustee or manager of the scheme or any officer, employee or agent thereof, any documents, records accounts, statements, correspondence or information relating to the scheme.

The interim administrator shall, within a period of twelve months from the date of his appointment, prepare and submit to the Chief Executive Officer, a report on the financial position and the management of the scheme with recommendations as to whether:

- a. The scheme is capable of being revived; or
- b. The scheme should be deregistered.

The Chief Executive Officer shall, after taking into account the report of the interim administrator, make appropriate recommendations to the Board which shall take a decision on the matter.

Neither the Chief Executive Officer nor any officer, employee or agent of the Authority nor the interim administrator nor any other person appointed, designated or approved by the Chief Executive Officer under the provisions of this Part shall be liable in respect of any act or omission done in good faith in the execution of the duties undertaken by him.

Insurance Regulatory Authority

Under section 3(2) of the insurance regulatory Act, the Authority shall be a body corporate with the following characteristics.

- a. Perpetual succession and a common seal
- b. Can sue and being sued in its corporate name.
- c. Can take, purchase or otherwise acquire, holding, charge or dispose off movable and immovable property
- d. Can borrow or lend money
- e. Is capable of doing or performing other things or acts for the furtherance of its functions under the provisions of the insurance regulatory act.

The things to be done are those which are lawful or required to be done by the body corporate.

Objectives and functions of the Authority

1. ensure the effective administration, supervision, regulation and control of insurance and reinsurance business in Kenya
2. formulate and enforce standards for the conduct of insurance and reinsurance business in Kenya
3. license all persons involved in or connected with insurance business, including insurance and reinsurance companies, insurance and reinsurance intermediaries, loss adjusters and assessors, risk surveyors and valuers
4. protect the interests of insurance policy holders and insurance beneficiaries in any insurance contract
5. promote the development of the insurance sector
6. advise the Government on the national policy to be followed in order to ensure adequate insurance protection and security for national assets and national properties
7. Issue supervisory guidelines and prudential standards from time to time, for better administration of the insurance business of persons licensed under the Act

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8. conduct inquiries and Share information with other regulatory authorities and to carry out any other related activities in furtherance of its supervisory role
9. Undertake such other functions as may be conferred on it by this Act or by any other written law

Management of the Authority

Section 3(b) of the insurance regulatory Authority provides that the management of the Authority shall vest in the board of directors of the authority. The board comprises of:-

- a. A chairman to be appointed by the President on the recommendation of the Minister
- b. The Commissioner of Insurance as appointed under the Insurance Regulatory Act
- c. The Permanent Secretary in the Ministry for the time being responsible for matters relating to finance or his representative
- d. The Chief Executive Officer of the Retirement Benefits Authority
- e. The Chief Executive Officer of the Capital Markets Authority
- f. The Governor of the Central Bank of Kenya or his representative
- g. A nominee of the Insurance Institute of Kenya
- h. Four other members, not being public officers, appointed by the Minister

The chairman and every member shall be appointed from amongst persons who have knowledge or experience in matters relating to insurance, finance, banking or actuarial science

Disqualification to the Board of directors

A person shall not be eligible for appointment to the management of the authority if such a person:-

- a. Has at any time been convicted of any offence involving fraud, theft, dishonesty, breach of trust or moral turpitude
- b. was previously involved in the management or administration of a financial institution which was deregistered, wound up or placed under statutory management for any failure on the part of the management or the administration
- c. Is a director, officer, employee or shareholder of any insurer, broker, insurance agent or any other member of the insurance industry
- d. Is disqualified under any other written law from holding public office or being a director of any institution

Powers of the Board

The Board shall have all the powers necessary for the performance of its functions under this Act, and, without prejudice to the generality of the foregoing, shall have power to:-

1. Control, supervise and administer the assets of the Authority in such manner and or such purposes as best promote the purpose for which the Authority is established
2. Determine the provisions to be made for capital and recurrent expenditure and for the reserves of the Authority
3. Receive any grants, gifts, donations or endowments on behalf of the Authority and make legitimate disbursements
4. Enter into association with such other bodies or organizations, within or outside Kenya, as it may consider desirable or appropriate and in furtherance of the purpose for which the Authority is established
5. Open a banking account or banking accounts for the funds of the Authority; and
6. Invest the funds of the Authority not currently required for its purposes in the manner provided in the Insurance Regulatory Act

Commissioner of Insurance

There shall be a Commissioner of Insurance who shall be the chief executive officer of the Authority and who shall be appointed by the Board, in consultation with the Minister, on such terms and conditions of service as may be determined by the board in the instrument of appointment, or otherwise in writing from time to time.

The Commissioner shall be an *ex officio* member of the Board but shall have no right to vote at any meeting of the Board

The Commissioner shall, subject to the directions of the Board, be responsible for the day to day management of the affairs of the Authority.

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Qualification for appointment of commissioner of insurance

A person shall be qualified to be appointed under this section if such person-

- i. Have considerable knowledge, competence and at least ten years' experience in a managerial capacity in insurance, accounting, finance, actuarial science or banking
- ii. Is not engaged in the insurance business as a director, employee, officer or shareholder of any insurer, broker, insurance agent, or in any other sector of the insurance industry, and if appointed shall be disqualified if he, his spouse or dependent child becomes such director, employee, officer or shareholder.

The Insurance Regulatory Authority Fund Act

The Authority shall establish a general fund to be known as the Insurance Regulatory Authority Fund, hereafter referred to as "the Fund", which shall vest in the Authority

There shall be paid into the Fund:-

1. all proceeds of the insurance premium levy
2. such moneys as may accrue to or vest in the Authority in the course of the exercise of its powers or performance of its functions under the Insurance Regulatory Act
3. such sums as may be payable to the Authority pursuant to this Act or any other written law, or pursuant to any gift or trust

Particular duties of the Commissioner

The duties of the Commissioner shall include

- i. Directing insurers and reinsurers on the standardization of contracts of compulsory insurance
- ii. Directing an insurer or a re-insurer, where he is satisfied that the wording of a particular contract of insurance issued by the insurer or re-insurer is obscure or contains ambiguous terms or terms and conditions which are unfair or oppressive to the policy-holders, to clarify, simplify, amend or delete the wording, terms or conditions, as the case may be, in respect of future contracts
- iii. The approval of tariffs and rates of insurance in respect of any class or classes of insurance
- iv. Such other duties as the Board may assign to him

Prevention of money laundering and other illicit activities

Every licensed person shall obtain through a client information questionnaire details from a client or a potential client with respect to the following –

1. The identity of the client or a potential supported by documentary evidence;
2. Nature of business activities of the client or potential client;
3. Origin and sources of funds used or to be used for investment in securities. Where the money or funds originate from outside Kenya a confirmation from the remitting entity of the nature of its business and of the source of the moneys or funds;
4. A written declaration by the client or potential client confirming :-
 - the accuracy of all information given
 - That the moneys or funds used for the investment in securities is not arising out of the proceeds of any money laundering or other illicit activities.
5. A licensed person shall maintain at least the following information in respect of their clients and shall ensure that they can link each transaction to the beneficial owner:
 - Where the client is a natural person, any person on whose behalf the client is acting, whether as nominee, trustee or any other capacity;
 - where the client is a limited partnership, the name of the general partner (and where the general partner is a body corporate, the information as prescribed under this sub-regulation shall be maintained);
 - where the client is an unlimited partnership, the names of the other partners;
 - Where the client is a body corporate, the names of all individuals who have direct or indirect interest amounting to thirty per cent or more of the equity;
 - Where the client is a trust, the name of the settlers, trustees, protectors and principal named beneficiaries;
 - Where the client is a legal arrangement other than a trust, the name of the owner or the controller.
6. where the customer is a financial institution, such as a bank, insurance company, pension fund or collective investment fund and is conducting business collectively on behalf of a large number of underlying customers, and where the institution is subject to rules or regulations that require the financial institution to conduct customer due diligence, the licensee is permitted to rely on the financial institution to hold beneficial ownership information and need not hold that information itself.

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The licensed person shall make such information available to the Authority on request and also to the central depository for the purpose of answering an enquiry made of it under Section 58 of the Central Depositories Act

Financial Self-Regulation

Financial policymakers today generally recognize that sound and stable long-term economic growth can best be supported by regulatory policies that minimize interference with the functioning of the market. Financial sector reforms in developing economies are thus increasingly oriented toward mechanisms to induce effective market discipline, and toward regulatory/supervisory regimes that are market-friendly or that mimic the market in driving agent decisions through incentives to honest and prudent behavior.

Honest and prudent behavior by a financial market institution is integral to its reputational capital, which in turn increases its franchise value. Private sector agreement on principles and rules for self-regulation can provide incentives for that honest and prudent behavior. Self-regulation, in turn, tends to emerge and to be effective when the franchise values of individual businesses in a community stand to receive a considerable boost from cooperation to reduce the costs to deal with limited trust and asymmetric information.

Thus, agents have a strong interest in establishing long-term mutual ties to enforce honest and prudent behavior through *self-policing arrangements*, that is, to the capability of a system of private-sector agents to induce compliance with common rules of conduct from each agent, without resorting to exogenous rule-enforcing mechanisms. Self-policing can either be the result of agents having incentives to undertake behavior that conforms to the collective interest, or the outcome of agents having an incentive to mutually monitor behaviour.

This following are the basic features of financial self-regulation; the benefits and limitations of self-regulatory organizations (SROs); less ambitious alternatives; and the role of the public sector.

Basic Features of Financial Self-Regulation

Spontaneous self-policing arrangements can be found in the history of international trade and commercial law, public security, maintenance of public services, and commercial bank clearinghouses. In developing countries, such arrangements are used for governing and managing natural resources, also known as *common pool resources*. Self-policing arrangements allow participants to undertake transactions that would otherwise be unprofitable due to high transaction costs

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