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EFFECT OF COMPLIANCE OF PRUDENT FINANCIAL REGULATION TO KENYA'S
COMMERCIAL BANKS' STABILITY

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ABSTRACT

The purpose of the study was to assess the effect of compliance of prudent financial regulation to Kenya's commercial banks' stability. The study sought to address the following research question: Is there any link between the compliance to prudent financial guidelines and domestic bank stability and will the link be stable over time.

The populations for this research are the 43 listed Commercial Banks in Kenya analyzed for a period from 2011-2015. The study found that commercial banks risk weighted assets had increased by 24.12% over the years indicating a similar growth in bank's assets. To meet the asset growth, core capital also increased by 14.761% with bank's undertaking rights issue in 2011 in order to meet the new capital requirements (CBK, 2015). The CAMEL rating also showed continuous growth in all the key ratios over the years as shown in the previous chapter. Capital structure is also seen to remain stable over the years. The study concludes that the financial statutory requirements have a clear impact on banks' stability

CHAPTER ONE: INTRODUCTION

1.1 Background

Before the 1990's financial crisis, there was a lacking in global financial integration of markets (Lane, 2012). The crisis cascaded across global financial markets and crippled them and eventually caused a downturn in the real economy. This crisis shook the market and as such, there have since been studies on how to reduce the possibilities of another financial crisis. The financial crisis demonstrated that the then-existing financial regulatory system was in need of substantial repair. By any measure, the financial regulatory reform that has followed has been extensive. In areas such as capital and liquidity, derivatives, resolution planning and consumer protection, the change has been sweeping. (Amir-Mokri, 2015)

Inconsistent regulation can lead to inefficiencies. (Bickel, 2015) These inefficiencies can lead to investors taking advantage through jurisdictional arbitrage. The finance industry has a very long way to go in terms of financial regulation. There are problems experienced at the national level where financial institutions have difficulties complying with the rules of all the different regulators. There has been a recent wave of financial globalization since the mid-1980s. There was and still is a stark margin between the financial integration of industrial and developing countries. Developing countries are at a lower level of financial integration. This combined with the inconsistency in regulation has created concerns like international harmonization of regulatory standards. (Asogwa, 2006)

Non-governmental organizations and International financial institutions, for example; International Monetary Fund, World Bank and Organization for Economic Co-operation and Development play leading roles towards regulatory harmonization in the financial sector. Basel Committee on banking supervision's objective is to enhance understanding of key supervisory issues and improve the quality of banking supervision worldwide. (BCBS, 2015) Attempts on compliance to international standards have forced the Central banks of many sub-Saharan countries to transplant foreign legal concepts into the national legal systems through creation of new domestic regulations and institutions.

International harmonization of regulatory standards has effects on the market and economy. The conclusion reached in the European Commission's Financial Sector Action Plan (EU, 1999) and later the Lamfalussy Report (EU, 2001) was that the harmonization of regulatory standards is a

prerequisite to the creation of a truly integrated European capital market. On combining measures derived from Data on securities regulation and investor protection with data on bilateral asset holdings, it is found that the harmonization of financial regulation can potentially have large effects on the integration of securities markets. (Vlachos, 2005)

Generally, we find that on aggregate, compliance to global financial regulatory standards show very weak effects on stability but when we disaggregate, we find that the informal measures of compliance to global regulatory standards have some noticeable effects on stability. (Amir-Mokri, 2015)

This paper seeks to determine the relationship between compliance of prudent financial guidelines and bank's stability in Kenya.

1.2 Research Objective

This paper seeks to determine the existence of a link between the compliance of prudent financial guidelines and Kenya's commercial banks' stability

1.3 Research Questions

Is there any link between the compliance to prudent financial guidelines and domestic bank stability?

1.5 Problem Statement

(Demirgüç-Kunt & Detragiache, 2010) explore whether Basel Core Principles compliance affects bank soundness using the Z-score to capture bank soundness, which is the number of standard deviations by which bank returns have to fall to wipe out bank equity. The sample size is of 3000 banks in over 86 countries. Their results suggest no evidence of a robust statistical relationship linking better compliance with Basel Core Principles and improved bank soundness.

(Sundararajan, Marston, & Basu, 2001) using non-performing loans as a measure of bank stability estimate the impact of compliance with Basel Core Principles on financial stability. Their results suggest a weak relationship between the degree of compliance with Basel Core Principles and financial instability. There also exists an indirect link through interacting effect on other banking or macro variables affecting bank stability.

There are few empirical studies on the effect of compliance with the Basel accords in Kenya; Waithaka (2013) focuses on bank stability in the form of lending; the study revealed that there was a strong positive relationship between commercial banks lending and the compliance to the Basel II requirements.

Kombo (2014) study shows; Basel III compliance increases capital requirements for counterparty credit risk arising from derivatives, repurchase agreements and securities financing activities.

To the best of the researcher's knowledge, no study had ever concentrated on assessing the relationship between the compliance of global financial regulations and the commercial banking industry in Kenya hence the research gap that the current study sought to fill.

Given that there are serious efforts to achieve full compliance to the Core Principles in Kenya it becomes necessary to assess the effectiveness of the observance of the current international financial standards.

CHAPTER TWO: LITERATURE REVIEW

2.1 Introduction.

This chapter covers the general aspects of literature review based on the effect of compliance of prudent financial guidelines to Kenya's commercial banks' stability starting with the theoretical literature review, empirical literature and chapter conclusion.

2.2. Theoretical Literature

This section contains a theoretical review of the study.

2.2.1 Overview of regulation

Stigler defines regulation as "any policy which alters market outcomes by the exercise of some coercive government power." (Stigler, 1997). This definition is attractive because of its expression of much in a few words, except, it does not give any indication why the government should intervene in market outcomes. (Chang, 1997) adds onto this definition that it is meant to serve the public interest. Regulators often have the intention to improve economic welfare by using regulation to promote economic efficiency. Three categories of regulation have been distinguished so as to determine what policies are included in regulation. These include; antitrust policy, economic regulation and social regulation (Swann, 1989). The regulation of banks and other financial intermediaries are in the economic category.

Regulation of the banking sector is very heavy. Macroeconomic theory stresses that the sound functioning of the banking system is vital for macroeconomic performance. Banks allocate risk and take risk in the economy (Hellwig, 1998). They facilitate the use of money for transactions when selling or buying goods and services, when paying a worker or being paid, and when saving money or receiving a loan. In the financial capital market, banks are financial intermediaries; that is, they operate between savers who supply financial capital and borrowers who demand loans. The banking sector is crucial for the economy's payments system. If this system is harmed, the economy as a whole suffers (Hebbink & Prast, 1998).

Banking regulation has a vital role in the mitigation of systemic risk. According to Goodhart et al. (1998), the systemic dimension is important in the financial sector because the social costs of financial distress exceed the private costs to those involved in the failing institution. The

financial system is fragile and subject to panic. This is due to large amounts of creditors, systemic risk and high investment in risky assets.

Normative Theory suggests that market failures are a justification for regulation. Given perfect competition, there are markets for all goods, with interaction between agents through price and that all agents are fully informed; then market failure exists if markets do not work properly.

These market failures could be caused by a lack of competitive equilibrium in the market, externalities, market power of one individual company and information asymmetry (Hebbink & Prast, 1998). All these can be reduced or controlled by regulation and hence there will be reduced market failures.

Global financial regulation occurs due to internationalization of businesses and the mobility of capital across the globe. As shown in the chart below, globalization has led to the invention of an international institutional structure for global finance. This is known as global financial standards. It usually influences Central Banks' choice of institutional changes and these changes can have a direct or indirect effect on bank stability or real economic stability. (Asogwa, 2006)

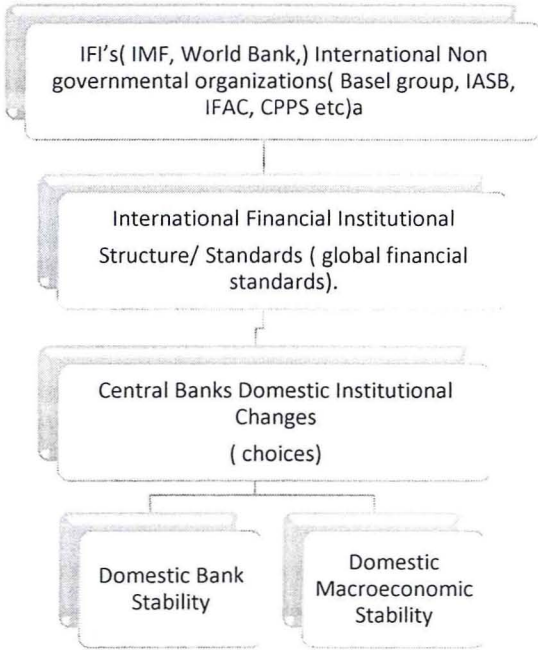


Figure 1 Link between financial regulation and Bank stability

2.2.2 Basel Process

Before the 1990's financial crisis there was not that much global financial integration of markets (Bickel, 2015). The Basel Accords are a series of banking regulations agreed by The Basel Committee on Banking Supervision (BCBS). This is a group made up of 27 major financial centers representatives which aims to regulate finance and banking practices on an international level. The G-10 countries; Belgium, Canada, France, Germany, Italy, Japan, the Netherlands, Sweden, Switzerland, the United Kingdom and the United States, consult and co-operate on economic, monetary and financial matters. They created the BCBS which is responsible for the Basel Accords.

Basel II: The new capital framework was released in June 2004. This was after the Committee issued a proposal for new capital adequacy framework. This framework consisted of three pillars;

- i. Minimum capital requirements, which sought to develop and expand the standardized rules set out in the 1988 Accord
- ii. Supervisory review of an institution's capital adequacy and internal assessment process
- iii. Effective use of disclosure as a lever to strengthen market discipline and encourage sound banking practices.

(BCBS, 2015)

The pillar on minimum capital requirements highlights approaches to measure credit risk, market risk and operational risk. The pillar on supervisory review processes guarantees the soundness of banks internal processes of risk evaluation. The third pillar introduces disclosure requirement as a way to enhance market discipline. (Asogwa, Global Financial Regulatory Harmonization, Central Banks' Supervisory Effectiveness and Macroeconomic Performance in the West African Monetary Zone (WAMZ) Countries: Analyzing the Role of Institutional Factors., 2006)

2.3 Review of Empirical Literature

This is a review of previous studies on the link between observance of global financial regulatory standards and performance and stability of banks. They are grouped together on basis of conclusions.

2.3.1 Lack of a relationship

(Ayadi, Naceur, Casu, & Quinn, 2015) assess whether compliance with international regulatory standards enhance bank operating efficiency. They use a sample of 863 publicly listed banks taken from countries, categorized by economic development and geographic location to evaluate the relationship between BCP compliance and bank performance. Using an aggregate BCP compliance score and a disaggregated approach, they assess the level of bank compliance and to measure bank performance they estimate a common global frontier. A two-stage procedure is adopted. The first stage produces efficiency estimates which are then used in the second-stage truncated regressions to infer how various factors influence the estimated efficiency. Their results suggest that compliance to Basel Core Principles has no relationship with bank stability. This analysis is done at a particular point in time and does not allow for taking into account the evolution of each country's banking system in compliance with international regulatory standards and these results need to be treated with caution, because they may also reflect the inability of assessors to provide a consistent cross-country evaluation of effective banking regulation.

Demirgüç-Kunt & Detragiache (2010) assess whether compliance with the Basel Core Principles for effective banking supervision (BCPs) is associated with bank soundness. Data has been chosen from 3000 banks in 86 countries to find if the overall index of BCP compliance affects bank risk. Bank risk is captured by the standard scores commonly known as Z scores. They find no evidence of a relationship between good compliance and bank stability. Other results suggest that stricter compliance with regulatory standards is associated with riskier banks. Their results reflect the inability of assessors to carry out evaluations that are comparable across countries.

2.3.2 Distinguished relationships

(Asogwa, 2006) tests a link between the observance of global financial regulatory standards and central bank performance and macroeconomic outcomes. The data used is that of five countries that are a part of the West African Monetary Zone. He uses a regression empirical model of Central Banks' supervisory effectiveness which contains many elements from (Sundararajan, Marston, & Basu, 2001) and (Podpiera, Rozhkov, Das, & Yossifov, 2005). The results indicate that compliance to international financial regulation has no significant effect on the central bank performance in any of the countries. There seems to be an effect of compliance to inflation, bank stability and private sector credit.

Sundararajan et al. (2001) sample 25 countries to study if an association exists between an overall index of BCP compliance and two indicators of bank soundness: nonperforming loans (NPLs) and loan spreads. Their results suggest that there is no discernible direct association between these estimates of soundness and BCP compliance. There is some evidence that BCP compliance influences bank soundness indirectly through its interactive effect on other macro or banking variables.

(Podpiera, 2004) increases the number of countries, changes the data to a new data set and the methodology and discovers a direct positive effect of compliance with the Basel Core Principles on the banking sector performance, as measured by the share of nonperforming loans and the net interest margin. Higher compliance with the BCP is associated with lower NPLs and lower net interest margin, suggesting that following the BCP creates a regulatory and supervisory environment that helps improve banking sector performance.

(Njeri, 2013) investigates the effect of Basel II on the lending of Kenyan Commercial Banks. She analyses 43 listed commercial banks in Kenya from 2009 to 2012. She focuses on risk weighted assets and core capital after implementation of Basel II. The results indicate that implementation of Basel II has clear implications on lending of commercial banks in Kenya growth in core capital and risk weighted assets clearly seen over the years. This research paper focuses on the lending section of the banking system instead of it as a whole.

(Quansah, 2014) assesses the degree of impact and implications of Basel 3 for large commercial banks in Ghana and Kenya. The thesis has only highlighted one aspect of the applications of Basel three, i.e, capital adequacy. This thesis has attempted to show that due to the global nature of banking today, an introduction of a global banking regulatory framework is bound to have far-reaching consequences and implications for banks world-wide irrespective of the jurisdictions in which they are located. These implications, some foreseen and others unforeseen are bound to occur as a direct result of how globalised the banking industry has become today.

CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Introduction

This chapter outlines the research methodology the study adopted. It looks at the research design, population of the study, sampling methods used, data collection techniques and data analysis technique.

3.2 Research Design

Research design has been defined by various authors as;

- a blueprint for conducting a study with maximum control over factors that may interfere with the validity of the findings
- the researcher's overall for answering the research question or testing the research hypothesis

The research design adopted is of quantitative nature. The quantitative research design specified is regression analysis. This design is one that is used in the event of obtaining a relationship between a dependent variable and one or more independent variables.

3.3 Population of the study

The population for this research is commercial banks in Kenya. These are the key players in the Kenyan banking sector. Under the provision of the banking Act and the regulations and prudent guidelines issued in the Act, commercial banks are the ones mainly licensed and regulated. The Central Bank of Kenya puts more focus and attention to them to ensure compliance with laws and regulation.

According to the banking supervision annual report of 2014 prepared by the central bank of Kenya, the banking sector comprised of the Central Bank of Kenya, as the regulatory authority, 44 banking institutions (43 commercial banks and 1 mortgage finance company).

Out of the 44 banking institutions, 30 were locally owned banks comprised 3 with public shareholding and 27 privately owned while 14 were foreign owned. Of the 14 foreign owned banking institutions, 10 are locally incorporated subsidiaries of foreign banks and 4 are branches

of foreign incorporated banks. Further, 11 of the 44 banking institutions are listed on the Nairobi Securities Exchange.

All 43 commercial banks will be analyzed over a period of 5 years as at 2011 -2015.

3.4 Data collection

The data for this study will mainly be collected from secondary sources. This is data that has already been collected and is readily available. These types of data are cheaper than primary data and faster to obtain in the instance that primary data would be hard to find.

Using secondary data in investigating saves time that would have been spent collecting data. When it comes to quantitative data, secondary data provides larger and higher-quality databases that would be impractical for any individual researcher to collect by themselves.

In Kenya, amid the most regulated sectors in the economy are commercial banks. The commercial banks are obliged by the Central Bank of Kenya, Nairobi Securities Exchange and the Capital Market Authority to reveal their financial statements every three months.

The statements needed in this case should include returns on assets, and equity of the specific bank that will be acquired through commercial banks' balance sheet, income statement and other disclosures which are published on a quarterly basis.

The central bank of Kenya also carries out bank inspections on the commercial banks. Although these are confidential, there is a provision for banks to disclose required information to the public through the financial statements.

3.5 Data Analysis Techniques

Regression analysis will be used to determine the relationship between compliance of Basel II requirements and bank stability. This type of analysis helps investigate the relationship between variables that are bivariate and multivariate. This is where it can be hypothesized that 1 variable depends on another variable or a combination of other variables. The method proposed includes essential elements from (Njeri, 2013) and (Demirgüç-Kunt & Detragiache, 2010) as they conducted similar research projects.

The regression equation estimated is in the form;

$$Z = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \varepsilon$$

1

Where;

Z is the index of bank stability (measured as the z-score)

X₁ is pillar 1- Capital Requirement

X₂ is pillar 2- Supervisory Review

X₃ is pillar 3- Market Discipline

ε is the error term

3.6 Variable estimation

3.6.1 Dependent Variables

The dependent variable is the bank stability denoted as Z.

3.6.1.1 Construction of the Bank stability index

A common measure of stability at the level of individual institutions is the z-score. The Z score is a popular measure for bank soundness (World Bank , 2012). It explicitly compares buffers (capitalization and returns) with risk (volatility of returns) to measure a bank's solvency risk.

The z-score is defined as $z \equiv (k+\mu)/\sigma$, where k is equity capital as percent of assets, μ is return as percent of assets, and σ is standard deviation of return on assets as a proxy for return volatility.

The popularity of the z-score stems from the fact that it has a clear (negative) relationship to the probability of a financial institution's insolvency, that is, the probability that the value of its assets becomes lower than the value of its debt.

The Z-score is defined as;

$$\frac{\text{average return on assets} + \left(\frac{\text{equity}}{\text{assets}}\right)}{\text{standard deviation of the return on assets}}$$

over [t, t-5].

It can be interpreted as the number of standard deviations by which returns would have to fall from the mean to wipe out all equity in the bank. (Boyd & Runkle, 1993)

3.6.2 Independent Variables

Capital requirement, Supervisory review and Market discipline.

3.6.2.1 Construction of the index

The measurement for each independent variable will be computed and rated as below:

Capital Requirement

Capital Adequacy = Total tier 1 Capital / Risk Weighted Assets

Supervisory Review

Capital Adequacy = Total tier 1 Capital / RWA

Asset Performance = Total Non- Performing Loan / Total Loan Book

Management Capability = Total operating expenses / Total operating income

Earnings = Total Operating Income - Total Operating Expenses.

Liquidity = Liquid Assets / Liquid Liabilities

This will be then rated to from 1 to 5 in terms of strength to create the CAMEL rating.

Market Discipline

Capital Structure = Total debt / Total equity

CHAPTER FOUR: DATA ANALYSIS, RESULTS AND DISCUSSION

4.1 Introduction

This chapter presents the results of the study. The results are based on the analysis of financial results of all Commercial banks in Kenya over a period of 5 years (2011-2015).

Multiple linear regressions were established through Ordinary Least Squares (OLS) on EViews statistical software, so as to determine the effect of Basel II requirement on Kenyan Commercial banks' lending. EViews (Econometric Views) is a statistical package for Windows that offers powerful statistical, forecasting, and modeling tools through an innovative, easy-to-use object-oriented interface.

The chapter presents the descriptive results as well as the regression analysis results. A discussion of findings is then made.

4.2 Capital Requirement

Capital requirement is a measure of core capital to risk weighted assets with the minimum regulatory capital set at 10.5% (CBK, 2015). Given the emergence of Basel II requirement, the risk weighted assets value has increased over the years from Ksh 1.5 trillion in 2012 to Ksh. 2.8 trillion in December 2015. (CBK, 2015)

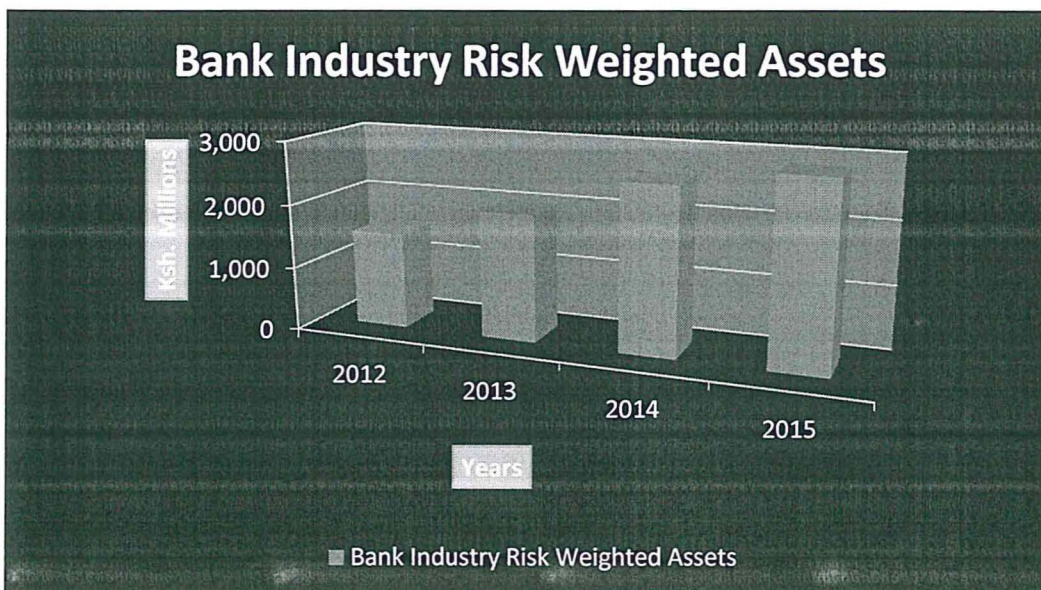


Figure 2 Bank Industry RWA

Banking industry core capital has significantly increased over the years from Ksh 304b to Ksh 457 in 2015 as a result of Commercial Banks in Kenya raising additional capital through rights issues in order to meet the Basel II higher capital requirements as shown below:

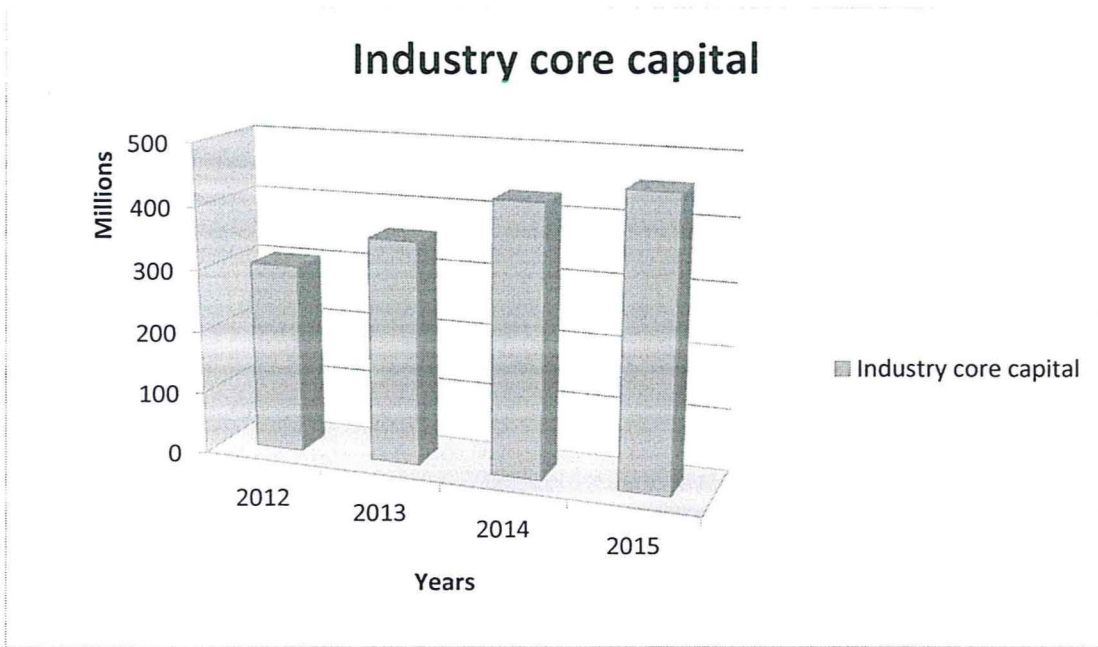


Figure 3 Bank Industry Core Capital

4.3 Supervisory Review

Central Bank of Kenya achieves this key pillar through conducting a CAMEL rating for individual commercial banks and the banking industry at large as shown below:

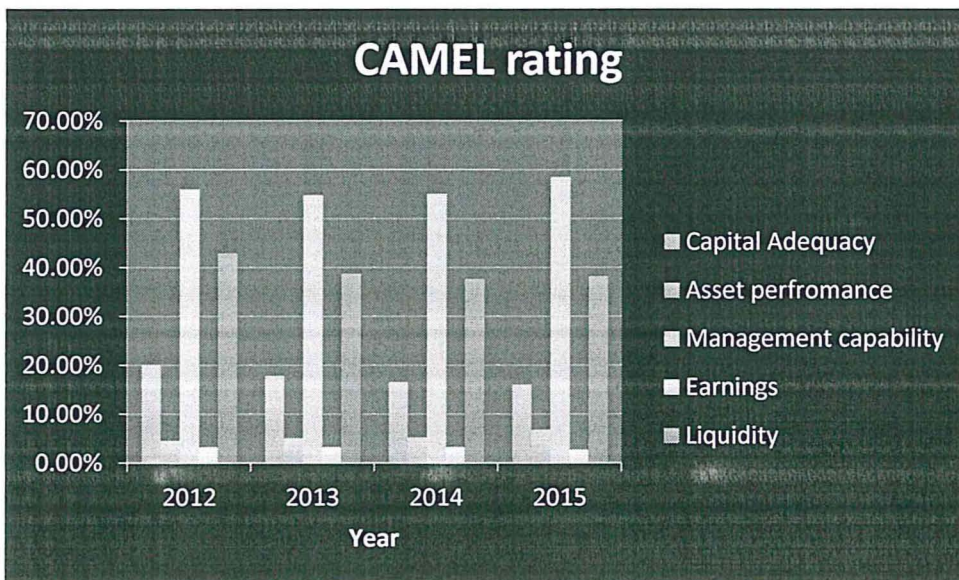


Figure 4 CAMEL rating

The key CAMEL ratios show a marginally falling trend in capital adequacy from 20.10% in 2012 to 16% in 2015 with the minimum requirement as set by CBK at 10.5%. There was improvement in non-performing loans over the years with asset performance showing improvement from 4.6% in 2012 to 6.8% in 2015. Management capability as a measure of cost to benefit has moved from 56% in 2012 to 58.59% in 2015 showing more focus made by management on cost management. Earnings have decreased from 3.25% in 2012 to 2.75% in 2015. Liquidity ratio has also decreased between 43% in 2012 to 38.3% in 2015 with the minimum requirement set by CBK at 20%.

4.4 Market discipline

Market discipline is measured by analyzing the capital structure ratio to review the level of debt to equity financing for commercial banks as shown below:

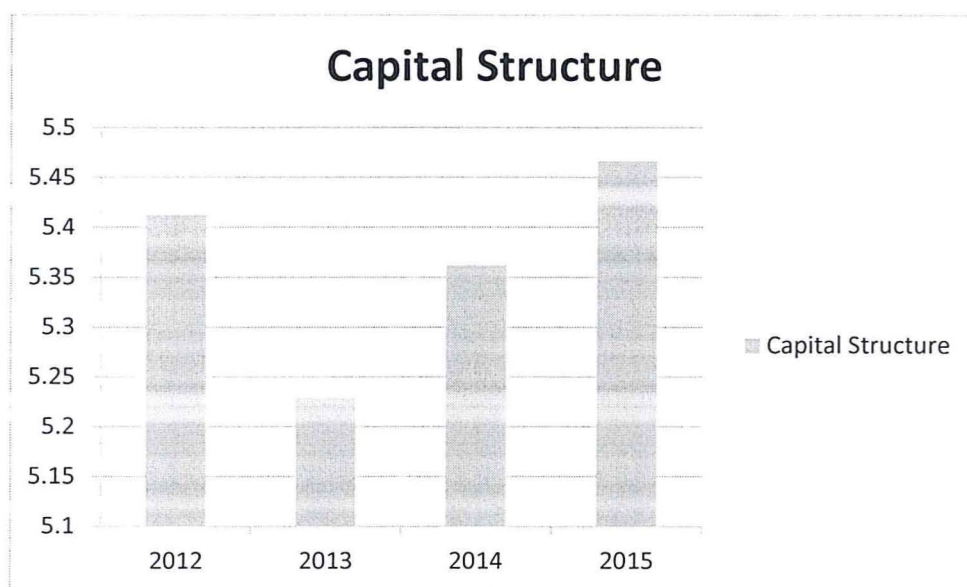


Figure 5 Capital Structure

The debt to equity ratio has consistently remained flat above 5.2 but showing a slight peak in 2015. This shows an increase in liabilities undertaken during the year.

4.6 Regression Analysis

Dependent Variable: Z_SCORE

Method: Least Squares

Date: 01/19/17 Time: 02:12

Sample: 1 20

Included observations: 20

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	26.15406	14.34398	1.823348	0.0870
CAPITAL_REQUIREMENT	-0.463673	0.136659	-3.392914	0.0037
SUPERVISORY_REVIEW	3.885591	1.283061	3.028376	0.0080
MARKET_DISCIPLINE	-1.151196	2.198049	-0.523735	0.6076
R-squared	0.840554	Mean dependent var	16.50198	
Adjusted R-squared	0.810658	S.D. dependent var	2.056142	
S.E. of regression	0.894699	Akaike info criterion	2.792197	
Sum squared resid	12.80778	Schwarz criterion	2.991344	
Log likelihood	-23.92197	Prob(F-statistic)	0.000001	
F- statistic	28.11579	Durbin-Watson stat	1.016107	

The estimated regression equation will be as follows;

$$Z = 26.15406 - 0.463673X_1 + 3.885591X_2 - 1.151196X_3$$

From the above regression equation it was revealed that holding capital requirement, supervisory review and market discipline to a constant zero, bank stability would stand at 26.15406, a unit increase in capital requirement would lead to increase in bank stability by a factors of 0.463673, unit increase in supervisory review would lead to increase in bank stability by factors of

3.885591 and unit increase in market discipline would lead to increase in bank stability by a factor of 0.232. This shows that there was positive association between bank stability and capital requirement, supervisory review and market discipline. The study found that all the sig values for all the variables; capital requirement, supervisory review and market discipline were found to significantly influence bank stability.

The standard error of the regression is the estimated standard deviation of the “noise” in the dependent variable that is unexplainable by the independent variable(s), and it is a lower bound on the standard deviation of any of the model’s forecast errors, under the assumption that the model is correct. It is 0.894699.

Adjusted R squared is coefficient of determination which tells us the variation in the dependent variable due to changes in the independent variable, from the findings in the above table the value of adjusted R squared was 0.811 an indication that there was variation of 81.1% on bank stability due to change in capital requirement, supervisory review and market discipline at 95% confidence interval.

R is the correlation coefficient which shows the relationship between the study variables, from the findings shown in the table above there was a strong positive relationship between the study variables as shown by 0.9168, which is the square root of R square ($\sqrt{.840554}$).

The estimated intercept is 26.15 with a standard error of 14.34. The standard error of a coefficient is the estimated standard deviation of the error in estimating it. By the rule of thumb, an approximate 95% confidence interval for a coefficient is the point estimate plus or minus two standard errors, which is $26.15 \pm 2(14) = [54.15, -1.85]$ for the intercept. The exact 95% confidence interval is $[54.15, -1.85]$. This is not too wide an interval. This is done similarly for capital requirement, supervisory review and market discipline;

	Coefficient	Standard error	Confidence interval
Capital requirement	-0.463673	0.136659	[-0.190355, -0.736991]
Supervisory review	3.885591	1.283061	[6.451713, 1.319469]
Market discipline	-1.151196	2.198049	[3.244902, -5.547294]

The t- statistic of capital requirement, supervisory review and market discipline are 0.136659, 1.83061 and 2.198049. By the usual rule of thumb, a coefficient estimate is significantly different from zero (at the 0.05 level of significance) if its t-stat is greater than 2 in magnitude. For capital requirement, the t-stat is considerably low whereas for the supervisory review and market discipline the t-stat is relatively close to 2 and larger.

If the p-value is less than 5%, it is significant. P-value in this case is .0001% meaning that capital requirement, supervisory review and market discipline can influence bank stability.

CHAPTER FIVE: SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This chapter presents the summary of the study findings, conclusion, and suggestions for further research.

5.2 Summary of study findings

The objective of this study was to determine the existence of a link between observance of the financial regulatory standards and Kenya Commercial banks' stability. The population of the study was all 43 Commercial Banks in Kenya where published financial statements from 2011-2015 were analyzed. The data was aggregated for the all the banks. Data was analyzed using descriptive analysis and regression analysis.

The study found that commercial banks risk weighted assets had increased by 24.12% over the years indicating a similar growth in bank's assets. To meet the asset growth, core capital also increased by 14.761% with bank's undertaking rights issue in 2011 in order to meet the new capital requirements (CBK, 2015). The CAMEL rating also showed continuous growth in all the key ratios over the years as shown in the previous chapter. Capital structure is also seen to remain stable over the years.

From the findings on the adjusted R squared the study revealed that there was a variation of commercial banks' performance due to changes in capital requirement, supervisory review and market discipline. The study further revealed a strong positive relationship.

5.3 Conclusion and Recommendation

The study concludes that the financial statutory requirements have a clear impact on banks' stability. The study found that commercial banks risk weighted assets had increased by 24.12% over the years indicating a similar growth in bank's assets. To meet the asset growth, core capital also increased by 14.761% with bank's undertaking rights issue in 2011 in order to meet the new capital requirements (CBK, 2015). The CAMEL rating also showed continuous growth in all the key ratios over the years as shown in the previous chapter. Capital structure is also seen to remain stable over the years.

5.4 Limitations of the Study

The study focused on Commercial Banks in Kenya. The study may therefore be limited by the sample selected for the study and interpretations should therefore be limited to Commercial Banks in Kenya and cannot be generalized to other countries as they have different operating environment from that of Kenya.

The study also heavily relied on the financial results of Commercial banks and therefore the results are skewed towards financial impact of the new capital requirements rather than also focusing on the regulator's perspective on the implementation of the new guidelines.

5.4 Suggestions for Further Research

The study suggests that future studies be undertaken in the future as with the emergence of more financial regulatory requirements. Most commercial banks took up rights issues in order to raise their core capital, this will however not be sustainable in the future and commercial banks may be faces with lower assets growth leading to decline in lending or higher interest rates charged on loans in order to meet the requirements.

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