STRATHMORE BUSINESS SCHOOL
MASTER OF SCIENCE IN DEVELOPMENT FINANCE
END OF SEMESTER EXAMINATION
MDF 8206: FINANCIAL SERVICES REGULATION

DATE: Tuesday, 7th April 2026 **TIME:** 3 hours

INSTRUCTIONS:

1. Answer **QUESTION ONE (COMPULSORY)** and **ANY OTHER TWO** questions.
2. Pay Attention to additional instructions in the answer booklet.

QUESTION ONE (50 MARKS)

The following information about the former Chase Bank has been obtained from various public sources:

The collapse of Chase Bank Kenya Limited in 2016 was primarily driven by serious weaknesses in corporate governance and insider lending practices that undermined the bank's financial stability. Investigations by the Central Bank of Kenya (CBK) revealed that a significant portion of the bank's loan portfolio consisted of large unsecured facilities extended to related parties and connected borrowers without proper disclosure or adherence to prudential lending limits. These insider loans substantially increased credit risk exposure and impaired asset quality, ultimately eroding depositor confidence once governance concerns became public.

A critical trigger for the crisis was the announcement of restated financial statements in early 2016, which disclosed previously unreported insider loans amounting to billions of Kenyan shillings. The disclosure created uncertainty regarding the accuracy and reliability of the bank's financial reporting and risk management systems. As confidence declined, depositors initiated massive withdrawals, leading to an acute liquidity crisis. The situation demonstrated how deficiencies in transparency, financial reporting integrity, and internal controls can rapidly translate into solvency and liquidity pressures within a commercial bank.

Regulatory intervention followed shortly thereafter when the Central Bank placed Chase Bank under receivership in April 2016 to safeguard depositors and maintain financial system stability. The regulator cited unsafe banking practices, weak risk governance structures, and failure by senior management and the board to exercise effective oversight. The crisis also exposed broader supervisory concerns relating to compliance monitoring, concentration risk management, and enforcement of prudential guidelines within Kenya's rapidly expanding banking sector at the time. After a prolonged resolution process aimed at protecting depositors and preserving banking services, the bank's assets and selected liabilities were eventually acquired by SBM Bank (Kenya) Limited, a subsidiary of SBM Holdings Ltd, in 2018. The acquisition facilitated the orderly transfer of customer accounts and restored operational continuity while minimizing systemic disruption. The takeover represented a regulatory resolution strategy designed to stabilize the banking sector, strengthen governance under new ownership, and rebuild public confidence following one of Kenya's most significant banking failures.

(a) Based on the short case facts, highlight **FOUR** challenges of regulating the banking sector in Kenya. **(8 Marks)**

(b) Highlight **FIVE** roles that the Kenya Bankers Association (KBA) can play in mitigating or minimizing the challenges described in (a) **(10 Marks)**

(c) According to the annual reports and other media sources, Faulu Microfinance Bank Limited, one of Kenya's earliest deposit-taking microfinance institutions, has faced a combination of financial and operational challenges common within the sector. The bank has periodically experienced pressure arising from high loan default rates among micro and small enterprise borrowers, rising operating costs linked to branch-based service delivery, and increased competition from digital lenders and mobile-based financial services offering faster unsecured credit. In addition, maintaining regulatory capital requirements and investing in digital transformation to remain competitive have strained profitability, particularly during periods of economic slowdown, such as the COVID-19 pandemic, when many small-business clients experienced reduced repayment capacity. These challenges illustrate the difficulty microfinance banks encounter in balancing financial inclusion objectives with sustainability, risk management, and technological modernization in Kenya's evolving financial landscape.

Required:

(i) Highlight **FIVE** ways that Microfinance Banks and Institutions differ from Commercial Banks that may influence the way they are regulated. **(10 Marks)**

(ii) As per the facts given in the case, Faulu is facing financial challenges. Explain the meaning and thresholds that the Central Bank of Kenya can use to evaluate the financial soundness of Faulu as per the following:

- Minimum Paid-Up Capital (Nationwide) **(2 Marks)**
- Minimum Paid-Up Capital (Community) **(2 Marks)**
- Capital Adequacy Ratios **(2 Marks)**
- Liquidity / Liquid Asset Ratio **(2 Marks)**
- Cash Reserve Ratio (CRR) **(2 Marks)**

(d) Discuss **SIX** benefits of the Central Bank of Kenya using SupTech in monitoring and enforcing compliance for commercial banks and microfinance banks **(12 Marks)**

QUESTION TWO (25 MARKS)

(a) Explain the following **FIVE** financial crimes and for each provide one strategy a financial institution can put in place to mitigate the crime **(10 Marks)**

(i) Market Manipulation
(ii) Insider Trading
(iii) Churning
(iv) Mis-selling of Financial Products
(iv) SIM Swap Fraud

Hint: Use a table

(b) Discuss **FIVE** roles of the Retirement Benefits (RBA) as the main regulator of pension funds in Kenya. **(10 Marks)**

(c) Provide a highlight of **FIVE** strategies at the global level being used to prevent Money laundering. **(5 Marks)**

QUESTION THREE (25 MARKS)

(a) During the period leading up to the collapse of major financial institutions in 2008, large commercial banks exerted significant influence over financial regulation through intensive lobbying, political financing, and close institutional relationships with regulatory agencies such as the U.S. Securities and Exchange Commission and the Federal Reserve System. Regulatory reforms progressively allowed banks to expand into high-risk activities, including complex securitization and derivatives trading. At the same time, capital and supervisory requirements were relaxed or insufficiently enforced despite growing systemic risk concerns.

In practice, large banking institutions successfully advocated for deregulation measures such as the repeal of structural separation between commercial and investment banking activities under the Gramm-Leach-Bliley Act, enabling consolidation and increased risk-taking. Regulators increasingly relied on banks' internal risk models to determine capital adequacy, effectively allowing institutions to influence how their own risks were measured and supervised. This environment contributed to excessive leverage, weak mortgage underwriting standards, and the proliferation of mortgage-backed securities that later destabilized the financial system.

When the financial system deteriorated in 2007–2008, governments were compelled to provide extensive public support to prevent systemic collapse, including emergency liquidity facilities and bailouts for major banking groups. Subsequent investigations revealed that regulatory oversight had become overly aligned with industry interests, limiting timely intervention despite clear warning signs. The crisis ultimately prompted sweeping reforms, including the Dodd-Frank Wall Street Reform and Consumer Protection Act, aimed at strengthening supervisory independence and reducing excessive influence from large commercial banks over financial regulation.

Required:

(i) State the Theory that may explain this phenomenon. **(1 Mark)**

(ii) Briefly explain the hypothesis about regulation that the theory posits. **(2 Marks)**

(iii) Discuss briefly how economic theory relates to the theory stated in (i) concerning regulation. **(2 Marks)**

(b) Discuss **FIVE** rationales for regulating the insurance sector. **(10 Marks)**

(c) Explain the meaning of the following cybercrimes that may arise in financial institutions and one strategy that can be used to prevent/mitigate each one:

(i) Malware **(2 Marks)**

(ii) Phishing **(2 Marks)**

(iii) Ransomware **(2 Marks)**

(iv) Distributed Denial of Service (DDoS) **(2 Marks)**

(v) SQL Injection **(2 Marks)**

QUESTION FOUR **(25 MARKS)**

(a) Discuss briefly how SACCOs are structured in Kenya for the purpose of regulation, indicating clearly the regulator. **(6 Marks)**

(b) Besides International Organization of Securities commissions (IOSCO), there are other global organizations that are involved in the regulation and oversight of capital/securities markets. These organizations work to establish international standards, promote investor protection, ensure market integrity, and facilitate cross-border cooperation.

Required:

Highlight **SIX** global bodies that aid in regulating capital markets. **(12 Marks)**

(c) Define a Sukuk bond and highlight **FIVE** ways it differs from a conventional bond. **(7 Marks)**