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Is Corporate Governance Effective in Preventing Bank Failure? A Case Study of the Collapse of Chase Bank Limited.

By



Master of Laws

2023

**Is Corporate Governance Effective in Preventing Bank Failure? A Case Study of
the Collapse of Chase Bank Limited.**

Arina, Grace Wambui

138104

**Submitted in Partial Fulfillment of the Requirements of the Degree of Master of
Laws, at Strathmore University**



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14th April 2023

APPROVAL

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ABSTRACT

Kenya experienced an onslaught of bank failures between 2015 and 2016 which had serious adverse effects on the economy and bank stakeholders. The bank failures have been attributed to corruption, weak internal control systems and poor Corporate Governance (CG)

Kenya being a Commonwealth country adopts the Anglo-American CG model. The model is shareholder-centric and arguably unsuitable for banking institutions, due to their unique features of being quasi-public, highly leveraged institutions with a wide range of key stakeholders, thus increasing the stakeholder conflict.

The peculiarities of banking institutions vis-a-vis corporations and the crucial stakeholder concerns, necessitate a probe into CG as a crisis prevention mechanism particularly because it has been used as an off-the-rack solution for a variety of problems in recent years despite its failure being elucidated globally by the Global Financial Crisis (GFC) and nationally by the bank failures experienced between 2015 and 2016.

This is a doctrinal research that analyses both primary and secondary sources of data on bank governance. The research interrogates several models of CG to determine the most suitable for Kenyan banking institutions, analyses the regulatory framework on bank governance in Kenya to determine whether the same is sufficient in curbing failure and includes a case study on the failure of Chase Bank Limited (CBL), which was felled by the failure of its CG mechanism and lax regulatory supervision.

Success in curbing future bank failures depends on the gatekeeper's accountability and the regulator's willingness to enforce already existing laws. To do so, the regulators must coordinate amongst themselves and be independent of external influence.

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LIST OF ABBREVIATIONS

BOD- Board of Directors

CAK- Competition Authority of Kenya

CBK- Central Bank of Kenya.

CBL- Chase Bank Limited.

CBLIR- Chase Bank Limited in Receivership.

CEO- Chief Executive Officer.

CG- Corporate Governance.

CGC- Corporate Governance Code.

CMA- Capital Markets Authority

EOI- Expression of Interest

FCP- Financial Consumer Protection

FOLTF- Failing or Likely to Fail

FSB- Financial Stability Board

FSCA- Financial Sector Conduct Authority

GFC- Global Financial Crisis

GCR- Global Credit Ratings

KCB- KCB Bank Kenya Limited

KDIC- Kenya Deposit Insurance Corporation.

LOLR- Lender of Last Resort

NED- Non-Executive Director

NHC- Non-Operating Holding Company

OECD- Organisation for Economic Cooperation and Development

OBA- Open Bank Assistance

OTC- Over-the-Counter

RBS- Risk Based Supervision

SARB-South Africa Reserve Bank



SBM- SBM Bank (Kenya) Limited

SEC- Securities and Exchange Commission

SPV- Special Purpose Vehicle

US- United States of America



LIST OF CASES

1. *Turquand v Marshall* (1868), The United Kingdom Court of Appeal.
2. *Dodge v Ford Motor Company* (1919), The Supreme Court of the United States.
3. *Litwin v Allen* (1940), The Supreme Court of the United States.
4. *Woods v Martins Bank Ltd.* (1958) The United Kingdom Queen's Bench.
5. *United Dominion Trust v Kirkwood* (1966) The United Kingdom Court of Appeal
6. *Jambo Biscuits (K) Ltd. v Barclays Bank of Kenya Ltd and 2 Others* (2001) eKLR.
7. *Afrasia Bank v SBM Bank (Kenya)* (2019) eKLR.
8. *SBM Bank (Kenya) Limited v Singh* (2020) eKLR.



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To my supervisor, Dr. Elizabeth Mokeira, thank you for guiding me through this process and giving me the encouragement and support which allowed me to complete this thesis.

To the Strathmore Law School, thank you for granting me the opportunity to undertake my studies.

To my family, friends and colleagues, thank you for your support, encouragement and prayers that carried me through my studies.



DEDICATION

I dedicate this book to my family; to my mother Irene for always encouraging me to pursue my dreams and for supporting me throughout, to my sister Joyce for motivating and supporting me, and to my aunt Catherine for her encouragement and prayers.



1. CHAPTER ONE: INTRODUCTION TO THE STUDY

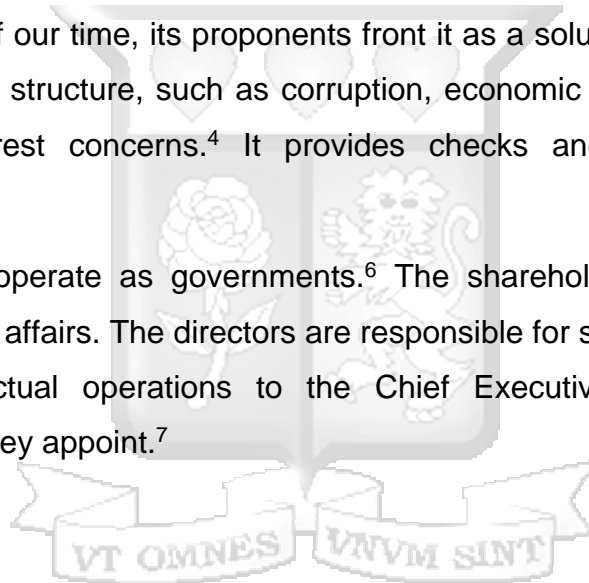
1.1. Background

Corporations are creatures of the law, and three elements attract persons to this form of business: its unlimited life, limited liability of the owners, and the ability to transfer ownership without disrupting the corporate structure.¹

Corporate Governance (CG) denotes a structure of systems, processes, practices and procedures that directs and regulates corporations.² CG is effective when a corporation, is achieving its purpose.³ Business success is directly linked to good governance practices.

CG is a key concern of our time, its proponents front it as a solution for many problems plaguing the corporate structure, such as corruption, economic development, systemic risk, and public interest concerns.⁴ It provides checks and balances within an organization.⁵

Modern corporations operate as governments.⁶ The shareholders elect directors to manage their business affairs. The directors are responsible for strategy formulation and they delegate the actual operations to the Chief Executive Officer (CEO) and management, whom they appoint.⁷



¹ Colley J, Stettinus W, Doyle J & Logan G, '*Corporate Governance: Business, Legal and Ethical Challenges Faced by Boards*, 1st ed, McGraw-Hill Executive MBA Series, United States, 2003,10.

² Mrabure K & Abhulimhen-lyoha A, 'Corporate Governance and Protection of Stakeholder Rights and Interest,' 11(1) *Beijing Law Review*, 2020, 293.

³ Colley J, *et al*, *Corporate Governance: Business, Legal and Ethical Challenges Faced by Boards*, 11.

⁴ Colley J, *et al*, *Corporate Governance: Business, Legal and Ethical Challenges Faced by Boards*, 11.

⁵ Pargendler M, 'The Corporate Governance Obsession,' 42(2), *Journal of Corporation Law*, 2016, 359.

⁶ Colley J, Doyle J, Logan G & Stettinus W, *What is Corporate Governance?* 1st ed, McGraw-Hill, United States, 2005, 3.

⁷ Colley J, *et al*, *What is Corporate Governance?* 3.

In *Turquand v. Marshall*,⁸ Lord Hatherley stated, “However ridiculous and absurd the director’s behavior may be, it is the misfortune of the company that they chose such an unwise director.” The failure of the courts to recognize directing as a profession with developing standards of expertise stunted the legal development of CG.⁹ However, over the years, directors’ and other executives’ roles in companies have evolved, with stricter standards being imposed to enhance accountability.

Banks in their very nature are corporations. The Banking Act CAP 488 refers to a bank as, a company that carries on business or proposes to carry on banking business in Kenya but does not include the central bank.¹⁰

The common law development of bank governance disappeared for several decades between World War II and the 1970s.¹¹ As courts were shaping corporate law and scholars were developing theoretical and normative frameworks, bank governance did not devolve from CG and the two developed as one body of law.

As a result, bank shareholders enjoy the same limited liability afforded to corporate shareholders and bank directors have similar fiduciary duties and just as in corporate law, these duties are owed primarily to shareholders.¹²

The very elements of the corporate structure that make it desirable, that is, the perpetual life of the corporation, the limited liability of the owners and the separate personality of the owners from the corporation, make it difficult for the corporation to act in the interest of the public.¹³

⁸ *Turquand v Marshall* (1868), The United Kingdom Court of Appeal

⁹ Clarke B, ‘Duty of Care, Skill and Diligence- From Warm Baths to Hot Water,’ 56 *Irish Jurist* 2016, 142.

¹⁰ Section 2, *Banking Act*, (CAP 488).

¹¹ Min D, ‘Balancing the Governance of Financial Institutions,’ 40(2) *Seattle University Law Review*, 2017, 748.

¹² Min D, ‘Balancing the Governance of Financial Institutions,’ 748.

¹³ Monks R & Minow N, *Corporate Governance*, 5th ed, John Wiley & Sons, United Kingdom, 2005, 4.

The corporate structure creates motive and opportunity to externalize costs benefitting insiders to the detriment of outsiders, that is, moral hazard.¹⁴ The opportunity for corporations and individuals to profit from risky behavior without incurring the associated cost is known as moral hazard.¹⁵

Moral hazard is inscribed within banks due to their triple layer of institutionalized limited liability,¹⁶ that is, shareholders enjoy limited liability meaning, their liability is limited to the amount they initially invested.¹⁷

Secondly, directors and managers enjoy limited liability in that they do not bear the full cost of their poor performance and thirdly, the Lender of Last Resort (LOLR) and deposit insurance regulatory mechanisms shift the burden of the cost from the bank to the government thus encouraging risk and exacerbating moral hazard.¹⁸

Finally, the shareholder primacy norm that dominates CG today in common law jurisdictions is unsuitable for banking institutions because of the key stakeholder concerns and their quasi-public functions of deposit-taking, credit advancing and money distribution.¹⁹ The board is therefore faced with unique demands to establish effective risk monitoring systems.

This research interrogates the failure of Chase Bank Limited (CBL) to determine the role CG plays in preventing bank failures.

¹⁴ Monks R & Minow N, *Corporate Governance*, 4.

¹⁵ Djelic M & Bothello J, 'Limited Liability and its Moral Hazard Implications: The Systemic Inscription of Instability in Contemporary Capitalism,' 42(6) *Theory and Society*, 2013, 589.

¹⁶ Djelic M & Bothello J, 'Limited Liability and its Moral Hazard Implications: The Systemic Inscription of Instability in Contemporary Capitalism,' 596.

¹⁷ Khoukaz G, 'Corporate Shareholders Limited Liability: Useful or Abusive,' 11 *Bocconi Legal Papers*, 2018, 85.

¹⁸ Djelic M & Bothello J, 'Limited Liability and its Moral Hazard Implications: The Systemic Inscription of Instability in Contemporary Capitalism,' 596.

¹⁹ Bruner C, 'Corporate Governance Reforms in Post-Crisis Financial Firms: Two Fundamental Tensions,' 60(4) *Arizona Law Review*, 2018, 961.

1.2. Statement of the Problem

In 2016, auditors uncovered that CBL had under-reported insider loans advanced to directors, shareholders, associates and employees of the bank.²⁰ The bank was thereafter placed under receivership by the CBK on the grounds of unsound transacting conditions, the likelihood of failure to meet financial obligations, substantially insufficient capital and violation of the law and regulation.²¹

The audit of CBL uncovered gaping CG issues, which ultimately led to the bank's failure. This is similar to what happened during the GFC whereby highly acclaimed financial firms with best-practice compliance engaged in predatory behavior and outright fraud.²²

Nevertheless, post-GFC CG regulation seems to be doubling down on the “self-governing” institution myth, potentially curving out more effective responses to the problem.²³ The unique nature of banks and their interconnectedness to the economy call for a specialized form of governance that inscribes key stakeholder concerns within it.²⁴

This research interrogates whether CG is effective in preventing bank failure due to its shortcomings being elucidated by various bank crises globally and nationally with the key focus being on the failure of CBL whose internal CG mechanism was undermined by fraudulent executives leading to the bank's collapse.²⁵

²⁰ Business Daily Africa, 'Chase Bank Shocks Market with Sh8n Secret Insider Loans,' Business Daily Africa, 7th April 2016 —<[Chase Bank shocks market with Sh8bn secret insider loans - Business Daily \(businessdailyafrica.com\)](https://www.businessdailyafrica.com/news/2016/04/07/chase-bank-shocks-market-with-sh8n-secret-insider-loans)> on 29th November 2021.

²¹ Central Bank of Kenya, Press Release, April 7th 2016, —<[Press Release Chase Bank Limited April 7 2016.pdf \(centralbank.go.ke\)](https://www.centralbank.go.ke/press-releases/press-release-chase-bank-limited-april-7-2016.pdf)> on 20th November 2021.

²² Fligstein N. & Roehrkasse A. 'The Causes of Fraud in the Financial Crisis of 2007 to 2009: Evidence from the Mortgage-Backed Securities Industry,' 81(4) *American Sociological Review*, 2016, 620-621.

²³ Pargendler M, 'The Corporate Governance Obsession,' 402

²⁴ Kotz H & Schmidt R, 'Corporate Governance of Banks- A German Alternative to the “Standard Model”,' Sustainable Architecture for Finance in Europe (SAFE), White Paper No.45, 2017, 4-5, —<[SAFE White Paper 45.pdf \(safe-frankfurt.de\)](https://www.safe-frankfurt.de/SAFE-White-Paper-45.pdf)> on 22nd June 2022.

²⁵ Business Daily Africa, 'Ousted Chase Bank Chairman Was Architect of Sh11bn Loot,' Business Daily Africa, 5th May 2016, —<[Ousted Chase Bank chairman was architect of Sh11bn loot - Business Daily \(businessdailyafrica.com\)](https://www.businessdailyafrica.com/news/2016/05/05/ousted-chase-bank-chairman-was-architect-of-sh11bn-loot)> on 26th July 2022.

1.3. Research Objectives

- i. To analyse various CG models and identify the most suitable one for private commercial banks in Kenya.
- ii. To interrogate the current regulatory framework on bank governance in Kenya and establish whether the same is sufficient in curbing bank failure.
- iii. To carry out a case study on CBL to establish the role of CG in preventing bank failure.
- iv. To make recommendations based on my findings.

1.4. Research Questions

- i. Which models of CG can be adapted and contextualized by Kenyan banks to prevent bank failures?
- ii. Is the current regulatory framework for banks sufficient to prevent bank failures in Kenya?
- iii. Is CG an appropriate crisis prevention mechanism?
- iv. What recommendations can be made to prevent bank failure in the future?

1.5. Significance of the Study

The peculiarities of banking institutions vis-a-vis corporations and the crucial stakeholder interests that require increased protection, necessitate a probe into CG as a crisis prevention mechanism particularly because it has been used as a panacea for a variety of problems in recent years despite its failure being elucidated globally by the Global Financial Crisis (GFC) and nationally by the bank failures experienced between 2015 and 2016.²⁶

Bank failure is a multi-faceted problem precipitated by various reasons. CG is often used as an off-the-rack solution for failure, despite its effectiveness being called into question.²⁷ It has been the cause of a robust scholarly debate throughout the years.

²⁶ Pargendler M, 'The Corporate Governance Obsession,' 361.

²⁷ Pargendler M, 'The Corporate Governance Obsession,' 361.

After all, even Lehman Brothers and Bear Stearns had established governance structures sophisticated enough to prevent their failures.²⁸ Nevertheless, post-GFC reform was largely carried out through prudential regulation directly involving CG.²⁹

Furthermore, modern banking regulation seems to be preoccupied with “safety and soundness” which emphasizes; capital requirements, disclosure and an extensive examination process while actual internal governance is overlooked.³⁰

Unfortunately, this is true post-GFC which seemed to illustrate the shortcomings of externally imposed regulation and elucidate the impact of compromised internal CG mechanism.³¹

This study seeks to fill the gap in the existing literature on bank governance in Kenya. Policymakers defer to CG literature while considering bank governance issues which in commonwealth jurisdictions, focuses on shareholder primacy and promotes the alignment of shareholder and manager interests.³²

However, banks are inherently different from non-financial firms and their governance, therefore, requires a different approach.³³ What makes banks different is their high degree of leverage, their assets having maturities that are substantially longer than their sources of funds, their susceptibility to bank runs, the need for bailouts through government guarantees upon their failure and their interconnectedness with the economy.³⁴

²⁸ Pargendler M, ‘The Corporate Governance Obsession,’ 383.

²⁹ Kim H-J. ‘Financial Regulation and Supervision in Corporate Governance of Banks,’ 41(3) *Journal of Corporation Law*, 2016, 711.

³⁰ Min D, ‘Balancing the Governance of Financial Institutions,’ 744.

³¹ Min D, ‘Balancing the Governance of Financial Institutions,’ 744.

³² Min D, ‘Balancing the Governance of Financial Institutions,’ 744.

³³ Armour J, Awrey D, Davies P, Enriques L, Gordon J, Mayer C, Payne J, ‘Bank Governance,’ European Corporate Governance Institute, Law Working Paper Number 316, 2016, 370, —< [delivery.php \(ssrn.com\)](#)> on 3rd June 2022.

³⁴ Kotz H & Schmidt R, ‘Corporate Governance of Banks- A German Alternative to the “Standard Model”,’ 4-5.

Bank governance remains an ongoing task for legislators, regulators and banks themselves.³⁵ There is a need for further economic, legal and interdisciplinary research on bank governance which could pave the way for a complete and free-standing discipline in Kenya and globally.

1.6. Hypothesis

- i. CG is insufficient in curbing bank failure.
- ii. Bank failure in Kenya is occasioned by poor internal CG mechanisms and a lax regulatory regime.

1.7. Theoretical Framework

There are two antagonistic theories underpinning bank governance literature today. These are; the agency cost theory and the stakeholder theory.

1.7.1. Agency Cost Theory

The agency cost theory is intrinsic to the Anglo-American model of governance and it entails corporate executives acting as agents and shareholders as the principal.³⁶ Therefore, the agent is duty-bound to act in the best interest of the principal.³⁷

The theory propounds that the shareholders' investment needs to be utilized for profit, thus increasing shareholder value.³⁸ This principle was affirmed in *Dodge v Ford Motor Company*.³⁹ In this case, the defendant, Ford Motor Company, refused to pay millions in special dividends to shareholders because it preferred to distribute that amount to the employees, contrary to the business purpose of profit maximization.⁴⁰

³⁵ Hopt K 'Corporate Governance of Banks and Financial Institutions: Economic Theory, Supervisory Practice, Evidence and Policy,' 22 *European Business Organisation Law Review*, 2021, 31.

³⁶ Mrabure K.O & Abhulimhen-lyoha A, 'Corporate Governance and Protection of Stakeholder Rights and, 294.

³⁷ Mrabure K.O & Abhulimhen-lyoha A, 'Corporate Governance and Protection of Stakeholder Rights and Interests,' 294.

³⁸ Mrabure K.O & Abhulimhen-lyoha A, 'Corporate Governance and Protection of Stakeholder Rights and Interests,' 301.

³⁹ *Dodge v Ford Motor Company* (1919), The Supreme Court of the United States.

⁴⁰ Elson C & Goosen J, 'E. Merrick Dodd and the Rise and Fall of Corporate Stakeholder Theory,' 72 (2) *The Business Lawyer*, 2017, 740.

The court ruled in favor of the plaintiff and ordered the defendant to pay special dividends to the shareholders. The court affirmed the notion that “A business corporation is carried on primarily for the profit of shareholders.”⁴¹

“The social responsibility of business is to make profits.”⁴² Friedman’s 1970s article affirmed the shareholder theory stating that businesses should focus exclusively on economic matters and profit maximization.

Therefore, spending the shareholders’ investment on social responsibilities that do not maximize profit, acts against the interest of the shareholder and the company.⁴³ However, this theory has been criticized for failing to prevent financial scandals such as Enron and WorldCom.

While the Anglo-American model is built on the proposition of interest alignment between management and shareholders, the various financial crises prove that interest alignment needs to incorporate a wider set of stakeholders.⁴⁴ Proper bank governance is crucial due to the adverse effects of bank failure on various stakeholders.

Furthermore, the arguments for shareholder primacy are far less compelling for bank governance due to the unstable nature of banking business which is not a mere quirk but an inherent part of it.⁴⁵ Additionally, depositors who are a crucial group of creditors, place a high premium on the safety, liquidity and the “moneyness” of their investments.”

Secondly, government backing of bank liabilities by offering liquidity support through the Lender of Last Resort (LOLR), relieves the creditors' downside risk and disincentives

⁴¹ Elson C & Goosen J, ‘E. Merrick Dodd and the Rise and Fall of Corporate Stakeholder Theory,’ 740.

⁴² Friedman M, ‘A Friedman Doctrine...The Social Responsibility of Business is to Increase its Profits,’ The New York Times, 13 September 1970 –<[A Friedman doctrine-- The Social Responsibility Of Business Is to Increase Its Profits - The New York Times \(nytimes.com\)](https://www.nytimes.com/1970/09/13/archives/a-friedman-doctrine--the-social-responsibility-of-business-is-to-increase-its-profits.html)> on 15th December 2021.

⁴³ West A, ‘Applying Metaethical and Normative Claims of Moral Relativism to (Shareholder and Stakeholder) Models of Corporate Governance,’ 135(2) *Journal of Business Ethics*, 2016, 203.

⁴⁴ Kim H-J. ‘Financial Regulation and Supervision in Corporate Governance of Banks,’ 717.

⁴⁵ Min D, ‘Balancing the Governance of Financial Institutions,’ 755.

them from their monitoring mandate.⁴⁶ This increases the capability of excessive risk-taking by bank executives. Another downside to government backing is that it turns a private conflict into a public policy concern.⁴⁷ For the aforementioned reasons, this research will be anchored on the stakeholder theory.

1.7.2. Stakeholder Theory

The stakeholder theory propounds that corporations maximize value for their stakeholders. A stakeholder is any person, actual or juristic, who can affect or is affected by the achievement of the organization's objectives.⁴⁸

Modern corporate stakeholder theory can be traced back to Professor E. Merrick Dodd Jr.'s article, 'For whom are corporate managers trustees?'⁴⁹ The article contended that corporations were no longer economic vehicles to produce shareholder wealth but had become important societal entities that share interests with various groups such as employees, consumers and the general public.⁵⁰

The needs of stakeholders may be hierarchical, with consumers being at the apex because their uptake of goods or services determines the firm's success.⁵¹ Employees fall at the second tier because they are responsible for business operations and are instrumental in meeting customer needs.

Distributors, creditors and suppliers are the next tiers of stakeholders who must be treated appropriately as their reliability is crucial to business success.⁵² Last but not least is the public interest. Firms need to provide goods/services in tandem with societal values and norms.⁵³

⁴⁶ Min D, 'Balancing the Governance of Financial Institutions,' 756.

⁴⁷ Min D, 'Balancing the Governance of Financial Institutions,' 757.

⁴⁸ Mrabure K.O & Abhulimhen-Iyoha A, 'Corporate Governance and Protection of Stakeholder Rights and Interests,' 298.

⁴⁹ Dodd Jr. E, 'For Whom Are Corporate Managers Trustees?' 45(7) *Harvard Law Review*, 1932.

⁵⁰ Elson C & Goosen J, 'E. Merrick Dodd and the Rise and Fall of Corporate Stakeholder Theory,' 735.

⁵¹ Colley J, *et al*, *What is Corporate Governance?* 5.

⁵² Colley J, *et al*, *What is Corporate Governance?* 5.

⁵³ Colley J, *et al*, *What is Corporate Governance?* 5.

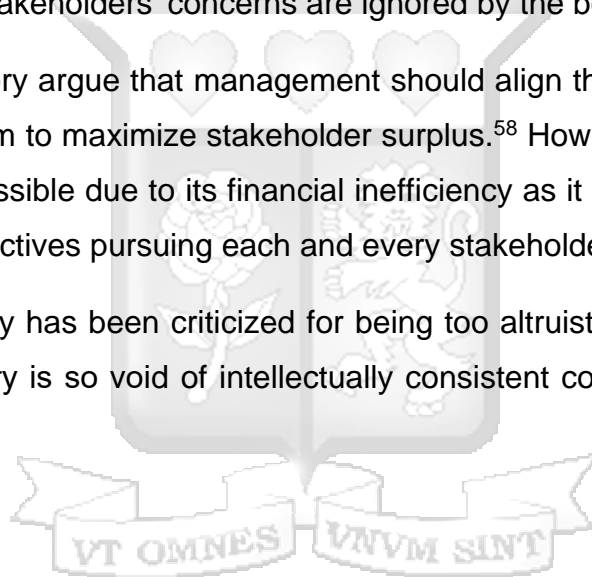
This principle is based on two fundamental concepts; Firstly, that no one should violate the legal rights of others and secondly, the corporation and its managers must be held accountable for the negative effects of their actions and/or inactions.⁵⁴

Corporations should be managed to benefit the stakeholders and their rights incorporated and represented in the corporation.⁵⁵ Additionally, stakeholder interests need to be accounted for and this can be achieved through their representation in the board, by appointing stakeholder directors.⁵⁶

The unintended consequence of the common law requirement that directors operate in the best interests of the company often construed by the courts to mean the interests of shareholders, is that stakeholders' concerns are ignored by the board.⁵⁷

Proponents of the theory argue that management should align their interests with those of stakeholders and aim to maximize stakeholder surplus.⁵⁸ However, implementing this claim is arguably impossible due to its financial inefficiency as it would be impractical to curate managerial objectives pursuing each and every stakeholder concern.⁵⁹

Furthermore, the theory has been criticized for being too altruistic. Coelho argues that; “The stakeholder theory is so void of intellectually consistent content that it provides a



⁵⁴ West A, 'Applying Metaethical and Normative Claims of Moral Relativism to (Shareholder and Stakeholder) Models of Corporate Governance,' 206.

⁵⁵ West A, 'Applying Metaethical and Normative Claims of Moral Relativism to (Shareholder and Stakeholder) Models of Corporate Governance,' 206.

⁵⁶ Goo S.H, 'An Economic Efficiency Approach to Reforming Corporate Governance: The Case of Multiple Stakeholder Boards,' 4, *Asian Journal of Law and Society*, 2017, 389.

⁵⁷ Goo S.H, 'An Economic Efficiency Approach to Reforming Corporate Governance: The Case of Multiple Stakeholder Boards,' 389.

⁵⁸ Zhong N, Wang S, Yang R, 'Does Corporate Governance Enhance Common Interests of Shareholders and Primacy of Stakeholders?' 141(2) *Journal of Business Ethics*, 2017, 415.

⁵⁹ Elson C & Goosen J, 'E. Merrick Dodd and the Rise and Fall of Corporate Stakeholder Theory,' 735.

refuge for knaves and/or fools.”⁶⁰ Furthermore, Freeman states; “I believe we can safely say that the stakeholder theory is or should at least be intellectually dead.”⁶¹

Perhaps what Dodd and other proponents of the theory failed to factor in was institutional investors such as; mutual funds, pension funds, hedge funds, etc.⁶² By shifting property rights from shareholders and diminishing shareholder value, the stakeholder theory could end up harming its beneficiaries.

Be that as it may, bank idiosyncrasies call for a specialized form of governance.⁶³ Bank governance cannot merely be preoccupied with profit maximization for shareholders due to the other crucial stakeholder groups such as depositors, creditors and the government.

1.8. Literature Review

1.8.1. Corporate Governance

Corporate Governance has gained traction in modern times as a favored policy response against corruption and enhancement of economic development.⁶⁴ However, whether or not corporate governance is the answer to corporate failure has been a debated topic among scholars over the years.

Pargendler M., in her article, “The Corporate Governance Obsession,” posits that modern society is obsessed with CG as the end-all-be-all solution to corporate failure.⁶⁵

She offers a political perspective to the modern preoccupation with CG in the United States of America (US).⁶⁶ She argues that Democrats favor CG as a checks and

⁶⁰ Coelho P.R.P, McClure, J.E, & Spry J.A, ‘The Social Responsibility of Corporate Management: A Classical Critique,’ 18(2) *Mid-American Journal of Business*, 2003, 54.

⁶¹ Freeman R.E. ‘The Politics of Stakeholder Theory: Some Future Directions,’ 4(4) *Business Ethics Quarterly*, 1994, 413.

⁶² Elson C & Goosen J, ‘E. Merrick Dodd and the Rise and Fall of Corporate Stakeholder Theory,’ 747.

⁶³ Hopt K ‘Corporate Governance of Banks and Financial Institutions: Economic Theory, Supervisory Practice, Evidence and Policy,’ 31.

⁶⁴ Pargendler M, ‘The Corporate Governance Obsession’ 359.

⁶⁵ Pargendler M, ‘The Corporate Governance Obsession,’ 359.

⁶⁶ Pargendler M, ‘The Corporate Governance Obsession,’ 359.

balances mechanism for big corporations, while Republicans favor CG because it acts as a reasonable compromise to government intervention.⁶⁷

CG treats corporations like government, by trying to solve the agency problem democratically through the doctrine of separation of powers, (ownership versus control), to ensure checks and balances.⁶⁸ This is supposedly achieved through a strong independent board and shareholder activism.

CG is not the only solution to the agency problem but one of the solutions. A distinction must be drawn between regulatory reforms which are externally imposed rules and regulations that influence corporate action and internal governance; which is the balance of power within the organization.⁶⁹

The dichotomy between ownership and control has evolved tremendously over the years with boards being more independent and shareholder activism being at its golden age.⁷⁰ However, even the most avid proponents of CG have come to acknowledge its deficiencies.

Firstly, the 2002 financial scandal was precipitated by corporate failures. Enron for example met and exceeded the CG standards required to prevent its failure.⁷¹ Additionally, the 2008 financial crisis preceded by the wave of financial deregulation, called the agency cost theory to question.⁷²

Aligning the interests of managers and shareholders contributed to the crisis by inducing executives to misbehave and engage in fraud, taking on excessive risk to increase short-term gains to the detriment of long-term performance.⁷³

⁶⁷ Pargendler M, 'The Corporate Governance Obsession,' 359.

⁶⁸ Pargendler M, 'The Corporate Governance Obsession,' 366.

⁶⁹ Pargendler M, 'The Corporate Governance Obsession,' 370.

⁷⁰ Pargendler M, 'The Corporate Governance Obsession,' 402.

⁷¹ Pargendler M, 'The Corporate Governance Obsession,' 384.

⁷² Pargendler M, 'The Corporate Governance Obsession,' 385.

⁷³ Pargendler M, 'The Corporate Governance Obsession,' 386.

Despite its poor track record, supporters of CG have yet to give up on the idea of “good CG” and have doubled down on the laws and regulations on the same.⁷⁴ Future research in the area should examine more effective responses to the problem and refrain from over-emphasis on the metaphor of the “self-governing corporation.”⁷⁵

Whether or not internal governance is the answer to corporate failure is a widely debated topic. The author advocates for alternative responses to the agency problem, to form the basis of future research because CG has failed in preventing various scandals and crises.

In contrast, Imbahala K. in her thesis, “Strengthening Corporate Governance to Curb Corruption in Banks in Kenya: A Case Study of Dubai Bank and Imperial Bank,” analyses the corruption in Dubai and Imperial bank to determine the reasons for collapse and suggests that CG is the solution to systemic bank failure.⁷⁶ The current legislative and regulatory framework does not incorporate bank governance. Such weaknesses have extensive consequences.⁷⁷

The lack of prompt enforcement by the regulator encouraged unethical practices in the banking sector to proceed unchecked.⁷⁸ Furthermore, the collapse of Imperial Bank Limited (IBL) revealed regulatory misconduct as it was averred that the CBK failed to act on whistleblower reports, including a 2012 report that money was transferred to the fake accounts monthly.⁷⁹ Such practices continued without sanction.

⁷⁴ Pargendler M, ‘The Corporate Governance Obsession,’ 402.

⁷⁵ Pargendler M, ‘The Corporate Governance Obsession,’ 402.

⁷⁶ Imbahala K, ‘Strengthening Corporate Governance to Curb Corruption in Banks in Kenya: A Case Study of Dubai Bank and Imperial Bank,’ Unpublished LL.M Thesis, University of Nairobi, 2019, 2.

⁷⁷ Imbahala K, ‘Strengthening Corporate Governance to Curb Corruption in Banks in Kenya: A Case Study of Dubai Bank and Imperial Bank,’ 3.

⁷⁸ Imbahala K, ‘Strengthening Corporate Governance to Curb Corruption in Banks in Kenya: A Case Study of Dubai Bank and Imperial Bank,’ 26.

⁷⁹ Imbahala K, ‘Strengthening Corporate Governance to Curb Corruption in Banks in Kenya: A Case Study of Dubai Bank and Imperial Bank,’ 27.

The corruption revealed post-collapse of several banks in 2015 and 2016 involves claims of regulatory collusion.⁸⁰ The author suggests that enhancing regulators' capacity to ensure the enforcement of laws on corporate governance with a specific interest in financial reporting, is the key to curbing failure.⁸¹

My research differs from the author's because she reviewed Dubai Bank and Imperial Bank whereas I will be undertaking a case study on CBL. Secondly, the author's research is limited to the corruption that took place within the banks and her recommendations entail strengthening CG, on financial reporting standards. However, corruption is a symptom of a much bigger issue plaguing banks, that is, poor CG. As earlier stated, poor governance equals poor performance.

Thirdly, in her analysis of the regulatory and legislative framework, she refers to the Companies Act, No. 17 of 2015,⁸² The Code of Corporate Governance Practices for Issuers of Securities to the Public, 2015,⁸³ and the Mwongozo- The Code of Governance for State Corporations,⁸⁴ correctly citing them as authorities of CG in Kenya. She fails to articulate that none of the laws and regulations mentioned above are concerned with banking institutions, which are primarily governed by the Banking Act CAP 488 and the Central Bank of Kenya CAP 491 and The Prudential Guidelines for Institutions Licensed Under the Banking Act, 2013.

As earlier stated, current legislation and regulation fail to divorce CG from bank governance thus, creating a gap in the interpretation. My research seeks to address this issue.

⁸⁰ Imbahala K, 'Strengthening Corporate Governance to Curb Corruption in Banks in Kenya: A Case Study of Dubai Bank and Imperial Bank,' 63.

⁸¹ Imbahala K, 'Strengthening Corporate Governance to Curb Corruption in Banks in Kenya: A Case Study of Dubai Bank and Imperial Bank,' 63.

⁸² Imbahala K, 'Strengthening Corporate Governance to Curb Corruption in Banks in Kenya: A Case Study of Dubai Bank and Imperial Bank,' 31.

⁸³ Imbahala K, 'Strengthening Corporate Governance to Curb Corruption in Banks in Kenya: A Case Study of Dubai Bank and Imperial Bank,' 35.

⁸⁴ Imbahala K, 'Strengthening Corporate Governance to Curb Corruption in Banks in Kenya: A Case Study of Dubai Bank and Imperial Bank,' 36.

Kimeu W., in his thesis, “Effect of Corporate Governance on Financial Performance of Commercial Banks in Kenya,” draws a direct relationship between financial performance and CG.⁸⁵ Good governance entails a fair business environment that is transparent and where corporations are held accountable for wrongdoing. Conversely, weak governance leads to waste, mismanagement and corruption.

Bank failure has been attributed to weak internal control systems, inefficient management and poor governance.⁸⁶ The Centre for Corporate Governance outlined several reasons for bank failure in Kenya: insider lending, which conflicts with stakeholder interests, weak regulatory/supervisory systems, poor risk management strategies, and overall poor internal governance structures.⁸⁷

From his empirical study, the author found a direct link between bank performance and good governance. Factors such as board independence, number of committees, number of meetings, liquidity and bank size affect performance.⁸⁸ However, the author places a caveat on the quality of the data, stating that it can only be assumed to be correct hence limiting his findings.

1.8.2. Internal Governance Solutions

Bank governance is different from that of corporations due to the quasi-public nature of banks, as deposit institutions.⁸⁹ There has been little to no advancement of bank governance from CG over the years.⁹⁰ Additionally, regulatory reforms have failed to address internal governance issues in banks.⁹¹

⁸⁵ Kimeu W, ‘Effect of Corporate Governance on Financial Performance of Commercial Banks in Kenya,’ Unpublished MSC Thesis, University of Nairobi, 2017, 3.

⁸⁶ Kimeu W, ‘Effect of Corporate Governance on Financial Performance of Commercial Banks in Kenya,’ 7.

⁸⁷ Kimeu W, ‘Effect of Corporate Governance on Financial Performance of Commercial Banks in Kenya,’ 8.

⁸⁸ Kimeu W, ‘Effect of Corporate Governance on Financial Performance of Commercial Banks in Kenya,’ 43.

⁸⁹ Kim H-J. ‘Financial Regulation and Supervision in Corporate Governance of Banks,’ 709.

⁹⁰ Min D, ‘Balancing the Governance of Financial Institutions,’ 744.

⁹¹ Bruner C, ‘Corporate Governance Reforms in Post-Crisis Financial Firms: Two Fundamental Tensions,’ 963.

Min D. in his article, “Balancing the Governance of Financial Institutions,” points out that modern banking regulation in the US focuses on the external regulatory framework while ignoring internal governance.⁹²

The Dodd-Frank Act of 2010 provides for minor changes to banks' internal governance, including provisions related to disclosures on executive compensation, shareholders' say on pay, increased proxy access, and clawback mandates.⁹³

Because bank governance did not develop as a separate body of law from corporate governance, the laws relating to the two are similar.⁹⁴ Bank shareholders enjoy the same limited liability as corporate shareholders and the fiduciary duties of directors are alike.

The shareholder primacy norm that dominates corporate law today is insufficient in addressing bank governance problems.⁹⁵ There are several features unique to banks that present a case against shareholder primacy in bank governance.

While the financial crisis of 2008 gave rise to significant regulatory changes, it is yet to incorporate noteworthy changes to bank governance.⁹⁶ Some academics and scholars have begun to examine bank governance in the aftermath of the crisis. However, regulators and policymakers have focused their efforts on risk management.⁹⁷

Banks, being in the risk-taking business, have an additional mandate to protect their stakeholders because of the adverse effects failure has on the economy and the public interest. Among their key stakeholders are the creditors, whose primary concern is being overleveraged.⁹⁸ Risk directly conflicts with the creditor's interests.

To boost bank capital, government guarantees certain debt obligations.⁹⁹ The government backing relieves creditors from their downside risk. Government guarantees

⁹² Min D, ‘Balancing the Governance of Financial Institutions,’ 744.

⁹³ Min D, ‘Balancing the Governance of Financial Institutions,’ 745.

⁹⁴ Min D, ‘Balancing the Governance of Financial Institutions,’ 748.

⁹⁵ Min D, ‘Balancing the Governance of Financial Institutions,’ 751.

⁹⁶ Min D, ‘Balancing the Governance of Financial Institutions,’ 746.

⁹⁷ Min D, ‘Balancing the Governance of Financial Institutions,’ 746.

⁹⁸ Min D, ‘Balancing the Governance of Financial Institutions,’ 752.

⁹⁹ Min D, ‘Balancing the Governance of Financial Institutions,’ 755.

have been criticized for harming the economy by disincentivizing creditors from their duty to monitor and discipline banks.¹⁰⁰ The second disadvantage of guarantees is the transformation of bank risks from private conflict to a public policy concern.

Realigning bank executive incentives by imposing sanctions on executives such as clawbacks on compensation and personal liability upon failure, decreasing the limited liability afforded to bank shareholders and imposing additional duties on directors, may curtail the future failure of financial institutions.¹⁰¹

The author's solution to realign managers' interests is not a new proposal. Several authors have made a similar proposition. Additionally, the solution to decrease limited liability is impractical. It would be impossible to implement and the law already provides an avenue for redress in the corporate law principle of 'piercing the veil'.

Also, the article focuses on two stakeholders; the government and creditors, while banks have a wide range of stakeholders.

Teklak P in the article; "The Role of Non-Executives Directors in Banks and the Provision of Guidance on How Directors Can Rectify Bank Governance Deficiencies," discusses the role of independent/ Non-Executive Directors (NEDs) in rectifying the shortfalls of bank governance.

NEDs have been described as "shareholder surrogates" as they are placed on the board to monitor executive directors.¹⁰² The U.K Corporate Governance Code (CGC) stipulates that NEDs constructively challenge and help develop proposals on strategy. Furthermore, the non-executive director must be independent, which means that they should be company outsiders, possessing the relevant skills, experience and knowledge.¹⁰³

¹⁰⁰ Min D, 'Balancing the Governance of Financial Institutions,' 756.

¹⁰¹ Min D, 'Balancing the Governance of Financial Institutions,' 761.

¹⁰² Teklak P. 'The Role of Non-Executive Directors in Banks and the Provision of Guidance on How Directors Can Rectify Bank Governance Deficiencies,' 2 *Exeter Law Review*, 2016, 61.

¹⁰³ Teklak P. 'The Role of Non-Executive Directors in Banks and the Provision of Guidance on How Directors Can Rectify Bank Governance Deficiencies,' 62.

Risk management is crucial to bank governance. The financial crisis of 2008 illustrated the importance of risk management in financial institutions.¹⁰⁴ As a result, the CGC made amendments to include the role of risk assessment and management for the long-term success of the business.¹⁰⁵

Though the CGC suits a broad range of companies, it cannot adequately address the issues of financial institutions subject to their guidelines, regulations and statutes.¹⁰⁶ The author posits that adopting the CGC into bank charters, may legitimize their stature in financial institutions and add a second category of directors' duties on the NEDs, into law.¹⁰⁷

In Kenya, the prudential guidelines act as a code of governance for banking institutions, therefore, making the author's point of adding the CGC to bank charters redundant. Furthermore, in CG the terms non-executive director and independent director are used interchangeably to denote board members who do not form part of the management or employment staff of the company or its affiliates but can own shares in the company.¹⁰⁸

The prudential guidelines, however, provide for NEDs and further distinguishes NEDs from independent NEDs. A NED is one who is not actively involved in day-to-day management and is not a full-time salaried employee of an institution or its affiliates.¹⁰⁹

On the other hand, an independent NED, is a person who has not worked for the institution within the past five years, is not connected to senior management, a key client

¹⁰⁴ Teklak P. 'The Role of Non-Executive Directors in Banks and the Provision of Guidance on How Directors Can Rectify Bank Governance Deficiencies,' 64.

¹⁰⁵ Teklak P. 'The Role of Non-Executive Directors in Banks and the Provision of Guidance on How Directors Can Rectify Bank Governance Deficiencies,' 65.

¹⁰⁶ Teklak P. 'The Role of Non-Executive Directors in Banks and the Provision of Guidance on How Directors Can Rectify Bank Governance Deficiencies,' 71.

¹⁰⁷ Teklak P. 'The Role of Non-Executive Directors in Banks and the Provision of Guidance on How Directors Can Rectify Bank Governance Deficiencies,' 70.

¹⁰⁸ The Code of Corporate Governance Practices for Issuers of Securities to the Public, 2015, Kenya —<[Code of Corporate Governance Practices for Issuers of Securities to the Public 2015 - Code-8.pdf](#)> on 20th November 2021.

¹⁰⁹ Clause 1.4.5. Prudential Guidelines for Institutions Licensed Under the Banking Act, 2013, 36, —<[PGs \(centralbank.go.ke\)](#)> on 20th November 2021.

or supplier, a non-profit organization that receives more than half of its funding from the institution, and has no other relationships with the institution (other than serving as a director) for which the institution is required to make disclosure.¹¹⁰

Further, he/she must have no service contract with the institution or a member of the institution's senior management, must not be a family member of any aforementioned persons, must not have a relationship with any affiliate of the institution, and must have no direct or indirect interest with the institution exceeding 5% and must not be a direct or indirect representative of a significant shareholder.¹¹¹

Omarova S. in her article, "Bank Governance and Systemic Stability: The Golden Share Approach," offers a unique perspective on the agency problem by introducing the 'golden share' which would essentially give the government a sit on the board of directors (BOD).

The financial crisis of 2008 exposed how insufficient the agency-cost theory was in addressing public interest issues.¹¹² The traditional system of governance is too shareholder-centric and fails to address stakeholder conflict.

The golden share mechanism would give the government a sit on the board with unique, exclusive and non-transferable governance rights in privately owned institutions.¹¹³ This method was used in the 1980s during the privatization wave of state-owned companies to ensure the government's continued control. It allowed the government to monitor the commercial activity of a corporation.¹¹⁴

As a golden shareholder, the government would have unfettered voting power without an equity stake.¹¹⁵ The ability to affect the internal decisions of a corporation without holding an equity stake is the main attraction of the golden share. The current overreliance on

¹¹⁰ Clause 1.4.6. Prudential Guidelines for Institutions Licensed Under the Banking Act, 2013, 36, —<[PGs \(centralbank.go.ke\)](http://PGs.centralbank.go.ke)> on 20th November 2021.

¹¹¹ Clause 1.4.6. Prudential Guidelines for Institutions Licensed Under the Banking Act, 2013, 36, —<[PGs \(centralbank.go.ke\)](http://PGs.centralbank.go.ke)> on 20th November 2021.

¹¹² Omarova S.T. 'Bank Governance and Systemic Stability: The Golden Share Approach,' 68(4) *Alabama Law Review*, 2017, 1032.

¹¹³ Omarova S.T. 'Bank Governance and Systemic Stability: The Golden Share Approach,' 1043.

¹¹⁴ Omarova S.T. 'Bank Governance and Systemic Stability: The Golden Share Approach,' 1044.

¹¹⁵ Omarova S.T. 'Bank Governance and Systemic Stability: The Golden Share Approach,' 1044.

risk management and internal decision-making poses a significant limitation to financial stability.¹¹⁶

Thinking along unconventional lines could be the key to unlocking the deficiencies of CG.¹¹⁷ Even so, the government playing such an active role on the board of private institutions can be likened to nationalization and it defeats the purpose of a free-market economy.

The author's outlook on improving bank governance is divergent from the Anglo-American CG model, it can be likened to the Chinese model characterized by majority state ownership. Implementing the same would be met with uproar due to government interference. Furthermore, it would require developing complex legal and regulatory frameworks.

1.8.3. Regulatory Reforms

The current response to the bank governance problem has been, to strengthen the regulatory framework while neglecting the internal governance structure. These reforms are evident even at the regional level.

Schmulow A's article, "Financial Regulatory Governance in South Africa: The Move Towards Twin Peaks," gives insight into South Africa's financial regulatory framework. The twin peak model entails the establishment of two independent regulatory bodies. One is mandated to ensure safety and soundness and the other is tasked with consumer protection.¹¹⁸

The model was first proposed in a pamphlet authored by Michael Taylor in 1994, aimed primarily at the Bank of England, the Building Societies Commission and the Securities and Investment Board.¹¹⁹

¹¹⁶ Omarova S.T. 'Bank Governance and Systemic Stability: The Golden Share Approach,' 1044.

¹¹⁷ Omarova S.T. 'Bank Governance and Systemic Stability: The Golden Share Approach,' 1067.

¹¹⁸ Schmulow A. 'Financial Regulatory Governance in South Africa: The Move Toward Twin Peaks,' 25(3) *African Journal of International and Comparative Law*, 2017, 393.

¹¹⁹ Schmulow A. 'Financial Regulatory Governance in South Africa: The Move Toward Twin Peaks,' 394.

Taylor envisioned that the Bank of England would address safety and soundness issues such as capital requirements, risk exposure requirements, vetting senior management and establishing policies,¹²⁰ while the second regulator is charged with protecting consumers from unscrupulous financial practices such as fraud, incompetence and market abuse.

Separate prudential and market conduct regulators allow for a system of checks and balances and prevent vesting too much power in one regulator.¹²¹ The inverse of creating checks and balances is the need to define responsibilities to avoid duplicity.

The regulatory architecture alone cannot solve bank failure as evidenced by the 2008 financial crisis.¹²² Success in curbing future failures is sometimes based on the regulator's ability to foresee the unforeseeable and regulate accordingly and the willingness to enforce already existing laws.¹²³

Since the proposal, there has been uptake of the same in several jurisdictions such as Australia, the Netherlands and more recently, South Africa (SA).¹²⁴ Ultimately the success of the twin peak model in SA will depend on enforcement and the regulator's capacity to pursue corrective action without interference. Also, the independence of regulators and their ability to coordinate amongst themselves to ensure adequate service provision will contribute to their success.¹²⁵

¹²⁰ Schmulow A. 'Financial Regulatory Governance in South Africa: The Move Toward Twin Peaks,' 395.

¹²¹ Republic of South Africa National Treasury 'A Safer Financial Sector to Serve South Africa Better,' 23rd February 2011, 36 –<[20131211 - item 2 a safer financial sector to serve south africa better.pdf \(treasury.gov.za\)](#)> on 21 November 2021.

¹²² Schmulow A. 'Financial Regulatory Governance in South Africa: The Move Toward Twin Peaks,' 394.

¹²³ Schmulow A. 'Financial Regulatory Governance in South Africa: The Move Toward Twin Peaks,' 401.

¹²⁴ Schmulow A. 'Financial Regulatory Governance in South Africa: The Move Toward Twin Peaks,' 416.

¹²⁵ Schmulow A. 'Financial Regulatory Governance in South Africa: The Move Toward Twin Peaks,' 416.

The model was adopted in SA in 2018.¹²⁶ The Prudential Authority established within the South African Reserve Bank (SARB) is responsible for supervising the safety and soundness of financial institutions. The Financial Sector Conduct Authority (FSCA) is mandated with financial conduct and consumer protection.

The twin peak model as previously mentioned ensures checks and balances in the regulatory system. The failure of the regulator in their supervisory mandate leading to the collapse of various banks in Kenya, begs the question, who regulates the regulator?

Kim H-J., in the article; “Financial Regulation and Supervision in Corporate Governance of Banks,” analyzes the role of the state’s interference through financial supervision and regulation in the US. The author also carries out a case study of KB Financial Group (KB), A Korean Bank.

In the USA, state interference through financial supervision became a necessary evil post the 2008 crisis.¹²⁷ As financial regulation became the only tool to manage the shareholder vs stakeholder conflict.

Corporate law applied to banks gives rise to stakeholder conflict because it does not protect depositors and the economic system.¹²⁸ Post-GFC reform was carried out through prudential regulation directly involving CG.

The collapse of large financial institutions can take down the economy.¹²⁹ The government has to step in to bypass the effects. Though government intervention through financial supervision serves a legitimate purpose, it comes at a heavy cost such as the deterioration of bank business through internal power struggles, cronyism, corruption and direct lending practices.¹³⁰

¹²⁶ South African Government, “Treasury on new Twin Peaks regulators 29th March 2018 — <[Treasury on new Twin Peaks regulators | South African Government \(www.gov.za\)](http://www.gov.za)> on 28th August 2021.

¹²⁷ Kim H-J. ‘Financial Regulation and Supervision in Corporate Governance of Banks,’ 710.

¹²⁸ Kim H-J. ‘Financial Regulation and Supervision in Corporate Governance of Banks,’ 711.

¹²⁹ Kim H-J. ‘Financial Regulation and Supervision in Corporate Governance of Banks,’ 715.

¹³⁰ Kim H-J. ‘Financial Regulation and Supervision in Corporate Governance of Banks,’ 714.

The author gives the example KB whereby, following new government directives for board composition and functions the bank reorganized its board with new outside directors all with government backing.¹³¹ The directors elected a close ally of the president as the Chief Executive Officer.

Bank governance reform may be achieved without government interference through;¹³²

1. Proper risk management. Leading up to the financial crisis, bank executives failed to prevent risky lending. Internal governance systems did not function properly because their risk appetite was too large and they regularly ignored risk officers' warnings.
2. Employing stricter duties for bank executives. As it was established in *Litwin v Allen*,¹³³ a higher standard of care must be imposed for bank directors because banks are charged with serving the public.

The alternatives put forth by the author though relevant fail to fill a gap in the existing literature.

1.8.4. Rescue Intervention

Calderon C & Schaek K in their article, "The Effects of Government Interventions in the Financial Sector on Banking Competition and the Evolution of Zombie Banks," investigate the effects of government intervention on banks in the U.S.

In 2011, The Congressional Oversight Panel issued a report stating that; "Rescuing large banks may have averted the immediate crisis, but it also provided these banks a competitive advantage... potentially destabilizing the financial system."¹³⁴

¹³¹ Kim H-J. 'Financial Regulation and Supervision in Corporate Governance of Banks,' 708-709.

¹³² Kim H-J. 'Financial Regulation and Supervision in Corporate Governance of Banks,' 717

¹³³ *Litwin v Allen* (1940) The Supreme Court of the United States.

¹³⁴ Financial Report of the Congressional Oversight Panel, (2011), 189.

Following the GFC, governments and regulators took unprecedented steps to nationalize banks via takeovers and to provide blanket guarantees, liquidity support, and injecting capital into failing banks.¹³⁵

Such interventions affect the financial market because they send the wrong message to banks, to anticipate future bailouts.¹³⁶ This distorts the bank's incentive to self-regulate and affects internal governance. It further suppresses the shakeout of unviable/ 'zombie' banks and affects the competition in the financial industry.

Rescue interventions keep failing banks in business as a going concern.¹³⁷ This creates stabilizing effects due to the restored consumer confidence and avoidance of disruptive disclosures.¹³⁸

However, the downside to intervention is that zombie banks prey on their rivals' market shares by preventing the exit of insolvent institutions.¹³⁹ Furthermore, they may keep up with unethical practices because they are in a no-lose situation.¹⁴⁰

CBL is a perfect example of a zombie bank. Its collapse having been brought on by insider lending and poor CG should have warranted its shakeout from the financial market as was the case for Imperial Bank and Dubai Bank which similar to CBL, were mid-level private commercial banks that were allowed to fail by the regulator while CBL was saved.

¹³⁵ Calderon C, & Schaeck K, 'The Effects of Government Interventions in the Financial Sector on Banking Competition and the Evolution of Zombie Banks,' 51 (4) *Journal of Financial and Quantitative Analysis*, 2016, 1392.

¹³⁶ Calderon C, & Schaeck K, 'The Effects of Government Interventions in the Financial Sector on Banking Competition and the Evolution of Zombie Banks,' 1392.

¹³⁷ Calderon C, & Schaeck K, 'The Effects of Government Interventions in the Financial Sector on Banking Competition and the Evolution of Zombie Banks,' 1423.

¹³⁸ Calderon C, & Schaeck K, 'The Effects of Government Interventions in the Financial Sector on Banking Competition and the Evolution of Zombie Banks,' 1425.

¹³⁹ Calderon C, & Schaeck K, 'The Effects of Government Interventions in the Financial Sector on Banking Competition and the Evolution of Zombie Banks,' 1394.

¹⁴⁰ Calderon C, & Schaeck K, 'The Effects of Government Interventions in the Financial Sector on Banking Competition and the Evolution of Zombie Banks,' 1423.

1.9. Research Methodology

This is a doctrinal research encompassing primary and secondary sources of literature. The primary sources include a review of the legal and regulatory framework on bank governance in Kenya, while the secondary sources encompassed the existing literature in textbooks, journal articles, theses, research and working papers, institutional reports, newspaper articles and online resources relevant to the study.

The research further interrogates three CG models, that is, the Anglo-American Model, the German Model and the Japanese Model to determine the most suitable for preventing bank failure in Kenya.

Moreover, the research includes a case study on the collapse of CBL, to analyse the catastrophic effects of bank failure on key stakeholders, review the regulatory response to the failure and establish the role of CG in crisis prevention.

CBL's failure unlike the other banks that failed at the same time prompted government intervention as the regulators employed several resolution strategies to ensure the bank's continuity thus giving a comprehensive view of prudential regulation, that is, preventive and protective regulatory measures.

1.10. Limitations of the Study

- i. This research is limited to the failure of one private commercial bank in Kenya, therefore, limiting the results. A similar study of different banking institutions in Kenya may yield different results.
- ii. The study is limited to private commercial banks.

1.11. Chapter Breakdown

This thesis is broken down into five chapters.

- i. Chapter one gives the background to the study by indicating an overview of the research topic. It highlights the background of the problem, and objectives of the research and puts forward several research questions that the research seeks to answer.
- ii. Chapter two analyses the Anglo-American, German and Japanese models of CG to establish the most suitable for private commercial banks in Kenya.

- iii. Chapter three analyses the legal and regulatory framework of bank governance in Kenya, to determine whether the current laws are sufficient in preventing bank failures.
- iv. Chapter four entails a case study on the collapse of CBL to establish the role of CG in preventing bank failure and finally,
- v. Chapter five concludes the research and makes recommendations based on the findings.



2. CHAPTER TWO: ANALYSIS OF CORPORATE GOVERNANCE MODELS

2.1. Introduction

CG has been in practice since the emergence of the corporate structure.¹⁴¹ Hence, CG issues have been in existence for as long as the corporate form has existed.¹⁴² Contemporary CG is multi-disciplinary involving corporate aspects such as accountability, disclosure, social responsibility, fairness and the relationship between the board, management, shareholders and other stakeholders.¹⁴³

This chapter will investigate three models of governance, that is, the Anglo-American Model, the German Model and the Japanese Model vis-a-vis banking institutions, to identify the most suitable governance model for private commercial banks in Kenya.

2.2. The Anglo-American Model

The Anglo-American model is the CG system applicable in the UK and the US.¹⁴⁴ It has globally been advanced, particularly in commonwealth countries such as Kenya. It is rooted in the agency-cost theory which as discussed in Chapter 1 is shareholder-centric.¹⁴⁵

There are three key components at the heart of the model, that is; a general assembly of shareholders, a BOD and executive management.¹⁴⁶ The company is accountable to the shareholders who appoint directors tasked with strategy formulation and ensuring implementation by overseeing management.

The model promotes a multiplicity of shareholders who are widely dispersed hence diffusing their ownership and impairing their ability to effectively run the business, raising

¹⁴¹ Shabir A & Rosmini O, 'Basic Corporate Governance Models: A Systematic Review,' 58(1) *International Journal of Law and Management*, 2016, 73.

¹⁴² Lund D & Pollman E, 'The Corporate Governance Machine,' 121(8) *Columbia Law Review*, 2021, 2569.

¹⁴³ Shabir A & Rosmini O, 'Basic Corporate Governance Models: A Systematic Review,' 74.

¹⁴⁴ Shabir A & Rosmini O, 'Basic Corporate Governance Models: A Systematic Review,' 76.

¹⁴⁵ Shabir A & Rosmini O, 'Basic Corporate Governance Models: A Systematic Review,' 76.

¹⁴⁶ Ntim C, 'Defining Corporate Governance: Shareholder versus Stakeholder Models' *Global Encyclopedia of Public Administration and Governance*, 2018, 1.

serious agency problems.¹⁴⁷ Additionally, because shareholders as the principals delegate control of their business to directors and managers, they run the risk of loss of control in the event the agents decide to pursue their self-interest.

The divergence of interest between the shareholders, directors and management is referred to as the agency cost, which is to be minimized.¹⁴⁸ Professor Daniel Fischel in his article *'The Corporate Governance Movement,'* stated "As residual claimants on the firms' income stream, shareholders want their agents...to maximize wealth."¹⁴⁹

He suggests, to minimize the agency-cost corporations could appoint directors as monitors and incentivize their alignment by tying their compensation to the share price.¹⁵⁰ Thus, maximizing corporate value and social welfare while negative externalities would be regulated by other bodies.¹⁵¹

Incorporating ethical standards and practices through codes of conduct that are grounded in the universal business principles of accountability, discipline, fairness, independence, responsibility and transparency to regulate director and managerial behavior has also been suggested as a solution to the agency problem.¹⁵²

The model further posits that external intervention by central regulatory authorities is to be reduced due to the notion of market discipline and self-correction, this was however dispelled by the GFC.¹⁵³

The model heavily relies on a free market regulatory regime based on equity financing as opposed to debt financing.¹⁵⁴ Equity is raised via efficiently operated capital markets and in such a market, capital is assumed to freely move to investments that offer the highest returns.

¹⁴⁷ Ntim C, 'Defining Corporate Governance: Shareholder versus Stakeholder Models' 3.

¹⁴⁸ Lund D & Pollman E 'The Corporate Governance Machine,' 2573.

¹⁴⁹ Fischel D, 'The Corporate Governance Movement,' 35 *Vanderbilt Law Review*, 6, 1982, 1259-1262.

¹⁵⁰ Fischel D, 'The Corporate Governance Movement,' 1259-1262.

¹⁵¹ Lund D & Pollman E, 'The Corporate Governance Machine,' 2574.

¹⁵² Ntim C, 'Defining Corporate Governance: Shareholder versus Stakeholder Models' 5.

¹⁵³ Ntim C, 'Defining Corporate Governance: Shareholder versus Stakeholder Models' 5.

¹⁵⁴ Ntim C, 'Defining Corporate Governance: Shareholder versus Stakeholder Models' 5.

The model has been criticized for assuming that residual power rests with shareholders such that they can adequately choose with whom operational power vests.¹⁵⁵ In practice, however, shareholders cannot exercise such control over directors and management because they are too dispersed.¹⁵⁶

It has further been criticized for its preoccupation with short-termism, that is; short-term; returns on investment, profits, management performance, share price and expenditures due to an over-reliance on efficient capital markets.¹⁵⁷ Additionally, the model's shareholder-centric nature subordinates the social, ethical and moral responsibilities of the firm.

Banks have certain special intricacies that demand a special form of governance requiring stakeholder protection such as; their low capitalization, their complex and non-transparent business activities and structures, the need for trust that is central to their business activities, their susceptibility to runs and their macro-economic importance to the economy.¹⁵⁸ The special governance of banks is enshrined in supervisory and regulatory legislation.¹⁵⁹

The Basel Committee on Banking Supervision, the leading authority on banking, in 2015, published guidelines on corporate governance principles for banks.¹⁶⁰ The guidelines stipulate that effective CG is crucial to the adequate functioning of the banking sector and the economy as a whole.¹⁶¹

¹⁵⁵ Ntim C, 'Defining Corporate Governance: Shareholder versus Stakeholder Models' 5-6.

¹⁵⁶ Ntim C, 'Defining Corporate Governance: Shareholder versus Stakeholder Models,' 6.

¹⁵⁷ Ntim C, 'Defining Corporate Governance: Shareholder versus Stakeholder Models,' 7.

¹⁵⁸ Hopt K 'Corporate Governance of Banks and Financial Institutions: Economic Theory, Supervisory Practice, Evidence and Policy,' 16.

¹⁵⁹ Hopt K 'Corporate Governance of Banks and Financial Institutions: Economic Theory, Supervisory Practice, Evidence and Policy,' 13.

¹⁶⁰ Hopt K 'Corporate Governance of Banks and Financial Institutions: Economic Theory, Supervisory Practice, Evidence and Policy,' 15.

¹⁶¹ Basel Committee on Banking Supervision, Guidelines, *Corporate Governance Principles for Banks*, 2015, 3, –<[Corporate governance principles for banks \(bis.org\)](https://www.bis.org/cgpr)> on 6th March 2023.

Furthermore, it specifies that maintaining stakeholder interests in line with the public interest should be the main goal of bank governance on a long-term basis.¹⁶² Among the stakeholders, the shareholders' interests are secondary to depositors. Additionally, well-run banks help to keep the supervision process effective and affordable, which lessens the need for supervisory intervention.¹⁶³

The Basel Committee stipulates that the board and senior management have the authority to govern the business affairs of a bank by; formulating strategies, recruiting and overseeing staff, engaging in day-to-day business operations, protecting depositor and other stakeholder interests, meeting shareholder obligations, aligning corporate culture with safety and soundness and establishing control functions.¹⁶⁴

The board's responsibility is to approve and monitor management's execution of the bank's strategic goals, governance structure, and corporate culture.¹⁶⁵ The corporate culture must incorporate responsible and ethical behavior particularly as it pertains to risk awareness, risk-taking behavior and risk management.

The board must select the CEO, senior management and other key personnel, monitor their actions ensuring that the same are in line with the approved strategies and policies, meet regularly with senior management, critically review and question information provided by the senior management, set appropriate remuneration standards, assess whether the overall knowledge and expertise of senior management remain relevant and

¹⁶² Basel Committee on Banking Supervision, Guidelines, *Corporate Governance Principles for Banks*, 2015, 3, –<[Corporate governance principles for banks \(bis.org\)](https://www.bis.org/cgpr)> on 6th March 2023.

¹⁶³ Basel Committee on Banking Supervision, Guidelines, *Corporate Governance Principles for Banks*, 2015, 3, –<[Corporate governance principles for banks \(bis.org\)](https://www.bis.org/cgpr)> on 6th March 2023.

¹⁶⁴ Basel Committee on Banking Supervision, Guidelines, *Corporate Governance Principles for Banks*, 2015, 3, –<[Corporate governance principles for banks \(bis.org\)](https://www.bis.org/cgpr)> on 6th March 2023.

¹⁶⁵ Principle 1, Basel Committee on Banking Supervision, Guidelines, *Corporate Governance Principles for Banks*, 2015, 8, –<[Corporate governance principles for banks \(bis.org\)](https://www.bis.org/cgpr)> on 6th March 2023.

be actively engaged in succession planning for the CEO and other key management positions.¹⁶⁶

The board should be competent and qualified individually and collectively with a balance of relevant knowledge, skills, diversity and expertise necessary to perform their duties.¹⁶⁷ Furthermore, to increase board efficiency, the board must establish specialized board committees such as; audit, risk, compensation, nomination, and human resource committees, allowing deeper focus on specialized areas.¹⁶⁸

The guidelines also provide for the governance of the corporate group structure.¹⁶⁹ The parent company is in charge of overseeing the entire group and making sure that a coherent governance framework with clearly defined roles and responsibilities is established and operated.

The parent's board should be aware of the material risks and issues that might affect the bank and its subsidiaries and establish a CG framework cognisant of those risks.¹⁷⁰

The Basel guidelines are more detailed and demanding than those governing non-financial corporations.¹⁷¹ For starters, the shareholders' interests are said to be

¹⁶⁶ Principle 1, Basel Committee on Banking Supervision, Guidelines, *Corporate Governance Principles for Banks*, 2015, 12, –<[Corporate governance principles for banks \(bis.org\)](https://www.bis.org/cgpr/2015/01)> on 6th March 2023.

¹⁶⁷ Principle 2, Basel Committee on Banking Supervision, Guidelines, *Corporate Governance Principles for Banks*, 2015, 13, –<[Corporate governance principles for banks \(bis.org\)](https://www.bis.org/cgpr/2015/01)> on 6th March 2023.

¹⁶⁸ Principle 3, Basel Committee on Banking Supervision, Guidelines, *Corporate Governance Principles for Banks*, 2015, 16-17, –<[Corporate governance principles for banks \(bis.org\)](https://www.bis.org/cgpr/2015/01)> on 6th March 2023.

¹⁶⁹ Principle 5, Basel Committee on Banking Supervision, Guidelines, *Corporate Governance Principles for Banks*, 2015, 22, –<[Corporate governance principles for banks \(bis.org\)](https://www.bis.org/cgpr/2015/01)> on 6th March 2023.

¹⁷⁰ Principle 5, Basel Committee on Banking Supervision, Guidelines, *Corporate Governance Principles for Banks*, 2015, 22, –<[Corporate governance principles for banks \(bis.org\)](https://www.bis.org/cgpr/2015/01)> on 6th March 2023.

¹⁷¹ Hopt K 'Corporate Governance of Banks and Financial Institutions: Economic Theory, Supervisory Practice, Evidence and Policy,' 18.

subordinate to those of depositors.¹⁷² The guidelines however offer no practical guidance as to how this is to be achieved. The same is on a principle basis.

Furthermore, the board has the responsibility of risk management, the governance of corporate groups has been spelled out and the composition, qualification and responsibilities of the board are more comprehensive than those of non-bank corporations.¹⁷³ However, the provisions of the guidelines have been criticized for being vague and familiar to researchers and practitioners of corporate law and tending towards over-regulation.¹⁷⁴

Banking institutions require a special form of governance because, firstly, tying bank executive pay to the share price exacerbates the agency cost.¹⁷⁵ Secondly, bank failure has a greater societal cost because it can trigger contagion.¹⁷⁶

As evidenced by the GFC, the government had to bail out troubled financial firms to avoid widespread contagion.¹⁷⁷ The more systemically significant the bank the more likely it is to receive government support which incentivizes banks to structure their operations in such a way as to be considered “too big to fail.”

Additionally, studies have shown that banks with shareholder-centric boards had the greatest risk levels before the GFC and therefore suffered greater losses for the likely reasons that; directors assumed regulators were exercising risk controls and therefore

¹⁷² Basel Committee on Banking Supervision, Guidelines, *Corporate Governance Principles for Banks*, 2015, 3, –<[Corporate governance principles for banks \(bis.org\)](https://www.bis.org/corporate/governance-principles-for-banks)> on 6th March 2023.

¹⁷³ Hopt K ‘Corporate Governance of Banks and Financial Institutions: Economic Theory, Supervisory Practice, Evidence and Policy,’ 18.

¹⁷⁴ Hopt K ‘Corporate Governance of Banks and Financial Institutions: Economic Theory, Supervisory Practice, Evidence and Policy,’ 18 & 20.

¹⁷⁵ Armour J, Awrey D, Davies P, Enriques L, Gordon J, Mayer C, Payne J, ‘Bank Governance,’ 374.

¹⁷⁶ Armour J, Awrey D, Davies P, Enriques L, Gordon J, Mayer C, Payne J, ‘Bank Governance,’ 374.

¹⁷⁷ Armour J, Awrey D, Davies P, Enriques L, Gordon J, Mayer C, Payne J, ‘Bank Governance,’ 374.

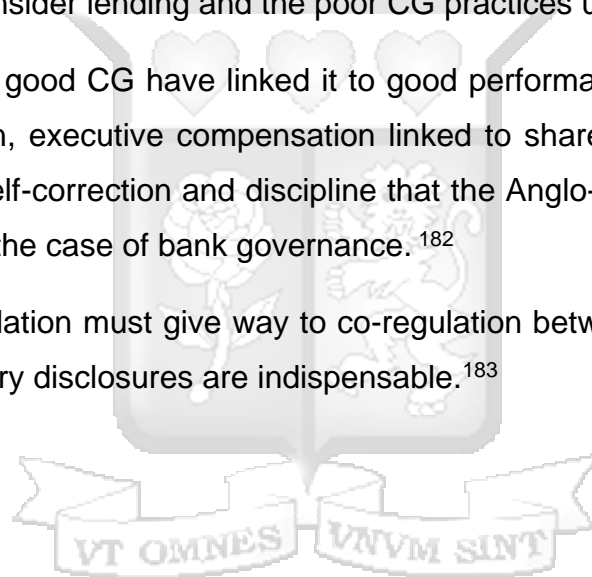
relaxed their internal control, hence shifting the cost of those risks to the government as evidenced by the mass bailouts.¹⁷⁸

Thirdly banking business is opaque because the stakeholder's deposit, investment and debt portfolios are unavailable for external scrutiny by shareholders and other relevant stakeholders for privacy reasons, thus making the external discipline of banks extremely difficult.¹⁷⁹

As a result, regulators are mandated with monitoring and controlling risk-taking, however, due to the information asymmetry, their effectiveness in doing so has been called to question.¹⁸⁰ As will be seen in chapter four during the CBL debacle the regulator was unable to deduce the insider lending and the poor CG practices until after the fact.¹⁸¹

Though proponents of good CG have linked it to good performance, the arguments for shareholder orientation, executive compensation linked to share price, efficient capital markets and market self-correction and discipline that the Anglo-American model posits are less compelling in the case of bank governance.¹⁸²

Furthermore, self-regulation must give way to co-regulation between the banks and the regulator and mandatory disclosures are indispensable.¹⁸³



¹⁷⁸ Armour J, Awrey D, Davies P, Enriques L, Gordon J, Mayer C, Payne J, 'Bank Governance,' 377.

¹⁷⁹ Armour J, Awrey D, Davies P, Enriques L, Gordon J, Mayer C, Payne J, 'Bank Governance,' 375.

¹⁸⁰ Armour J, Awrey D, Davies P, Enriques L, Gordon J, Mayer C, Payne J, 'Bank Governance,' 375.

¹⁸¹ Business Daily Africa, 'Chase Bank Shocks Market with Sh8n Secret Insider Loans, 'Business Daily, 7th April 2016 —<[Chase Bank shocks market with Sh8bn secret insider loans - Business Daily \(businessdailyafrica.com\)](http://businessdailyafrica.com)> on 8th June 2022.

¹⁸² Hopt K 'Corporate Governance of Banks and Financial Institutions: Economic Theory, Supervisory Practice, Evidence and Policy,' 31.

¹⁸³ Hopt K 'Corporate Governance of Banks and Financial Institutions: Economic Theory, Supervisory Practice, Evidence and Policy,' 31.

As stated in Chapter 1, bank governance remains an ongoing task for legislators, regulators and banks themselves.¹⁸⁴ Additionally, there is a need for further research on the topic which could lead to a complete and free-standing discipline.

2.3. The German Model

The German model comprises a two-tier board system and is based on the stakeholder theory which premises that a manager's fiduciary duty is to safeguard the legitimate interests of shareholders as well as internal and external stakeholders such as; employees, consumers, suppliers, creditors, management itself, government, political, social and environmental groups and society at large.¹⁸⁵

The model has gained global acclaim for incorporating stakeholder interests which have led academics to discuss a possible convergence towards it.¹⁸⁶ The model is also characterized by some major differences compared with the Anglo-American model. For example, banks and financial institutions own a significant portion of shares in corporations and have control of the decision-making process at the corporate level.¹⁸⁷

The model's two-tiered board is made up of the management board and the supervisory board.¹⁸⁸ The management board is responsible for managing the enterprise in its own best interest by formulating strategies and coordinating with the supervisory board to ensure implementation.¹⁸⁹ The board also ensures legal and regulatory compliance and

¹⁸⁴ Hopt K 'Corporate Governance of Banks and Financial Institutions: Economic Theory, Supervisory Practice, Evidence and Policy,' 31-32.

¹⁸⁵ Shabir A & Rosmini O, 'Basic Corporate Governance Models: A Systematic Review,' 77.

¹⁸⁶ Shabir A & Rosmini O, 'Basic Corporate Governance Models: A Systematic Review,' 78.

¹⁸⁷ Shabir A & Rosmini O, 'Basic Corporate Governance Models: A Systematic Review,' 77.

¹⁸⁸ Principle 1 & 2, German Corporate Governance Code, *Deutscher Corporate Governance Kodex*, 2019 —<[191216 German Corporate Governance Code.pdf \(dcgk.de\)](#)> on 19th March 2022.

¹⁸⁹ Principle 1 & 2, German Corporate Governance Code, *Deutscher Corporate Governance Kodex*, 2019 —<[191216 German Corporate Governance Code.pdf \(dcgk.de\)](#)> on 19th March 2022.

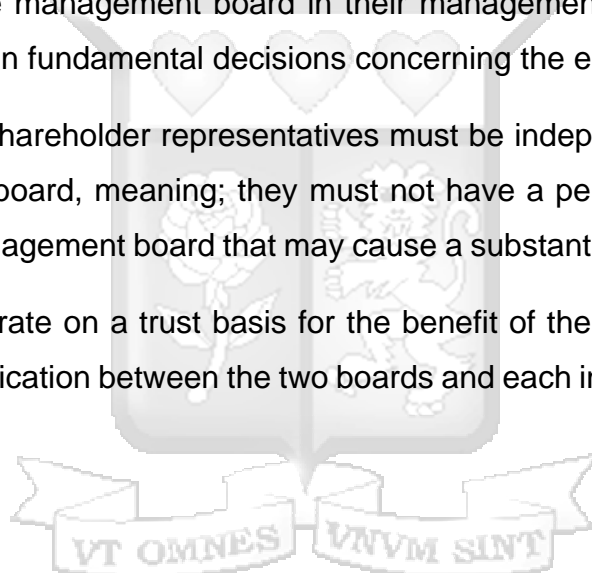
is further responsible for incorporating effective internal control and risk management systems.¹⁹⁰

The supervisory board represents shareholders and employees.¹⁹¹ It makes decisions regarding the appointment and supervision of management and directors and reviews major business decisions.¹⁹² The composition of the supervisory board varies across European countries, however, in most cases, employees have the right to appoint or recommend members to the supervisory board.

In Germany, the supervisory board comprises shareholder and employee representatives.¹⁹³ It is mandated with appointing and discharging management board members, advising the management board in their management of the enterprise and they must be included in fundamental decisions concerning the enterprise.¹⁹⁴

More than half of the shareholder representatives must be independent of the company and the management board, meaning; they must not have a personal relationship with the company or its management board that may cause a substantial conflict of interest.¹⁹⁵

The two boards cooperate on a trust basis for the benefit of the business.¹⁹⁶ Good CG requires open communication between the two boards and each individual on the boards.



¹⁹⁰ Principle 4, German Corporate Governance Code, *Deutscher Corporate Governance Kodex*, 2019 –<[191216 German Corporate Governance Code.pdf \(dcgk.de\)](#)> on 19th March 2022.

¹⁹¹ Shabir A & Rosmini O, 'Basic Corporate Governance Models: A Systematic Review,' 77.

¹⁹² Shabir A & Rosmini O, 'Basic Corporate Governance Models: A Systematic Review,' 77.

¹⁹³ Principle 10, German Corporate Governance Code, *Deutscher Corporate Governance Kodex*, 2019 –<[191216 German Corporate Governance Code.pdf \(dcgk.de\)](#)> on 19th March 2022.

¹⁹⁴ Principle 6, German Corporate Governance Code, *Deutscher Corporate Governance Kodex*, 2019 –<[191216 German Corporate Governance Code.pdf \(dcgk.de\)](#)> on 19th March 2022.

¹⁹⁵ German Corporate Governance Code, *Deutscher Corporate Governance Kodex*, 2019, 8, –<[191216 German Corporate Governance Code.pdf \(dcgk.de\)](#)> on 19th March 2022.

¹⁹⁶ Principle 13, German Corporate Governance Code, *Deutscher Corporate Governance Kodex*, 2019 –<[191216 German Corporate Governance Code.pdf \(dcgk.de\)](#)> on 19th March 2022.

The stakeholder-centric nature of Germany's governance model poses unique problems for financial managers and regulators.¹⁹⁷ The consideration of an alternative means to CG of banks is fairly recent.

The academic discussions on the peculiarities of banks so far have centered around the agency conflict between shareholders and creditors, bank's high leverage and the overreliance on the public sector through deposit insurance, LOLR and government guarantees upon failure which create a conflict of interest between taxpayers and bank claimants.¹⁹⁸

Private commercial banks in Germany are primarily concerned with profit maximization and they control 40% of the market share.¹⁹⁹ Legally, they are formed like corporations and therefore corporate law applies.

Until 1990 bank managers embraced the stakeholder-centric model and their chief mandate was to ensure the proper functioning of Germany's economy.²⁰⁰ Residual power lay with top management and the role of the supervisory board was limited.²⁰¹ The supervisory board was chaired by a former CEO who typically shared the management board's position rather than representing the views of the stakeholders.

A unique feature of the governance of private commercial banks was an informal rule known as, "the consensus principle," this meant that important decisions were taken in the presence of all board members and would only be approved if the decision was

¹⁹⁷ Kotz H & Schmidt R, 'Corporate Governance of Banks- A German Alternative to the "Standard Model",' 2.

¹⁹⁸ Kotz H & Schmidt R, 'Corporate Governance of Banks- A German Alternative to the "Standard Model",' 2.

¹⁹⁹ Kotz H & Schmidt R, 'Corporate Governance of Banks- A German Alternative to the "Standard Model",' 9.

²⁰⁰ Kotz H & Schmidt R, 'Corporate Governance of Banks- A German Alternative to the "Standard Model",' 14.

²⁰¹ Kotz H & Schmidt R, 'Corporate Governance of Banks- A German Alternative to the "Standard Model",' 14.

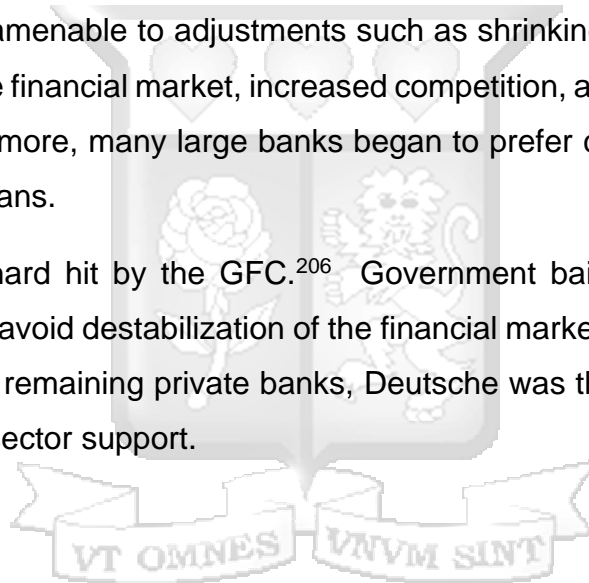
unanimous.²⁰² Therefore, there was no need for a chairman of the management board instead, the members elected a speaker or two at times.

Furthermore, the appointment of the management board was formally done by the supervisory board who always followed the management board's recommendations.²⁰³ Top management was therefore self-recruiting and its entrenchment was almost perfect.

Between 1990 and 2007 however, the weight attached to different stakeholder groups diminished and bank policies began emphasizing shareholder value.²⁰⁴ This was a consequence of legal and political debates and the changing economic landscape of banking in Germany.

Big banks were more amenable to adjustments such as shrinking interest margins, new foreign entrants into the financial market, increased competition, and increased regulatory restrictions.²⁰⁵ Furthermore, many large banks began to prefer capital market financing over traditional bank loans.

German banks were hard hit by the GFC.²⁰⁶ Government bail-outs of private banks became a necessity to avoid destabilization of the financial market and many banks were delisted.²⁰⁷ Among the remaining private banks, Deutsche was the only one that did not have to rely on public sector support.



²⁰² Kotz H & Schmidt R, 'Corporate Governance of Banks- A German Alternative to the "Standard Model",' 14.

²⁰³ Kotz H & Schmidt R, 'Corporate Governance of Banks- A German Alternative to the "Standard Model",' 14.

²⁰⁴ Kotz H & Schmidt R, 'Corporate Governance of Banks- A German Alternative to the "Standard Model",' 21.

²⁰⁵ Kotz H & Schmidt R, 'Corporate Governance of Banks- A German Alternative to the "Standard Model",' 21.

²⁰⁶ Kotz H & Schmidt R, 'Corporate Governance of Banks- A German Alternative to the "Standard Model",' 22.

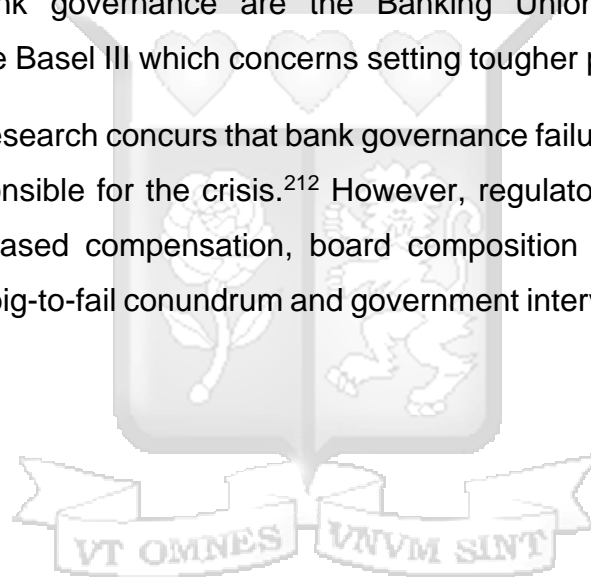
²⁰⁷ Kotz H & Schmidt R, 'Corporate Governance of Banks- A German Alternative to the "Standard Model",' 23.

As a response to the crisis, new regulations were introduced to contain the crisis.²⁰⁸ Changing rules and institutions arose initially as an international effort to resolve the crisis. Beginning in 2009 at the G20 Summit in London under the umbrella of the Financial Stability Board (FSB).²⁰⁹

The objectives pursued were capital adequacy, liquidity, dealing with too-big-to-fail, strengthening accounting standards, improving compensation practices, expanding the oversight of the financial system, strengthening Over-the-Counter(OTC) markets, improving securitization and adhering to international standards.²¹⁰

The regulations imposed are too many to enumerate in this study but those directly affecting German bank governance are the Banking Union which concerns the implementation and the Basel III which concerns setting tougher prudential guidelines.²¹¹

Post-crisis academic research concurs that bank governance failures are among the most crucial elements responsible for the crisis.²¹² However, regulatory reform has centered around performance-based compensation, board composition and qualifications, risk management, the too-big-to-fail conundrum and government interventions and their moral hazard implications.



²⁰⁸ Kotz H & Schmidt R, 'Corporate Governance of Banks- A German Alternative to the "Standard Model",' 24.

²⁰⁹ Kotz H & Schmidt R, 'Corporate Governance of Banks- A German Alternative to the "Standard Model",' 24.

²¹⁰ Kotz H & Schmidt R, 'Corporate Governance of Banks- A German Alternative to the "Standard Model",' 24.

²¹¹ Kotz H & Schmidt R, 'Corporate Governance of Banks- A German Alternative to the "Standard Model",' 24.

²¹² Kotz H & Schmidt R, 'Corporate Governance of Banks- A German Alternative to the "Standard Model",' 27.

The crisis further revealed that the broader stakeholder-oriented institutions, that is; the public sector-owned savings banks and the cooperative sector credit institutions,²¹³ that focused less on short-termism were more resilient during the crisis.²¹⁴

It is imperative to note that the German banking system was fragilized by changes in the privately owned banks' business models.²¹⁵ Therefore, a possible convergence towards it may be the key to addressing stakeholder concerns.

While the German model is stakeholder-centric, it does not include all stakeholders.²¹⁶ The German model's two-tier board system entails the management board focusing on management, strategy formulation and coordination of the supervisory board, while the supervisory board's core mandate is to represent shareholders and employees.²¹⁷

As previously explained, due to the broad range of key stakeholders, banking business requires a specialized form of governance that encompasses all the crucial stakeholders.²¹⁸

2.4. The Japanese Model

The Japanese model entails connecting industrial groups that consist of companies with common interests and similar strategies.²¹⁹ The managers derive responsibility from

²¹³ Kotz H & Schmidt R, 'Corporate Governance of Banks- A German Alternative to the "Standard Model",' 3.

²¹⁴ Kotz H & Schmidt R, 'Corporate Governance of Banks- A German Alternative to the "Standard Model",' 30.

²¹⁵ Kotz H & Schmidt R, 'Corporate Governance of Banks- A German Alternative to the "Standard Model",' 30.

²¹⁶ Principle 1,2 &4, German Corporate Governance Code, *Deutscher Corporate Governance Kodex*, 2019 —<[191216 German Corporate Governance Code.pdf \(dcgk.de\)](#)> on 19th March 2022.

²¹⁷ Principle 1,2 &4, German Corporate Governance Code, *Deutscher Corporate Governance Kodex*, 2019 —<[191216 German Corporate Governance Code.pdf \(dcgk.de\)](#)> on 19th March 2022.

²¹⁸ Bruner C, 'Corporate Governance Reforms in Post-Crisis Financial Firms: Two Fundamental Tensions,' 961.

²¹⁹ Ungureanu M, 'Models and Practices of Corporate Governance Worldwide,' Alexandru Ioan Cuza University, Centre for European Studies, Working Paper, 2012, 629 —<[CESWP2012_IV3a_UNG.pdf \(uaic.ro\)](#)> on 24th June 2022.

shareholders and 'keiretsu,' that is, a network of long-term transactional relationships including; banks, manufacturers, supply chain partners, distributors and consumers.

The model is bank-based.²²⁰ Two groups lie within this system; corporate shareholders, recognized as market investors and bank shareholders referred to as stable investors. This structure ensures profit maximization for corporate shareholders and protects bank shareholders' rights by safeguarding their loan portfolio because banks have a far-reaching arm in management decision-making.²²¹

The model does not focus on strong capital markets but strategic shareholdership such as bank shareholders.²²² The model, therefore, facilitates monitoring and flexible financing of enterprises and effective communication between corporations and banks.

The model entails having a relatively large BOD as compared with the Anglo-American or the German model, which represents the shareholders and must act in their best interest.²²³ The boards contain both executive and independent directors who are all responsible for business operations.

The independent directors are less focused on monitoring the executive directors and are usually retired government officials, bankers or managers from the firm's partners.²²⁴ They serve at the board president's discretion and are less independent than their Anglo-American and German counterparts.

The banking industry in Japan is crucial and is not limited to a pure lender-borrower relationship.²²⁵ Japanese banks are allowed to own up to 5% of the shares in corporations

²²⁰ Alam K, Ab Rahman S, Mustafa H, Shah S & Rahman M, 'An Overview of Corporate Governance Models in Financial Institutions,' *8 International Journal of Management Sustainability*, 4, 2019, 185.

²²¹ Alam K, Ab Rahman S, Mustafa H, Shah S & Rahman M, 'An Overview of Corporate Governance Models in Financial Institutions,' 185.

²²² Ungureanu M, 'Models and Practices of Corporate Governance Worldwide,' 629.

²²³ Lessambo F, 'Corporate Governance in Japan,' in Lessambo F (eds) *The International Corporate Governance System: Audit Roles and Board Oversight*, Palgrave Macmillan, London, 2014, 109.

²²⁴ Lessambo F, 'Corporate Governance in Japan,' 109.

²²⁵ Wan W, Hoskisson R, Kim H & Yiu D, 'Network Opportunities and Constraints in Japan's Banking Industry: A Social Exchange Perspective on Governance,' in Keasey K, Thompson S &

that are also their clients and this was purported to foster efficient CG and long-term investment.

Furthermore, Japan's banking industry is an excellent example of what banking theory refers to as relationship banking as opposed to transactional banking prevalent in the Anglo-American system.²²⁶

The difference between the two is that relationship banking maintains long-term relationships with client firms often providing both equity and debt financing, sitting on the board as well as participating in corporate restructuring when necessary whereas, transactional banking maintains arms-length relationships with its clients.²²⁷

Before the Japanese financial crisis of the 1980s and 1990s, the model was considered worthy of imitation around the world because it provided transparency between firms and shareholders, inter-firm cooperation and employment stability.²²⁸

The arguments for bank-centered governance came to a halt during the Japanese economic downturn.²²⁹ Japanese banks failed to prevent client firms' collapse and to assist in the resolution of the crisis. The conclusion that such relationships would foster efficient CG was premature.²³⁰

Furthermore, Regulators coerced healthy banks to support weak banks masking their problems and creating a convoy system.²³¹ In some cases, they cooperated in

Wright M (eds) *Corporate Governance: Accountability, Enterprise and International Comparisons*, John Wiley & Sons Ltd, 2005, 327.

²²⁶ Wan W, Hoskisson R, Kim H & Yiu D, 'Network Opportunities and Constraints in Japan's Banking Industry: A Social Exchange Perspective on Governance,' 330.

²²⁷ Wan W, Hoskisson R, Kim H & Yiu D, 'Network Opportunities and Constraints in Japan's Banking Industry: A Social Exchange Perspective on Governance,' 330.

²²⁸ Lessambo F, 'Corporate Governance in Japan,' 108.

²²⁹ Wan W, Hoskisson R, Kim H & Yiu D, 'Network Opportunities and Constraints in Japan's Banking Industry: A Social Exchange Perspective on Governance,' 327.

²³⁰ Wan W, Hoskisson R, Kim H & Yiu D, 'Network Opportunities and Constraints in Japan's Banking Industry: A Social Exchange Perspective on Governance,' 328.

²³¹ Anderson C & Campbell II T, 'Corporate Governance of Japanese Banks,' 10 *Journal of Corporate Finance*, 200, 330-331.

concealment and accepted bribes. In short, when the regulator fails, the entire system fails with them as was further evidenced by the GFC.²³²

The distinctive nature of the Japanese model is that it gives banks a share of the corporation, a seat on the board and decision-making power, particularly in keiretsu firms.²³³

Management benefits from cross-ownership by insulating themselves from market discipline, while the banks benefit by influencing internal decision-making, increasing the certainty of cash flows and profitability.²³⁴ This suggests that the banks intervene to promote their fixed claimant interest as creditors rather than their residual claimant interests as shareholders.

Japan is an excellent case study for the argument forwarded by the Anglo-American model that increased regulatory control is an inefficient substitute for internal CG.²³⁵ The economic downturn of the 1990s exposed several regulatory weaknesses.²³⁶

The prominence of banks in the Japanese economy shows the importance of bank governance as a research topic.²³⁷ There are however few studies on the subject matter.

2.5. Conclusion

As mentioned in the introduction part of this chapter, Kenya adopts the Anglo-American CG model. The Companies Act 2015 set to cure the strict shareholder-centric interpretation of the law of former years particularly, Section 143 of the Act which widened

²³² Anderson C & Campbell II T, 'Corporate Governance of Japanese Banks,' 330-331.

²³³ Macey J, 'Corporate Governance and Banking in Germany, Japan and the United States,'1 Corporations, Securities & Antitrust Practice Group Newsletter, 2, 1997 —< [Corporate Governance and Banking in Germany, Japan, and the United States | The Federalist Society \(fedsoc.org\)](#)> on 26th August 2022.

²³⁴ Macey J, 'Corporate Governance and Banking in Germany, Japan and the United States,'1 Corporations, Securities & Antitrust Practice Group Newsletter, 2, 1997 —< [Corporate Governance and Banking in Germany, Japan, and the United States | The Federalist Society \(fedsoc.org\)](#)> on 26th August 2022.

²³⁵ Anderson C & Campbell II T, 'Corporate Governance of Japanese Banks,' 331.

²³⁶ Anderson C & Campbell II T, 'Corporate Governance of Japanese Banks,' 330.

²³⁷ Anderson C & Campbell II T, 'Corporate Governance of Japanese Banks,' 328.

the scope of the duty to promote the success of the company for the benefit of its members.²³⁸

The clause states that while promoting the company's success, directors must take into account the long-term effects of their decisions, strengthening business relationships with stakeholders, the impact of the company's operations on the community and the environment, the importance of maintaining a reputation for high standards of business conduct, and fairness to all member.²³⁹

Section 143 is a direct transplant from Section 172 of the UK Companies Act 2006. The section was enacted to ensure that directors are cognisant of the consequences of their actions and not merely concerned with the quarterly figures.²⁴⁰ It further intended to broaden their decision-making process.

Though the provision echoes the sentiments of the German and Japanese models of stakeholder protection, its incorporation in the law did not mitigate the fallout from the GFC in the UK nor did it do so in the Kenyan context during the bank failures of 2015 and 2016.²⁴¹

It has also been criticized for lending directors a “get out of jail free card,” whereby their actions are challenged because it allows them to defend their breach by asserting that they were promoting the interest of stakeholders.²⁴²

The provision seems like a half-hearted attempt at stakeholder orientation.²⁴³ The wording itself is ambiguous and provides no guidance to directors tasked with decision-making or the courts tasked with reviewing directors' actions.

²³⁸ Section 143, *Companies Act* (Act No. 17 of 2015)

²³⁹ Section 143, *Companies Act* (Act No. 17 of 2015)

²⁴⁰ Key A, 'The Duty to Promote the Success of the Company: is it Fit for Purpose?' University of Leeds, Centre for Business Law and Practice, Working Paper, 2010, 36 —<[delivery.php \(ssrn.com\)](#)> on 4th November 2022.

²⁴¹ Key A, 'The Duty to Promote the Success of the Company: is it Fit for Purpose?' 36.

²⁴² Key A, 'The Duty to Promote the Success of the Company: is it Fit for Purpose?' 36.

²⁴³ Key A, 'The Duty to Promote the Success of the Company: is it Fit for Purpose?' 36.

It might as well be viewed as a broad declaration of principles, encouraging directors to focus on the company's long-term success.²⁴⁴ Ultimately, it will be for the courts to determine how far the new directors' duties extend as there is scope for interpretation and differing applications in practice.²⁴⁵

Perhaps the recent shift in our laws toward a more stakeholder-inclusive governance regime is evidence of a possible convergence of the three governance models.²⁴⁶ Proponents of the convergence argument suggest that it will likely tend towards the Anglo-American model because it is the superior of the three due to its longevity and economic soundness as evidenced by the power of the US and UK capital markets.²⁴⁷

To circumvent the complexities of incorporating a new regulatory framework, proponents of convergence argue that countries should adopt a functional approach, that is, incorporating similarities in goals and practices rather than a strictly formal approach that entails incorporating similarities in laws, regulations and institutions.²⁴⁸ However, this seems to be the sentiment of post-GFC bank governance regulation that includes stakeholder concerns on a principle basis.

Conversely, adopting a hybrid of the models will maintain the certainty and predictability of the Anglo-American model while ensuring that stakeholder concerns are inscribed into the bank governance framework and may be the key to preventing future bank failures.²⁴⁹

²⁴⁴ Keay A, 'The Duty to Promote the Success of the Company: is it Fit for Purpose?' 36.

²⁴⁵ Keay A, 'The Duty to Promote the Success of the Company: is it Fit for Purpose?' 36

²⁴⁶ Onuk M, 'Corporate Governance Models and the Possibility of Future Convergence,' 4(1) *Journal of Corporate Governance Research*, 2020, 31.

²⁴⁷ Onuk M, 'Corporate Governance Models and the Possibility of Future Convergence,' 19&31.

²⁴⁸ Onuk M, 'Corporate Governance Models and the Possibility of Future Convergence,' 31.

²⁴⁹ Onuk M, 'Corporate Governance Models and the Possibility of Future Convergence,' 31.

3. CHAPTER THREE: THE LEGAL AND REGULATORY FRAMEWORK OF BANK GOVERNANCE IN KENYA

3.1. Introduction

Kenya has a robust legal and regulatory framework on bank governance shaped by the global changes post-GFC. Despite this, private commercial banks have been prone to mismanagement, corruption, fraud and failure. This chapter will analyze the legal and regulatory framework governing private commercial banks in Kenya, to determine their effectiveness in curbing failure.

3.2. The Constitution of Kenya, 2010

The Constitution of Kenya, 2010, is the grundnorm, meaning it does not derive its power from any other laws. It is the supreme law of the Republic and is binding to all persons and all State organs at both levels of government.²⁵⁰

Article 46 enshrines consumer rights stating that Consumers have a right to quality products and services, the information they need to fully utilize such products and services, protection for their health, safety, and financial interests, as well as compensation for damages resulting from product or service flaws.²⁵¹

The article encompasses all goods and services including financial services and therefore, banking institutions must be cognizant of consumer rights and ensure they are safeguarded. Failure of this would occasion a breach of the consumer's constitutional right.

As it pertains to governance, the integrity of leadership is one of the core principles of the Constitution under Chapter six.²⁵² Leaders must exemplify integrity, impartiality, honesty, accountability and discipline. Notably, chapter six makes specific reference to state officers.²⁵³ This does not mean that private sector officials need not demonstrate the above-mentioned qualities.

²⁵⁰ Article 2(1), *Constitution of Kenya* (2010).

²⁵¹ Article 46(1), *Constitution of Kenya* (2010).

²⁵² Chapter 6, *Constitution of Kenya* (2010).

²⁵³ Article 73 (1), *Constitution of Kenya* (2010).

The Constitution's provision for leadership and integrity forms the basis for the private sector and the laws and regulations pertaining thereto.²⁵⁴ However, critics opine that extending the principles of Chapter Six to private banks may be stretching the law too far due to the explicit reference to the "state officer".²⁵⁵

3.3. Central Bank of Kenya Act (Chapter 491 of the Laws of Kenya)

The CBK is a body corporate with perpetual succession and a common seal with the authority to enter into contracts, own property, possess it, dispose of it, bring legal actions, and be sued on its behalf.²⁵⁶

The bank's primary goal is to support the government's economic policies, including its goals for economic growth and employment, by developing and implementing monetary policies aimed at achieving and maintaining price stability in general, promoting liquidity, solvency and ensuring the proper operation of a stable market-based financial system.²⁵⁷

Other objectives include acting as a banker, advisor, and monetary agent of the government, issuing money, holding and managing foreign exchange reserves, licensing and overseeing authorized dealers, promoting the establishment, regulation and supervision of efficient and effective payment, clearing, and settlement systems, and formulating and implementing foreign exchange policies.²⁵⁸

As the LOLR, the CBK is mandated with providing liquidity to financial institutions that are experiencing financial difficulties ideally to prevent bank runs or panics from spreading to other banks due to lack of liquidity.²⁵⁹ Opponents of the LOLR function criticize it for promoting risky investments because financial institutions know they will be bailed out by the government.

²⁵⁴ Imbahala K, 'Strengthening Corporate Governance to Curb Corruption in Banks in Kenya: A Case Study of Dubai Bank and Imperial Bank,' 31.

²⁵⁵ Imbahala K, 'Strengthening Corporate Governance to Curb Corruption in Banks in Kenya: A Case Study of Dubai Bank and Imperial Bank,' 31.

²⁵⁶ Section 3, *Central Bank of Kenya Act (CAP 491)*.

²⁵⁷ Section 4(1) -(3), *Central Bank of Kenya Act (CAP 491)*.

²⁵⁸ Section 4A(1), *Central Bank of Kenya Act (CAP 491)*.

²⁵⁹ Corporate Finance Institute, 'Lender of Last Resort'—<[Lender of Last Resort - How Lenders of Last Resort Ensure Liquidity \(corporatefinanceinstitute.com\)](https://www.corporatefinanceinstitute.com)> on 21st April 2022.

The LOLR function exacerbates moral hazard.²⁶⁰ The collapse of banks may devastate the economy formulating the “too big to fail” conundrum that necessitates state intervention.²⁶¹

Moreover, as Bando argues, “Only independent central banks have the broad macroeconomics understanding, the authority and the knowledge required to make the kind of macro-prudential judgements that are required...because central banks are the Lenders of Last Resort, the experience of the crisis has shown that they need to be familiar with every aspect of the institutions they may have to support. So they must also be responsible for the day-to-day micro-prudential regulation as well.”²⁶²

The regulator's independence is marked by its ability to dispense its duties without being restricted by powers above it in the chain of delegation.²⁶³ Issues arise when agency serves several masters.

Additionally, because regulatory relationships are plagued by information asymmetries, regulators need to foster strong relationships with their regulatees to overcome this problem.²⁶⁴ Their cooperation cultivates regulatory efficiency.

3.4. The Banking Act (Chapter 488 of the Laws of Kenya)

At common law, the terms ‘bank’ and ‘banking business’ have accounted for a broad-based discussion.²⁶⁵ Banks may be defined as institutions undertaking banking

²⁶⁰ Djelic M & Bothello J, ‘Limited Liability and its Moral Hazard Implications: The Systemic Inscription of Instability in Contemporary Capitalism, 596.

²⁶¹ Djelic M & Bothello J, ‘Limited Liability and its Moral Hazard Implications: The Systemic Inscription of Instability in Contemporary Capitalism, 596

²⁶² Bando H ‘Single Regulator or Twin Peaks, The Different Regulatory Approach by UK, Switzerland and Japan,’ 1st May 2014 —< [Single Regulator or Twin Peaks, The Different Regulatory Approach by UK, Switzerland and Japan by Hiroyuki Bando :: SSRN](#)>

²⁶³ Coen D and Salter J-P, ‘Multilevel Regulatory Governance: Establishing Bank-Regulator Relationships at the European Banking Authority,’ 22(1) *Business and Politics* 2020, 117.

²⁶⁴ Coen D and Salter J-P, ‘Multilevel Regulatory Governance: Establishing Bank-Regulator Relationships at the European Banking Authority,’ 116.

²⁶⁵ Ellinger E.P, Lomnicka E, Hare C.V.M, *Ellinger’s Modern Banking Law* 5th ed, Oxford University Press, United Kingdom, 2011, 79.

business.²⁶⁶ As previously mentioned, the Act refers to banks as companies that carry on banking business in Kenya.²⁶⁷

The Act defines banking business as accepting money from the public on deposits that are repayable immediately or after a specified period, accepting money on current accounts and accepting checks as payment, using money on deposits or current accounts, or any portion of them, for lending, investing, or other uses at the risk of the bank, or engaging in any other activity that the CBK has prescribed.²⁶⁸

Banking business has further been defined through case laws.²⁶⁹ In *Woods v Martins Ltd*,²⁷⁰ Salmon J stated that “...the limits of a banker’s business cannot be laid down as a matter of law. The matter of such business must in each case be a matter of fact.”

Furthermore, the characteristics of banking business were set out in *United Dominion Trust v Kirkwood*²⁷¹ as; “the conduct of current accounts, the payment of cheques drawn on bankers and the collection of cheques from customers.”

Additionally, banking business operates through the parent-subsiary/corporate group structure. The corporate group structure has three basic preconditions for its existence.²⁷² Firstly, the right of one company to be a shareholder of another company thus having voting rights and the ability to affect the decisions of its subsidiary.

In most, if not all jurisdictions, banks are owned by Non-Operational Holding Companies (NHC) which are typically structured like corporations.²⁷³ The NHC holds a majority share and controls virtually all bank assets hence, most banks/banking activity is controlled by holding companies and governed by corporate boards to which corporate law applies.²⁷⁴

²⁶⁶ Ellinger E.P, Lomnicka E, Hare C.V.M, *Ellinger’s Modern Banking Law*, 79.

²⁶⁷ Section 2, *Banking Act* (CAP 488).

²⁶⁸ Section 2, *Banking Act* (CAP 488).

²⁶⁹ Ellinger E.P, Lomnicka E, Hare C.V.M, *Ellinger’s Modern Banking Law*, 79.

²⁷⁰ *Woods v Martins Bank Ltd*. (1958) The United Kingdom Queen’s Bench.

²⁷¹ *United Dominion Trust v Kirkwood* (1966) The United Kingdom Court of Appeal

²⁷² Mackie C, ‘A Tale of Unintended Consequence: Corporate Membership in Early UK Company Law,’ 2016, 2, —<http://dx.doi.org/10.1080/14735970.2016.1209803> on 9th April 2022.

²⁷³ Min D, ‘Balancing the Governance of Financial Institutions’ 749.

²⁷⁴ Min D, ‘Balancing the Governance of Financial Institutions,’ 748

The Act defines a NHC as a company other than the institution that controls the institution and whose activities are restricted to; holding investments in subsidiaries, holding properties used by group members, raising capital, fund-raising to conduct restricted business activities, risk management and providing financial services to support the efficient operation of the group.²⁷⁵

There lay a significant moral hazard in the corporate group structure in the parent company's ability to insulate itself from the liability of its subsidiary.²⁷⁶ The parent utilizes its voting rights to take on risks and maximize profits while the subsidiary, bears the cost of such behavior.²⁷⁷

The Act further provides for bank governance, that is, the ownership and control of institutions. It describes 'control' as, the ability to influence the management of an institution and the ability to directly or indirectly influence the decisions of the shareholders of an institution.²⁷⁸

The Act distinguishes between shareholders and significant shareholders by defining significant shareholders as; persons other than the government or a public entity who directly or indirectly hold a beneficial interest amounting to five percent or more of the share capital of an institution or a corporate entity seeking to become an institution.²⁷⁹

Moreover, directors, CEOs and significant shareholders must be 'fit and proper' persons to manage or control the institution.²⁸⁰ The term 'fit and proper' is determined by the CBK by establishing the professional and moral suitability of directors, senior officers and

²⁷⁵ Section 2, *Banking Act*, (CAP 488).

²⁷⁶ Mackie C, 'A Tale of Unintended Consequence: Corporate Membership in Early UK Company Law,' 5.

²⁷⁷ Mackie C, 'A Tale of Unintended Consequence: Corporate Membership in Early UK Company Law,' 5-6.

²⁷⁸ Section 9A(3B), *Banking Act* (CAP 488).

²⁷⁹ Section 2, *Banking Act* (CAP 488).

²⁸⁰ Section 9A(1), *Banking Act* (CAP 488).

significant shareholders.²⁸¹ Where persons are found not to satisfy the conditions for 'fit and proper' of the CBK, they shall be disqualified from holding office.²⁸²

The professional and moral suitability of directors and senior officers of banking institutions is determined by their possession of adequate professional credentials or experience or both and their ability to recommend sound practices, objectivity and impartiality.²⁸³

Whereas significant shareholders must be vetted and certified by the CBK as fit and proper before acquiring ownership or upon new evidence that an existing significant shareholder does not fulfill the fit and proper criteria.²⁸⁴

Additionally, the CBK when it deems it necessary may from time to time carry out assessments of the professional suitability of persons managing and controlling institutions.²⁸⁵

The CBK may have regard to the previous conduct of directors or senior officials, in particular, where there is any evidence of; prior conviction of fraud or dishonesty, contravention of laws designed to protect the public against financial loss due to incompetence, dishonesty or malpractice, where a director or senior officer acted in a similar capacity in an institution that has been liquidated or is under liquidation, where a director or senior officer was part of any undertaking deemed fraudulent, prejudicial or otherwise improper by the CBK if any doubt is cast on their competence or soundness of judgment and if they are defaulters on the repayment of loans advanced by any financial institution.²⁸⁶

Regarding the professional and moral suitability of significant shareholders, the CBK shall consider their prior conduct and activities in business or financial matters, particularly,

²⁸¹ Section 9A(7) *Banking Act* (CAP 488).

²⁸² Section 32A(1), *Banking Act* (CAP 488).

²⁸³ First Schedule, Part A-Criteria for Determining Professional and Moral Suitability, *Banking Act* (CAP 488).

²⁸⁴ Section 9A(2)&(3), *Banking Act* (CAP 488).

²⁸⁵ Section 32A(1), *Banking Act* (CAP 488).

²⁸⁶ First Schedule, Part A-Criteria for Determining Professional and Moral Suitability, *Banking Act* (CAP 488).

any evidence of fraud or dishonesty, violation of consumer protection laws intended to protect the public from financial loss, or malpractice in banking, insurance, investment, or other financial services.²⁸⁷

Determining the moral and professional suitability of a person is not an exact science. The prudential guidelines under licensing of new institutions provide a form for determining the professional and moral suitability of persons in control of institutions, using a checkbox mechanism.²⁸⁸ Whereby, applicants are required to answer a questionnaire on their previous conduct and execute a statement of declaration before a commissioner for oaths.

The effectiveness of the checkbox mechanism of governance is questionable and has been subject to scrutiny over the years.

In 2003, William Donaldson then Securities and Exchange Commission (SEC) chairman while addressing the Washington Economic Policy Conference stated, “A ‘check the box’ approach to good corporate governance will not inspire a true sense of ethical obligation. It could merely lead to an array of inhibiting ‘politically correct’ dictates. If this was the case, ultimately corporations would not strive to meet higher standards they would strain under new costs associated with fulfilling a mandated process that could produce little of the desired effect...”²⁸⁹

The ineffectiveness of this approach was evidenced by the onslaught of bank failures between 2015 and 2016 in Kenya because moral suitability is difficult to ascertain. Additionally, the ‘check the box’ mechanism is plagued with the likelihood of fraud and misrepresentation.

²⁸⁷ First Schedule, Part A-Criteria for Determining Professional and Moral Suitability, *Banking Act* (CAP 488).

²⁸⁸ Prudential Guidelines for Institutions Licensed Under the Banking Act, 2013.

²⁸⁹ Monks R & Minow N, *Corporate Governance*, xxiv.

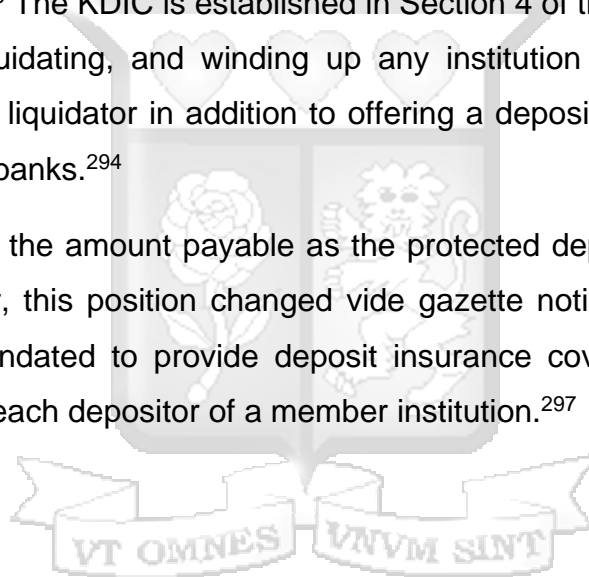
3.5. Kenya Deposit Insurance Act No.10 of 2012

The Act was established to institute a deposit insurance system and for the receivership and liquidation of deposit-taking institutions and to establish the Kenya Deposit Insurance Corporation (KDIC).²⁹⁰

The Kenyan deposit insurance system is part of an effective financial safety net protecting consumers and unsophisticated depositors from failing banks.²⁹¹ Kenya subscribes to an explicit deposit insurance system. This means that the government formally commits in advance to guarantee part or all of a failed bank's deposits.²⁹²

The Act defines deposit insurance as the deposit or any part thereof whose repayment is insured by the KDIC.²⁹³ The KDIC is established in Section 4 of the Act, and its mandate includes receiving, liquidating, and winding up any institution for which it has been designated receiver or liquidator in addition to offering a deposit insurance scheme for customers of member banks.²⁹⁴

The Act stipulates that the amount payable as the protected deposit is Kenya Shillings 100,000/=.²⁹⁵ However, this position changed vide gazette notice No. 159 of 2020.²⁹⁶ Now, the KDIC is mandated to provide deposit insurance coverage of up to Kenya Shillings 500,000/= to each depositor of a member institution.²⁹⁷



²⁹⁰ Preamble, *Kenya Deposit Insurance Act* (Act No. 10 of 2012).

²⁹¹ Kenya Deposit Insurance Corporation —<[DEPOSIT INSURANCE | Kenya Deposit Insurance Corporation \(kdic.go.ke\)](https://www.kdic.go.ke)> on 6th April 2022.

²⁹² McCoy P, 'The Moral Hazard Implications of Deposit Insurance: Theory and Evidence' Seminar on Current Developments in Monetary and Financial Law, Washington D.C., 2007,2, —< [The Moral Hazard Implications of Deposit Insurance: Theory and Evidence; Patricia A. McCoy. Seminar on Current Developments in Monetary and Financial Law; Washington, D.C., October 23-27, 2006 \(imf.org\)](#)> on 6th April 2022.

²⁹³ Section 2, *Kenya Deposit Insurance Act* (Act No. 10 of 2012).

²⁹⁴ Section 2, *Kenya Deposit Insurance Act* (Act No. 10 of 2012).

²⁹⁵ Section 28, *Kenya Deposit Insurance Act* (Act No. 10 of 2012).

²⁹⁶ Vol CXXII—No.159, *The Kenya Gazette*, 2020.

²⁹⁷ Kenya Deposit Insurance Corporation —<[DEPOSIT INSURANCE | Kenya Deposit Insurance Corporation \(kdic.go.ke\)](https://www.kdic.go.ke)> on 6th April 2022.

Where a depositor has more than one account in an institution and/or in the case of joint account deposits, the accounts are consolidated for settlement as one claim subject to the maximum protected limit.²⁹⁸

The KDIC is designated as the sole and exclusive receiver of all institutions.²⁹⁹ Once the CBK determines that an institution's assets are less than its liabilities, unsafe or unsound transacting conditions, willful violation of a regulatory/supervisory order, concealment of books, papers, records or assets, or, refusal to submit the same for inspection to any lawful CBK agent, it appoints the KDIC as the sole receiver.³⁰⁰

Additionally, the KDIC is appointed whereby an institution is likely to fail to meet its financial obligations or depositor demands, the institution is likely to incur losses that will deplete a significant portion of its capital and there is no prospect for the institution to become adequately capitalized without assistance, the institution is undercapitalized failing to meet the imposed minimum capital requirements, or, the institution is in breach of Kenyan law or other applicable law.³⁰¹

The CBK is to notify the KDIC of the non-viability of an institution in writing.³⁰² Upon which, the institution is required to; take action as stipulated by the KDIC, to stop receiving or taking deposits or carrying on any of its business and to restructure the whole or part of its business.³⁰³

The KDIC further assumes management of all or a portion of the institution's assets, liabilities, businesses, and affairs, it may also designate any individual to run all of the institution's activities and manage its assets, liabilities, and affairs.³⁰⁴

²⁹⁸ Kenya Deposit Insurance Corporation —<[DEPOSIT INSURANCE | Kenya Deposit Insurance Corporation \(kdic.go.ke\)](https://www.kdic.go.ke)> on 6th April 2022.

²⁹⁹ Section 43, *Kenya Deposit Insurance Act* (Act No. 10 of 2012).

³⁰⁰ Section 43(2), *Kenya Deposit Insurance Act* (Act No. 10 of 2012).

³⁰¹ Section 43(2), *Kenya Deposit Insurance Act* (Act No. 10 of 2012).

³⁰² Section 44, *Kenya Deposit Insurance Act* (Act No. 10 of 2012).

³⁰³ Section 44(2)(a), *Kenya Deposit Insurance Act* (Act No. 10 of 2012).

³⁰⁴ Section 44(2)(b), *Kenya Deposit Insurance Act* (Act No. 10 of 2012).

The KDIC or its appointed persons shall have vested powers of the institution and its directors under the constituent documents of the institution.³⁰⁵

Furthermore, the CBK appoints the KDIC as the liquidator in response to a recommendation made under the act or in any situation where; the institution is deemed unable to pay its debts, a winding-up order is made or a resolution for voluntary winding-up is passed, the institution is unable to pay creditors and depositors sums owed to them, the CBK determines that the value of the institution's assets is less than its liabilities, or, the institution breaches the law.³⁰⁶

Deposit insurance has contributed to robust academic discourse and literature following its widespread adoption post-GFC.³⁰⁷ The rationale for deposit insurance is that banks' balance sheets are inherently unstable because they borrow short (by accepting deposits on demand) and lend long (by creating loans with long maturities) resulting in a “term mismatch.”³⁰⁸

If depositors insist on withdrawing more cash than the bank holds, the bank will be unable to liquidate its assets fast enough to satisfy depositor demands, ensuing in a bank run.³⁰⁹ This was the case in CBL whereby rumors triggered a run on the bank causing the CBK to place it under receivership due to unsafe financial conditions.³¹⁰

3.6. The Companies Act No.17 of 2015

As previously stated, a bank is a company that carries on business or proposes to carry on banking business in Kenya but does not include the central bank.³¹¹ A company is a

³⁰⁵ Section 45(2), *Kenya Deposit Insurance Act* (Act No. 10 of 2012).

³⁰⁶ Section 54, *Kenya Deposit Insurance Act* (Act No. 10 of 2012).

³⁰⁷ McCoy P, 'The Moral Hazard Implications of Deposit Insurance: Theory and Evidence,' 1.

³⁰⁸ McCoy P, 'The Moral Hazard Implications of Deposit Insurance: Theory and Evidence,' 4.

³⁰⁹ McCoy P, 'The Moral Hazard Implications of Deposit Insurance: Theory and Evidence,' 4.

³¹⁰ Business Daily Africa, 'Rumors Triggered Chase Bank Run: CBK' Business Daily Africa, 7th April 2016—<[Rumours triggered Chase Bank run: CBK - Business Daily \(businessdailyafrica.com\)](http://businessdailyafrica.com)> on 8th April 2022.

³¹¹ Section 2, *Banking Act*, (CAP 488).

legal entity formed by a group of individuals to engage in and operate a business enterprise with a profit motive.³¹²

CG encompasses the ownership and control of corporations. The Act defines the shareholders as the subscribers to the memorandum of association,³¹³ and the directors as persons occupying the position of a director of a body corporate.³¹⁴ Shareholders have a right to; “elect” the BOD,³¹⁵ to affect decisions by passing resolutions and voting,³¹⁶ and to bring suit against the company or the board for failure to act or to meet obligations.³¹⁷

Directors act as the agents of the shareholders making them fiduciaries of the company, of which certain duties are owed. The act prescribes the following general duties of a director; to act within powers,³¹⁸ to promote the company’s success,³¹⁹ to exercise independent judgment,³²⁰ to exercise reasonable care, skill and diligence,³²¹ to avoid conflict of interest³²² and duty not to benefit from third parties.³²³ Breach of the aforementioned duties warrants civil action.³²⁴

3.7. Capital Markets Act (Chapter 485A of the Laws of Kenya)

The Act establishes the Capital Markets Authority (CMA) to promote, regulate and facilitate the development of an orderly, fair and efficient capital market in Kenya.³²⁵

The CMA is a body corporate with perpetual succession and a common seal capable in its corporate name to; sue and be sued, take, purchase or otherwise acquire movable property, borrow and lend money, enter into contracts and perform all other acts

³¹² Merriam Webster Dictionary, 4th ed.

³¹³ Section 12, *Companies Act* (Act No. 17 of 2015).

³¹⁴ Section 2, *Companies Act* (Act No. 17 of 2015).

³¹⁵ Section 128, *Companies Act* (Act No. 17 of 2015).

³¹⁶ Part XIII-Resolutions and Meetings, *Companies Act* (Act No. 17 of 2015).

³¹⁷ Section 238, *Companies Act* (Act No.17 of 2015).

³¹⁸ Section 142, *Companies Act* (Act No.17 of 2015).

³¹⁹ Section 143, *Companies Act* (Act No.17 of 2015).

³²⁰ Section 144, *Companies Act* (Act No.17 of 2015).

³²¹ Section 145, *Companies Act* (Act No.17 of 2015).

³²² Section 146, *Companies Act* (Act No.17 of 2015).

³²³ Section 147, *Companies Act* (Act No.17 of 2015).

³²⁴ Section 148, *Companies Act* (Act No.17 of 2015).

³²⁵ Preamble, *Capital Markets Act* (CAP 485A).

necessary for the proper performance of its functions and which may lawfully be done by a body corporate.³²⁶

The CMA's duties include safeguarding investor interests, establishing, maintaining, and regulating a market where securities can be issued and traded in an efficient, fair, and orderly manner, as well as facilitating a compensation fund to shield investors from financial loss resulting from a licensed broker or dealer's breach of contract.³²⁷

CBL fell under the jurisdiction of the CMA as it was licensed to issue securities to the public.

The CMA failed in its regulatory mandate of investor protection in the case of CBL and came under fire for approving CBL's 10 Billion Kenya Shilling bond of which at the time of failure, 4.8 Billion Kenya Shillings was raised, despite the blatantly obvious CG issues in the bank.³²⁸

In August 2022, six years after the fact, the CMA fined three CBL executives, five board members and the bank's auditor Deloitte and Touché over their alleged role in the issuance of the 10 Billion Kenya Shilling Bond.³²⁹

3.8. Central Bank of Kenya, Prudential Guidelines for Institutions Licensed Under the Banking Act in 2013

In 2013, the CBK published the Prudential Guidelines.³³⁰ According to the guidelines, CG involves how an institution's board and senior management manage its business and

³²⁶ Section 5, *Capital Markets Act* (CAP 485A).

³²⁷ Section 11 (c), (d)& (e), *Capital Markets Act* (CAP 485A).

³²⁸ Business Daily, 'How Chase Bank Director Lent Himself Sh7.9 Billion,' Business Daily Africa, 7th April 2016 —< [How Chase Bank director lent himself Sh7.9 billion - Business Daily \(businessdailyafrica.com\)](https://www.businessdailyafrica.com/news/2016/04/07/how-chase-bank-director-lent-himself-sh7.9-billion)> on 9th September 2022.

³²⁹ Ndege A, 'CMA Fines ex-Chase Bank Bosses, Deloitte over Sh10bn Loan,' Business Daily Africa, 3rd August 2022, —< [CMA fines ex-Chase Bank bosses, Deloitte over Sh10bn loan | Business Daily \(businessdailyafrica.com\)](https://www.businessdailyafrica.com/news/2022/08/03/cma-fines-ex-chase-bank-bosses-deloitte-over-sh10bn-loan)> on 9th September 2022.

³³⁰ Prudential Guidelines for Institutions Licensed Under the Banking Act, 2013 —<[PGs \(centralbank.go.ke\)](https://www.centralbank.go.ke/PGs)> on 10th September 2022.

affairs and gives a framework for establishing the institution's goals, determining how they will be met, and evaluating performance.³³¹

The guidelines further define Good CG as that which provides for the alignment of incentives of the institution and its shareholders by setting corporate objectives, managing day-to-day operations, recognizing the interests of other stakeholders and protecting the interests of depositors and creditors.³³²

The guidelines stipulate that shareholders of a banking institution shall jointly and severally protect, preserve and actively exercise the supreme authority of the institution in general meetings.³³³

They are mandated with; electing credible persons to the board, holding the board accountable and responsible for the efficient and effective governance of the institution, ensuring that no persons with more than 5% shareholding are elected to the board and they must make an application to the CBK regarding a transfer or acquisition of shares exceeding 5% of the share capital.³³⁴

As it pertains to directorship, the guidelines provide a distinction between executive directors, non-executive directors and independent directors as explained in Chapter 1.

Directors must; possess the necessary knowledge and skills required to govern an institution effectively, be diligent in performing their duties, devote sufficient time to the institution and its affairs and possess the courage to take the risks associated with directing and controlling a successful and sustainable institution.³³⁵

³³¹ Clause 1.4.1. Prudential Guidelines for Institutions Licensed Under the Banking Act, 2013, 35, —<[PGs \(centralbank.go.ke\)](http://centralbank.go.ke)> on 10th September 2022.

³³² Clause 1.4.1. Prudential Guidelines for Institutions Licensed Under the Banking Act, 2013, 35, —<[PGs \(centralbank.go.ke\)](http://centralbank.go.ke)> on 10th September 2022.

³³³ Clause 3.2. Prudential Guidelines for Institutions Licensed Under the Banking Act 2013, 39, —<[PGs \(centralbank.go.ke\)](http://centralbank.go.ke)> on 10th September 2022.

³³⁴ Clause 3.2. Prudential Guidelines for Institutions Licensed Under the Banking Act, 2013, 39, —<[PGs \(centralbank.go.ke\)](http://centralbank.go.ke)> on 10th September 2022.

³³⁵ Clause 3.1.4. Prudential Guidelines for Institutions Licensed Under the Banking Act, 2013, 39, —<[PGs \(centralbank.go.ke\)](http://centralbank.go.ke)> on 10th September 2022.

The board should provide effective leadership based on an ethical foundation, reinforced by the basic values of responsibility, accountability, fairness, and transparency, according to the rules, which echo the Constitution in that regard.³³⁶

The board must cultivate a culture of ethical conduct and values to which the institution must adhere.³³⁷ The institution must inculcate integrity in its vision, mission, strategic objectives and operations.³³⁸

The BOD is in charge of authorizing and supervising the execution of the bank's business goals, risk management plan, and CG.³³⁹ Moreover, the board is in charge of regulating senior management as well.

The protection of stakeholders' rights is central to the principle of ethical leadership and integrity.³⁴⁰ Directors as stewards of the institution have the moral duty to act with intellectual honesty and independence in the best interest of all stakeholders and avoid any conflict of interest.

The guidelines further provide consumer protection by mandating that each institution's BOD promote just and equitable financial services, enhance transparency to educate and empower consumers about their goods and services, foster faith in the banking industry, and offer efficient channels for handling customer complaints.³⁴¹

The board is in charge of formulating policies, procedures and guidelines that protect consumer interests, refrain from unethical and unfair business practices that harm

³³⁶ Clause 3.1.3. Prudential Guidelines for Institutions Licensed Under the Banking Act, 2013, 38, —<[PGs \(centralbank.go.ke\)](http://PGs.centralbank.go.ke)> on 10th September 2022.

³³⁷ Clause 3.1.1. Prudential Guidelines for Institutions Licensed Under the Banking Act, 2013, 38, —<[PGs \(centralbank.go.ke\)](http://PGs.centralbank.go.ke)> on 10th September 2022.

³³⁸ Clause 3.1.2. Prudential Guidelines for Institutions Licensed Under the Banking Act, 2013 38, —<[PGs \(centralbank.go.ke\)](http://PGs.centralbank.go.ke)> on 10th September 2022.

³³⁹ Clause 3.3. Prudential Guidelines for Institutions Licensed Under the Banking Act, 2013, 39, —<[PGs \(centralbank.go.ke\)](http://PGs.centralbank.go.ke)> on 10th September 2022.

³⁴⁰ Clause 3.1.4. Prudential Guidelines for Institutions Licensed Under the Banking Act, 2013, 38, —<[PGs \(centralbank.go.ke\)](http://PGs.centralbank.go.ke)> on 10th September 2022.

³⁴¹ Clause 2.1. Prudential Guidelines for Institutions Licensed Under the Banking Act, 2013, 487, —<[PGs \(centralbank.go.ke\)](http://PGs.centralbank.go.ke)> on 14th September 2022.

consumers, making sure that consumer complaints are resolved quickly and that the institution complies with the guidelines.³⁴²

The provisions of the prudential guidelines are more or less similar to those governing non-financial corporations because banks by law are defined as companies. They fail to take into account that banks are materially different in their business, modes of financing and their balance sheets.³⁴³

The guidelines specify that good governance entails aligning corporate activities with safety and soundness provisions in compliance with applicable laws and regulations,³⁴⁴ reflective of the argument that regulators have sought to curb risk-taking exclusively through external safety and soundness while ignoring internal bank governance.³⁴⁵

Moreover, the guidelines specifically provide that good CG entails alignment of interest of the institution and its shareholders and in doing so, the board must have regard for other stakeholders and protect the interests of depositors and creditors.³⁴⁶ This is in tandem with the half-hearted incorporation of stakeholder orientation encapsulated in Section 143 of the Companies Act explained in Chapter 2.

Strengthening the link between bank shareholders and directors has the adverse effect of encouraging risks as was the case pre-GFC.³⁴⁷ If banks were like non-financial corporations, then shareholder opportunism would be solved through market discipline.³⁴⁸

³⁴² Clause 2.3. Prudential Guidelines for Institutions Licensed Under the Banking Act, 2013, 487, —<[PGs \(centralbank.go.ke\)](http://PGs.centralbank.go.ke)> on 14th September 2022.

³⁴³ Armour J, Awrey D, Davies P, Enriques L, Gordon J, Mayer C, Payne J, 'Bank Governance,' 370

³⁴⁴ Clause 1.4.1. Prudential Guidelines for Institutions Licensed Under the Banking Act, 2013, 35, —<[PGs \(centralbank.go.ke\)](http://PGs.centralbank.go.ke)> on 10th September 2022.

³⁴⁵ Min D, 'Balancing the Governance of Financial Institutions,' 744.

³⁴⁶ Clause 1.4.1. Prudential Guidelines for Institutions Licensed Under the Banking Act, 2013, 35, —<[PGs \(centralbank.go.ke\)](http://PGs.centralbank.go.ke)> on 10th September 2022.

³⁴⁷ Armour J, Awrey D, Davies P, Enriques L, Gordon J, Mayer C, Payne J, 'Bank Governance,' 371.

³⁴⁸ Armour J, Awrey D, Davies P, Enriques L, Gordon J, Mayer C, Payne J, 'Bank Governance,' 370.

However, in the instance of banks, creditors are dispersed, have no oversight rights and are protected by deposit insurance and therefore are protected by banking regulation and supervision.³⁴⁹

3.9. The Code of Corporate Governance Practices for Issuers of Securities to the Public, 2015

The code moved from the rule-based approach of its predecessor which adopted the “apply or explain” basis of CG to a principle-based approach adopting the “comply or explain,” basis of CG, premised on the notion that CG practices are persuasive enough.³⁵⁰ This approach has had success in countries like UK and Germany but has failed to yield similar results in developing countries due to corruption.³⁵¹

The code defines CG as the structure and procedure used to supervise and manage the business affairs of corporations and improve corporate accountability and economic prosperity with the ultimate goal of maximizing long-term shareholder value while considering stakeholder interests.³⁵² The definition reflects the shareholder-centric nature of CG in Kenya.

The shareholders have rights to information, voting and dividends,³⁵³ Information entails company performance and Annual General Meetings (AGM) and the same must be sufficient and timely.³⁵⁴ They are also responsible for board appointments because it is in

³⁴⁹ Armour J, Awrey D, Davies P, Enriques L, Gordon J, Mayer C, Payne J, ‘Bank Governance,’ 370.

³⁵⁰ Areneke G, Yusuf F & Kimani D, ‘Anglo-American Governance Adoption in Non-Anglo-American Settings: Assessing Practitioner Perceptions of Corporate Governance Across Three Emerging Economies,’ 34(4) *Managerial Auditing Journal*, 2019, 486.

³⁵¹ Ordu L, ‘The Enforcement of Corporate Governance Practices on Nigerian Banks,’ Doctor of Philosophy Thesis, Anglia Ruskin University, East Anglia, 2021, 42-43.

³⁵² Clause 1.1.2. The Code of Corporate Governance Practices for Issuers of Securities to the Public, 2015, 2, —<[Code of Corporate Governance Practices for Issuers of Securities to the Public 2015 - Code-8.pdf](#)> on 19th September 2022.

³⁵³ Clause 1.1.2. The Code of Corporate Governance Practices for Issuers of Securities to the Public, 2015, 4, —<[Code of Corporate Governance Practices for Issuers of Securities to the Public 2015 - Code-8.pdf](#)> on 19th September 2022.

³⁵⁴ Clause 3.1. The Code of Corporate Governance Practices for Issuers of Securities to the Public, 2015, 22, —<[Code of Corporate Governance Practices for Issuers of Securities to the Public 2015 - Code-8.pdf](#)> on 19th September 2022.

their best interest to ensure the board is properly constituted.³⁵⁵ They must ensure that only credible persons who can add value to the company are appointed.³⁵⁶

The code defines the BOD as the single most important institution in CG.³⁵⁷ For CG to be effective, the board must be comprised of qualified and competent members capable of exercising objective and independent judgement and their core mandate is strategic guidance and monitoring management.

It distinguishes executive, non-executive and independent directors. An executive director is defined as a board member who also serves as a manager of the company,³⁵⁸ a non-executive director means a board member who is not involved in the management, affiliated with, or is under the company's employ but is allowed to own shares,³⁵⁹

Whereas, an independent director is defined as a board member with no material or pecuniary relationship with the company, owns no shares in the company and ceases to hold the position after nine years of service, after which they assume the position of non-executive director.³⁶⁰

³⁵⁵ Clause 2.1(a), The Code of Corporate Governance Practices for Issuers of Securities to the Public, 2015, 6, —<[Code of Corporate Governance Practices for Issuers of Securities to the Public 2015 - Code-8.pdf](#)> on 19th September 2022.

³⁵⁶ Clause 2.1(b), The Code of Corporate Governance Practices for Issuers of Securities to the Public, 2015, —<[Code of Corporate Governance Practices for Issuers of Securities to the Public 2015 - Code-8.pdf](#)> on 19th September 2022.

³⁵⁷ Clause 2.0. The Code of Corporate Governance Practices for Issuers of Securities to the Public, 2015, —<[Code of Corporate Governance Practices for Issuers of Securities to the Public 2015 - Code-8.pdf](#)> on 19th September 2022.

³⁵⁸ Clause 1.1.2. The Code of Corporate Governance Practices for Issuers of Securities to the Public, 2015, 2, —<[Code of Corporate Governance Practices for Issuers of Securities to the Public 2015 - Code-8.pdf](#)> on 19th September 2022.

³⁵⁹ Clause 1.1.2. The Code of Corporate Governance Practices for Issuers of Securities to the Public, 2015, 3, —<[Code of Corporate Governance Practices for Issuers of Securities to the Public 2015 - Code-8.pdf](#)> on 19th September 2022.

³⁶⁰ Clause 1.1.2. The Code of Corporate Governance Practices for Issuers of Securities to the Public, 2015, 2, —<[Code of Corporate Governance Practices for Issuers of Securities to the Public 2015 - Code-8.pdf](#)> on 19th September 2022.

The board structure must include different skills and expertise relevant to the effective discharge of their duties,³⁶¹ and further ensure; it is competent to deal with the current and emerging issues of the business, exercises independent judgment, encourages enhanced performance and can effectively review and challenge management's performance.³⁶²

The board is accountable to the shareholders and as fiduciaries, each board member is required to exercise reasonable care, skill and diligence, act in the best interest of the company and not for any other purpose, act honestly at all times and avoid conflict of interests.³⁶³

Additionally, they must exercise independent judgment at all times, devote sufficient time to their responsibilities and enhance their skills, promote and protect the company's image, owe their duty to the company and not to the nominating authority and they must uphold the duty of confidentiality.³⁶⁴

The board's mandate is separate from management's and it includes; defining the company's mission, vision, strategy, goals, risk policy and objectives.³⁶⁵ It must monitor managerial operations, identify corporate business opportunities and risks, develop appropriate remuneration policies, ensure legal regulatory compliance, ensure

³⁶¹ Clause 2.2.1. The Code of Corporate Governance Practices for Issuers of Securities to the Public, 2015, 9, —<[Code of Corporate Governance Practices for Issuers of Securities to the Public 2015 - Code-8.pdf](#)> on 20th September 2022.

³⁶² Clause 2.2. The Code of Corporate Governance Practices for Issuers of Securities to the Public, 2015, 9, —<[Code of Corporate Governance Practices for Issuers of Securities to the Public 2015 - Code-8.pdf](#)> on 20th September 2022.

³⁶³ Clause 2.3.1. The Code of Corporate Governance Practices for Issuers of Securities to the Public, 2015, 11, —<[Code of Corporate Governance Practices for Issuers of Securities to the Public 2015 - Code-8.pdf](#)> on 20th September 2022.

³⁶⁴ Clause 2.3.1. The Code of Corporate Governance Practices for Issuers of Securities to the Public, 2015, 11, —<[Code of Corporate Governance Practices for Issuers of Securities to the Public 2015 - Code-8.pdf](#)> on 20th September 2022.

³⁶⁵ Clause 2.3.2. The Code of Corporate Governance Practices for Issuers of Securities to the Public, 2015, 11, —<[Code of Corporate Governance Practices for Issuers of Securities to the Public 2015 - Code-8.pdf](#)> on 20th September 2022.

dissemination of information to shareholders, ensure the company's CG practices are effective and up to date and consider shareholder interests in their decision making.³⁶⁶

Management, on the other hand, is tasked with the execution of the board's policies.³⁶⁷ Their mandate encompasses planning, organizing, staffing, coordinating, controlling, reporting and budgeting.

Regarding stakeholder interests, the code provides for a stakeholder-inclusive CG approach by including stakeholder relations.³⁶⁸ The CG framework of every company is required to recognize stakeholders' rights. The stakeholders include; shareholders, consumers, suppliers, employees, creditors, regulators, lenders, media, auditors and potential investors.³⁶⁹

The board is tasked with developing strategies and policies to manage stakeholder relations that will foster long-term sustained growth.³⁷⁰ They are also to supply relevant information to stakeholders and establish whistle-blowing mechanisms that encourage stakeholders to bring out information that helps enforce good CG practices.³⁷¹

³⁶⁶ Clause 2.3.2. The Code of Corporate Governance Practices for Issuers of Securities to the Public, 2015, 11, —<[Code of Corporate Governance Practices for Issuers of Securities to the Public 2015 - Code-8.pdf](#)> on 20th September 2022.

³⁶⁷ Clause 2.3.2. The Code of Corporate Governance Practices for Issuers of Securities to the Public, 2015, 11, —<[Code of Corporate Governance Practices for Issuers of Securities to the Public 2015 - Code-8.pdf](#)> on 20th September 2022.

³⁶⁸ Clause 4.0. The Code of Corporate Governance Practices for Issuers of Securities to the Public, 2015, 24, —<[Code of Corporate Governance Practices for Issuers of Securities to the Public 2015 - Code-8.pdf](#)> on 20th September 2022.

³⁶⁹ Clause 4.0. The Code of Corporate Governance Practices for Issuers of Securities to the Public, 2015, 24, —<[Code of Corporate Governance Practices for Issuers of Securities to the Public 2015 - Code-8.pdf](#)> on 20th September 2022.

³⁷⁰ Clause 4.1.1 & 4.1.2. The Code of Corporate Governance Practices for Issuers of Securities to the Public, 2015, 24, —<[Code of Corporate Governance Practices for Issuers of Securities to the Public 2015 - Code-8.pdf](#)> on 20th September 2022.

³⁷¹ Clause 4.2.1. The Code of Corporate Governance Practices for Issuers of Securities to the Public, 2015, 25, —<[Code of Corporate Governance Practices for Issuers of Securities to the Public 2015 - Code-8.pdf](#)> on 20th September 2022.

The code mirrors the prudential guidelines on matters of ownership and control which goes to show that, despite the numerous scholarly research outlining the differences between corporations and financial firms, they are still treated similarly.

Both the guidelines and the code incorporate independent and non-executive directors who have been described as ‘shareholder surrogates’ as they are placed on the board to monitor executive directors.³⁷² Further, these individuals are believed to have the ability to assess the business objectively and voice their views assertively, without deferring to a domineering CEO.³⁷³

The excessive use of monitoring agents has been criticized over the years and has been likened to the Dr. Seuss’ “Bee Watcher” paradigm. Also, one of the main disadvantages plaguing independent directors is information asymmetry. Insiders generally have more information than outsiders.

3.10. Conclusion

Banking reforms the world over are focused on risk management almost exclusively through external “safety and soundness” regulations which emphasize capital adequacy, risk management, disclosures and an extensive examination process while largely ignoring internal bank governance.³⁷⁴

As evidenced by the GFC, the assimilation of shareholder-centric CG structures into bank institutions was erroneous as it encouraged excessive risk-taking by executives to the detriment of stakeholders.³⁷⁵

³⁷² Teklak P. ‘The Role of Non-Executive Directors in Banks and the Provision of Guidance on How Directors Can Rectify Bank Governance Deficiencies,’ 61.

³⁷³ Bruner C, ‘Corporate Governance Reform in Post Crisis Financial Firms: Two Fundamental Tensions,’ 975.

³⁷⁴ Min D, ‘Balancing the Governance of Financial Institutions,’ 744-746.

³⁷⁵ Armour J, Awrey D, Davies P, Enriques L, Gordon J, Mayer C, Payne J, ‘Bank Governance,’ 371.

Kenya's prudential regulations encapsulate the Anglo-American notion of shareholder orientation as they accommodate stakeholder concerns as secondary to those of shareholders.³⁷⁶

The inclusion of stakeholder interests in the laws and guidelines is evidence of the post-GFC push to promote active corporate engagement in protecting different stakeholder groups and promoting their welfare.³⁷⁷ However, the same is on a principle basis.³⁷⁸

For a sound business environment, the stakeholders' rights must be included and corporations be encouraged to foster and prioritize relationships with their stakeholders.³⁷⁹

While the legislation and regulation appreciate the differences between banks and non-financial firms by incorporating stakeholder protection in the regulations and through the deposit insurance and LOLR regulatory functions, these mechanisms have been criticized for fostering moral hazard.³⁸⁰

Additionally, the moral hazard of banks is amplified by their corporate group form that creates the opportunity for a parent company to insulate themselves from liabilities through their subsidiaries,³⁸¹ as was the case in Enron's collapse, which used subsidiary companies known as Special Purpose Vehicles (SPV's) to isolate financial risk.³⁸²

Moreover, the meagre clawback mandates and fines imposed by the regulations have proved to be insufficient deterrents to fraudulent behavior therefore, stricter standards

³⁷⁶ Clause 1.4.1. Prudential Guidelines for Institutions Licensed Under the Banking Act, 2013, 35, —<[PGs \(centralbank.go.ke\)](http://PGs.centralbank.go.ke)> on 10th September 2022.

³⁷⁷ Mrabure K & Abhulimhen-Iyoha A, 'Corporate Governance and Protection of Stakeholders Rights and Interests,' 293.

³⁷⁸ Keay A, 'The Duty to Promote the Success of the Company: is it Fit for Purpose?' 36.

³⁷⁹ Mrabure K & Abhulimhen-Iyoha A, 'Corporate Governance and Protection of Stakeholders Rights and Interests,' 298.

³⁸⁰ Djelic M & Bothello J, 'Limited Liability and its Moral Hazard Implications: The Systemic Inscription of Instability in Contemporary Capitalism, 596.

³⁸¹ Mackie C, 'A Tale of Unintended Consequence: Corporate Membership in Early UK Company Law,' 5.

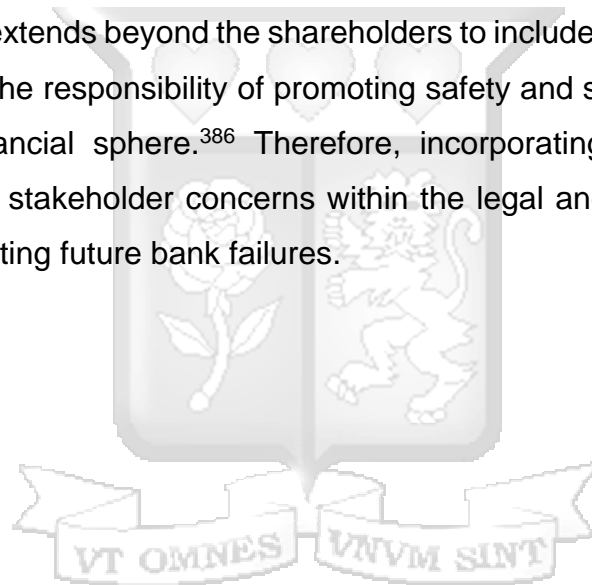
³⁸² Jenkins P, 'The Echoes of Enron in Greensill Saga,' Financial Times, March 29 2021, —<[The echoes of Enron in Greensill saga | Financial Times \(ft.com\)](https://www.ft.com/content/2021/03/29/enron-echoes-greensill-saga)> on 3rd April 2023.

have been suggested by scholars, such as, imposing personal liability on shareholders, directors and managers.³⁸³

While imposing personal liability may incentivize directors and managers to align their interests with those of stakeholders, it is imperative to note that they are agents and fiduciaries of the shareholders who may be justifiably removed for failure to maximize shareholder values.³⁸⁴

Furthermore, targeting the shareholder's limited liability would be impractical and difficult to implement as stated in the literature review in Chapter 1.³⁸⁵

Banks are multi-constituency organizations necessitating specialized governance because their domain extends beyond the shareholders to include other stakeholders and they are saddled with the responsibility of promoting safety and soundness with minimal disruptions to the financial sphere.³⁸⁶ Therefore, incorporating a hybrid model that primarily encapsulates stakeholder concerns within the legal and regulatory framework may be the key to averting future bank failures.



³⁸³ Min D, 'Balancing the Governance of Financial Institutions,' 760.

³⁸⁴ Min D, 'Balancing the Governance of Financial Institutions,' 761.

³⁸⁵ Min D, 'Balancing the Governance of Financial Institutions,' 762.

³⁸⁶ Abata M, Tijani O & Odutola O, 'Corporate Governance Practices in Holding and Non-Holding Operating Structured Banks in Nigeria,' *6 Journal of Social Development*, 1, (2017), 58.

4. CHAPTER FOUR: CASE STUDY ON THE COLLAPSE OF CHASE BANK LIMITED

4.1. Introduction

A country's economic health and productivity depend on the efficiency of its banking sector and a stable banking system is crucial to economic sustainability.³⁸⁷ Consequently, the frailty of the banking sector adversely affects the economy.

Bank failure significantly affects its stakeholders, negatively impacts the economy, disrupts enterprise, dissipates individual and corporate investments and creates a loss of confidence in the financial sector.³⁸⁸ This chapter analyses the failure of CBL and its effects on various stakeholders and further illustrates the importance of effective banking regulation and supervision.

4.2. Brief History of Chase Bank Limited

CBL was a licensed private commercial bank and the 11th largest out of 43 lenders, with a total asset base of 142 Billion Kenya Shillings as of 2015.³⁸⁹ Its initial share capital of 75 Million Kenya Shillings in 1996, steadily increased over the years, as the bank was highly reputable with an Islamic window approach, offering quality financial solutions and lasting value to all stakeholders.³⁹⁰ The bank had a growing consumer base across Kenya and its target market was the middle class and the growing SME sector.

³⁸⁷ Torqu K & Laryea E, 'Corporate Governance and Bank Failure: Ghana's 2018 Banking Sector Crisis,' *Journal of Sustainable Finance & Investment*, 2021, 1-2, —< <https://doi.org/10.1080/20430795.2021.1981210>> on 18th July 2022.

³⁸⁸ Yomboi J, Nangpiire C, Kutochigaga E & Majeed M, 'The Impact of the Collapsed Banks on Customers in Ghana,' 21 (17) *Asian Journal of Economics, Business and Accounting*, 2021, 22.

³⁸⁹ Achuka V, 'Local and Foreign Suitors Jostle to Buy Chase Bank,' Daily Nation, 16th April 2016, —< [Local and foreign suitors jostle to buy Chase Bank | Nation](#)> on 4th August 2022.

³⁹⁰ The World Folio, 'Company Database: Chase Bank,' —< [Chase Bank \(theworldfolio.com\)](#) > on 4th August 2022.

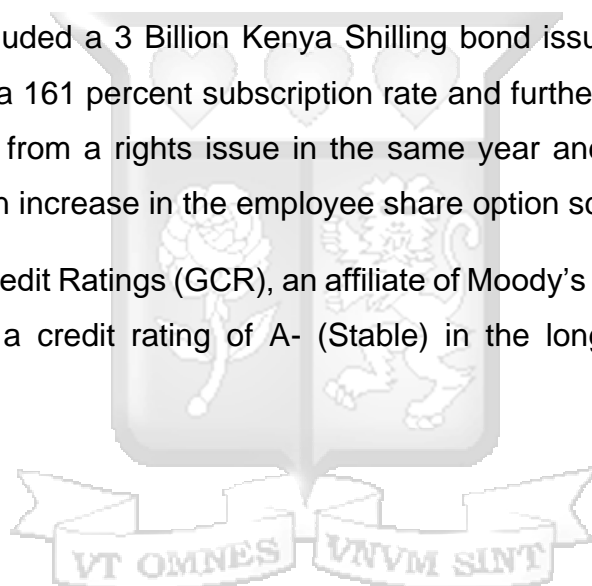
In 2014 the bank strengthened its capital base through a rights issue that raised an estimated 1 Billion Kenya Shillings and retained an estimated 2 Billion Kenya Shillings in earnings, which grew the capital reserves by 47.8 percent.³⁹¹

Furthermore, the CBK issued revised prudential guidelines that increased the 12 percent capital requirement by 2.5 percent to 14.5 percent which consequently increased CBL's capital.³⁹²

CBL had a total risk-weighted capital adequacy ratio of 21.1 percent during the first half of 2015 compared to its 15.3 percent ratio in 2014, which was well above the revised regulatory benchmark.³⁹³

The bank further concluded a 3 Billion Kenya Shilling bond issue in 2015 as their first public offer which had a 161 percent subscription rate and further raised an estimated 2 Billion Kenya Shillings from a rights issue in the same year and recouped 600 Million Kenya Shillings from an increase in the employee share option scheme.³⁹⁴

Furthermore, Global Credit Ratings (GCR), an affiliate of Moody's Investor Services, gave CBL in July of 2015, a credit rating of A- (Stable) in the long term and short term respectively.³⁹⁵



³⁹¹ The East African, 'Kenya Government Among Losers in Chase Bank Fall After Pumping in \$2m for SMEs,' The East African, 9th April 2016, —< [Kenya govt among losers in Chase Bank fall after pumping in \\$2m for SMEs - The East African](#)> on 21st July 2022.

³⁹² The East African, 'Kenya Government Among Losers in Chase Bank Fall After Pumping in \$2m for SMEs,' The East African, 9th April 2016, —< [Kenya govt among losers in Chase Bank fall after pumping in \\$2m for SMEs - The East African](#)> on 21st July 2022.

³⁹³ The East African, 'Kenya Government Among Losers in Chase Bank Fall After Pumping in \$2m for SMEs,' The East African, 9th April 2016, —< [Kenya govt among losers in Chase Bank fall after pumping in \\$2m for SMEs - The East African](#)> on 21st July 2022.

³⁹⁴ The East African, 'Kenya Government Among Losers in Chase Bank Fall After Pumping in \$2m for SMEs,' The East African, 9th April 2016, —< [Kenya govt among losers in Chase Bank fall after pumping in \\$2m for SMEs - The East African](#)> on 21st July 2022.

³⁹⁵ The East African, 'Kenya Government Among Losers in Chase Bank Fall After Pumping in \$2m for SMEs,' The East African, 9th April 2016, —< [Kenya govt among losers in Chase Bank fall after pumping in \\$2m for SMEs - The East African](#)> on 21st July 2022.

4.3. The Collapse of Chase Bank Limited

In 2016, a whistleblower's anonymous letter brought the bank to its knees.³⁹⁶ The leaked document was sent to Paris-based firm Amethis Finance (one of CBL's shareholders) pointing out the anomalies in the institution's financials.

Furthermore, insiders alleged that top executives were at odds and were playing power games, affecting decisions and the whistleblower report was occasioned by the power struggle.³⁹⁷

The bank dismissed rising concerns by stakeholders by issuing a statement asserting that, customers' investments and funds were safe and that the bank remained strong, sound and transparent.³⁹⁸

However, the sudden management changes that followed the whistleblower's report, further fueled social media speculation, causing panic and a run on the bank and necessitated the CBK to place the bank under receivership to protect depositors, creditors and public interest.³⁹⁹

Additionally, a 'qualified' audit opinion by the bank's auditor revealed under-reported insider loans.⁴⁰⁰ A qualified opinion generally applies whereby the financial information provided by the company was limited in scope, there was a material issue with the

³⁹⁶ Daily Nation, 'How Whistleblower's Secret Note to Investors Brought Chase Bank to its Knees,' Daily Nation, 9th April 2016, —< [How whistleblower's secret note to investors brought Chase Bank to its knees | Nation](#)> on 26th July 2022.

³⁹⁷ Daily Nation, 'How Whistleblower's Secret Note to Investors Brought Chase Bank to its Knees,' Daily Nation, 9th April 2016, —< [How whistleblower's secret note to investors brought Chase Bank to its knees | Nation](#)> on 26th July 2022.

³⁹⁸ Business Daily Africa, 'Chase Bank Shocks Market with Sh8n Secret Insider Loans,' Business Daily Africa, 7th April 2016 —<[Chase Bank shocks market with Sh8bn secret insider loans - Business Daily \(businessdailyafrica.com\)](#)> on 16th July 2022.

³⁹⁹ Daily Nation, 'How Whistleblower's Secret Note to Investors Brought Chase Bank to its Knees,' Daily Nation, 9th April 2016, —< [How whistleblower's secret note to investors brought Chase Bank to its knees | Nation](#)> on 26th July 2022.

⁴⁰⁰ Business Daily Africa, 'Chase Bank Shocks Market with Sh8n Secret Insider Loans,' Business Daily Africa, 7th April 2016 —<[Chase Bank shocks market with Sh8bn secret insider loans - Business Daily \(businessdailyafrica.com\)](#)> on 16th July 2022.

application of the generally accepted accounting principles but the same was not pervasive, or, in instances of inadequate disclosures.⁴⁰¹

The insider loans were worth an estimated 13.62 Billion Kenya Shillings exceeding the bank's shareholder equity which stood at 11.9 Billion Kenya Shillings.⁴⁰² The loans were advanced to directors, shareholders, associates and employees.

The CBK in exercising its mandate appointed KDIC as the receiver of CBL for a period not exceeding twelve months, which could be extended for a period not exceeding six months.⁴⁰³

Following their appointment, the KDIC was mandated to assume the management, control and conduct of the business affairs of the institution and exercise all the powers of the institution to the exclusion of the BOD and advise the CBK on a resolution strategy as soon as practicable.⁴⁰⁴

The KDIC's initial response to the failure of Chase Bank Limited in Receivership (CBLIR) was to resolve the bank through an acquisition by appointing KCB Bank Kenya Ltd (KCB) as the receiver manager pending their acquisition of a majority stake in CBLIR.⁴⁰⁵

KCB's credentials of being a strong and reputable bank were viewed as a means to safeguard the interests of CBL's depositors and creditors.⁴⁰⁶ Additionally, KCB was to

⁴⁰¹ Business Daily Africa, 'Chase Bank Shocks Market with Sh8n Secret Insider Loans,' Business Daily Africa, 7th April 2016 —<[Chase Bank shocks market with Sh8bn secret insider loans - Business Daily \(businessdailyafrica.com\)](#)> on 16th July 2022.

⁴⁰² Business Daily Africa, 'Chase Bank Shocks Market with Sh8n Secret Insider Loans,' Business Daily Africa, 7th April 2016 —<[Chase Bank shocks market with Sh8bn secret insider loans - Business Daily \(businessdailyafrica.com\)](#)> on 16th July 2022.

⁴⁰³ Central Bank of Kenya, Press Release, 7th April 2016 —<[Press Release Chase Bank Limited April 7 2016.pdf \(centralbank.go.ke\)](#)> on 18th July 2022.

⁴⁰⁴ Central Bank of Kenya, Press Release, 7th April 2016 —<[Press Release Chase Bank Limited April 7 2016.pdf \(centralbank.go.ke\)](#)> on 18th July 2022.

⁴⁰⁵ Central Bank of Kenya, Press Release, 20th April 2016, —< [ChaseBankLimited-20042016.pdf \(centralbank.go.ke\)](#)> on 18th July 2022.

⁴⁰⁶ Central Bank of Kenya, Press Release, 20th April 2016, —< [ChaseBankLimited-20042016.pdf \(centralbank.go.ke\)](#)> on 18th July 2022.

carry out a thorough due diligence review of CBLIR to determine whether they would move forward with the proposed acquisition.

The appointment of KCB allowed CBLIR branches to reopen, giving customers immediate access to a maximum of 1 Million Kenya Shillings and any exceeding amounts were to be structurally released to depositors.⁴⁰⁷

Moreover, a moratorium on payments to creditors and lenders was placed and efforts to recover non-performing/ irregular loans were ramped up and the CBK and KCB offered liquidity support to CBLIR.⁴⁰⁸

The proposed acquisition of CBLIR by KCB failed to move forward and in 2017 the CBK extended the appointment period of KDIC.⁴⁰⁹ Furthermore, the CBK released a statement inviting investors to present an Initial Expression of Interest (EOI) to take an equity interest in CBLIR.⁴¹⁰

Following the EOI, CBK and KDIC (the regulators), jointly announced their receipt of a non-binding offer from SBM Holdings Limited (SBM), a leading financial services group and the second largest listed on the Stock Exchange of Mauritius with a growing international presence.⁴¹¹

In 2018, the regulators announced their acceptance of a binding offer with SBM.⁴¹² The offer entailed an acquisition of CBLIR by SBM and was viewed as a viable proposal for

⁴⁰⁷ Central Bank of Kenya, Press Release, 20th April 2016, —< [ChaseBankLimited-20042016.pdf \(centralbank.go.ke\)](#)> on 18th July 2022.

⁴⁰⁸ Central Bank of Kenya, Press Release, 20th April 2016, —< [ChaseBankLimited-20042016.pdf \(centralbank.go.ke\)](#)> on 18th July 2022.

⁴⁰⁹ Central Bank of Kenya, Press Release, 28th March 2017, —< [2081137250_PRESS RELEASE - Chase Bank Limited \(In Receivership\) - March 28, 2017.pdf \(centralbank.go.ke\)](#)> on 19th July 2022.

⁴¹⁰ Central Bank of Kenya, Press Release, 30th March 2017, —< [654252239_Press_Release - Chase Bank Limited EOI.pdf \(centralbank.go.ke\)](#)> on 19th July 2022.

⁴¹¹ Central Bank of Kenya & Kenya Deposit Insurance Corporation, Press Release, 9th October 2018, —< [1797382873_Press_Release - Chase Bank - Non-Binding Offer.pdf \(centralbank.go.ke\)](#)> on 19th July 2022.

⁴¹² Central Bank of Kenya & Kenya Deposit Insurance Corporation, Press Release, 5th January 2018, —< [547132684_Press_Release - Chase Bank - Acceptance of the Binding Offer.pdf \(centralbank.go.ke\)](#)> on 19th July 2022.

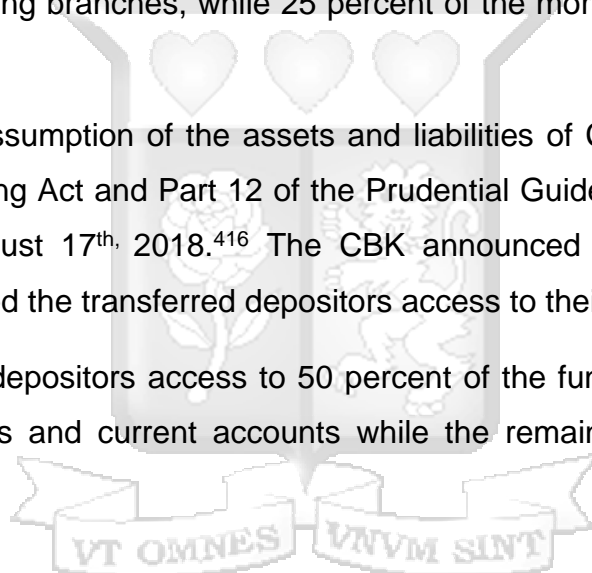
the substantial resolution of CBLIR, for the benefit of depositors and the strengthening of the Kenyan financial sector.

The acquisition would further enhance competitiveness within the Kenyan banking sector as SBM would bring its experiences and expertise from the international and Mauritian markets.⁴¹³

The regulators executed an agreement with SBM Bank (Kenya) Limited (SBM Kenya), setting out the parameters of the acquisition.⁴¹⁴ The agreement stipulated that 75 percent of the value of deposits under a moratorium be transferred to SBM Kenya together with non-moratorium deposits, a majority of the existing operations of CBLIR including employees and operating branches, while 25 percent of the moratorium deposits would remain with CBLIR.⁴¹⁵

The acquisition and assumption of the assets and liabilities of CBLIR as stipulated by Section 9 of the Banking Act and Part 12 of the Prudential Guidelines, were forecast to be completed by August 17th, 2018.⁴¹⁶ The CBK announced the completion of the acquisition that provided the transferred depositors access to their frozen deposits.⁴¹⁷

The completion gave depositors access to 50 percent of the funds transferred to SBM Kenya through savings and current accounts while the remaining 50 percent of the



⁴¹³ Central Bank of Kenya & Kenya Deposit Insurance Corporation, Press Release, 5th January 2018, —< [547132684_Press_Release_-_Chase_Bank_-_Acceptance_of_the_Binding_Offer.pdf \(centralbank.go.ke\)](#)>on 19th July 2022.

⁴¹⁴ Central Bank of Kenya & Kenya Deposit Insurance Corporation, Press Release, 17th April 2018, —< [1206917992_Press_Release_-_Chase_Bank_-_April_17_2018.pdf \(centralbank.go.ke\)](#)>on 19th July 2022.

⁴¹⁵ Central Bank of Kenya & Kenya Deposit Insurance Corporation, Press Release, 17th April 2018, —< [1206917992_Press_Release_-_Chase_Bank_-_April_17_2018.pdf \(centralbank.go.ke\)](#)>on 19th July 2022.

⁴¹⁶ Central Bank of Kenya, Press Release, 6th July 2018, —< [913050567_Press_Release_-_Chase_Bank_\(Kenya\)_Limited_\(In_Receivership\).pdf \(centralbank.go.ke\)](#)>on 19th July 2022.

⁴¹⁷ Central Bank of Kenya, Press Release, 30th August 2018, —< [1236253842_Press_Release_-_Chase_Bank_\(Kenya\)_Limited_\(In_Receivership\)_and_SBM_Bank_\(Kenya\)_Limited.pdf \(centralbank.go.ke\)](#)>on 19th July 2022.

moratorium deposits would be made available over a three-year term and would earn interest during that period.⁴¹⁸

SBM Kenya offered borrowers full banking operations on their accounts and resumed operations on the transferred loan accounts.⁴¹⁹ Furthermore, it gave borrowers access to new trade finance lines and credit and non-credit facilities.

Moreover, the bank offered customers revamped services at its branches with additional products across retail, SME and corporate sectors and ensured continuity of employment by retaining a vast majority of the employees.⁴²⁰

The acquisition was praised as the first of its kind in Africa as it was solely private-sector driven and CBK Governor Dr. Patrick Njoroge remarked; “This is one small step for depositors, but a giant leap for the stability of the financial sector.”⁴²¹ The transaction stands as a reference for future resolutions in Kenya.⁴²²

Though the carve-out addressed some stakeholder concerns, the creditors of CBLIR were not covered. The CBK held a meeting with the creditors in which they emphasized their key objectives were ensuring asset recovery for creditors, financial stability and protection of stakeholder interests.⁴²³

⁴¹⁸ SBM Group, ‘SBM Holdings Ltd Completes Acquisition of Chase Bank Kenya Ltd (In Receivership),’ 23rd August 2018, —< [SBM Holdings Ltd completes acquisition of Chase Bank Kenya Ltd \(In Receivership\) | SBM Group](#)> on 25th July 2022.

⁴¹⁹ SBM Group, ‘SBM Holdings Ltd Completes Acquisition of Chase Bank Kenya Ltd (In Receivership),’ 23rd August 2018, —< [SBM Holdings Ltd completes acquisition of Chase Bank Kenya Ltd \(In Receivership\) | SBM Group](#)> on 25th July 2022.

⁴²⁰ SBM Group, ‘SBM Holdings Ltd Completes Acquisition of Chase Bank Kenya Ltd (In Receivership),’ 23rd August 2018, —< [SBM Holdings Ltd completes acquisition of Chase Bank Kenya Ltd \(In Receivership\) | SBM Group](#)> on 25th July 2022.

⁴²¹ Central Bank of Kenya, Press Release, 30th August 2018, —< [1236253842 Press Release - Chase Bank \(Kenya\) Limited \(In Receivership\) and SBM Bank \(Kenya\) Limited.pdf \(centralbank.go.ke\)](#)>on 19th July 2022.

⁴²² SBM Group, ‘SBM Holdings Ltd Completes Acquisition of Chase Bank Kenya Ltd (In Receivership),’ 23rd August 2018, —< [SBM Holdings Ltd completes acquisition of Chase Bank Kenya Ltd \(In Receivership\) | SBM Group](#)> on 25th July 2022.

⁴²³ Central Bank of Kenya, Press Release, 9th November 2018, —< [854813240 Press Release - Chase Bank Creditors' Meeting - November 2018.pdf \(centralbank.go.ke\)](#)>on 19th July 2022.

The CBK requested the appointment of an independent external auditor by KDIC to facilitate the comprehensive audit of CBLIR.⁴²⁴ The external auditor submitted a report in September 2020, pointing out several gaps that the CBK requested the KDIC to resolve within 60 days.⁴²⁵

On April 7th, 2021, the KDIC submitted their Receiver's Report to the CBK indicating the weak status of CBLIR's financial position and recommending that CBLIR be liquidated per Section 53(2) of the Kenya Deposit Insurance Act.⁴²⁶

Following their assessment of the report, the CBK found that liquidation was the only feasible option and appointed the KDIC as the liquidator, according to Section 54 of the Kenya Deposit Insurance Act, for purposes of orderly resolution of the residual assets and liabilities of CBLIR.⁴²⁷

On April 16th 2021, the KDIC released a statement on the commencement of payment of protected deposits to all eligible depositors of CBLIR, under Section 33 of the Kenya Deposit Insurance Act.⁴²⁸ Depositors were advised to collect/ download, complete and return claim forms to SBM Kenya branches country-wide.

The maximum amount payable for the insured deposits as previously mentioned in Chapter 3, is Kenya Shillings 500,000.⁴²⁹ Any amount above the insured threshold forms

⁴²⁴ Central Bank of Kenya, Press Release, 16th April 2021, —< [706595395 Press Release - Chase Bank - Liquidation.pdf \(centralbank.go.ke\)](#)>on 19th July 2022.

⁴²⁵ Central Bank of Kenya, Press Release, 16th April 2021, —< [706595395 Press Release - Chase Bank - Liquidation.pdf \(centralbank.go.ke\)](#)>on 19th July 2022.

⁴²⁶ Central Bank of Kenya, Press Release, 16th April 2021, —< [706595395 Press Release - Chase Bank - Liquidation.pdf \(centralbank.go.ke\)](#)>on 19th July 2022.

⁴²⁷ Central Bank of Kenya, Press Release, 16th April 2021, —< [706595395 Press Release - Chase Bank - Liquidation.pdf \(centralbank.go.ke\)](#)>on 19th July 2022.

⁴²⁸ Kenya Deposit Insurance Corporation, Press Release, 16th April 2021, —<[PRESS RELEASE-COMMENCEMENT OF PAYMENT OF PROTECTED DEPOSITS FOR CHASE BANK LIMITED IN LIQUIDATION AND LODGING OF CLAIMS BY CREDITORS. | Kenya Deposit Insurance Corporation \(kdic.go.ke\)](#)> on 25th July 2022.

⁴²⁹ Kenya Deposit Insurance Corporation, Press Release, April 16th 2021, —<[PRESS RELEASE-COMMENCEMENT OF PAYMENT OF PROTECTED DEPOSITS FOR CHASE BANK LIMITED IN LIQUIDATION AND LODGING OF CLAIMS BY CREDITORS. | Kenya Deposit Insurance Corporation \(kdic.go.ke\)](#)> on 25th July 2022.

part of the creditors' claims to be equitably divided by the liquidator if sufficient funds remain from the liquidation process.

Furthermore, the KDIC advised creditors to lodge their claims by completing and submitting proof of debt forms for verification, to be equally distributed with depositors' balances above the insured threshold following the completion of the liquidation process.⁴³⁰

4.4. Analysis of the Collapse and Resolution of Chase Bank Limited

As previously stated CBL was placed under receivership in 2016 following CBK's assessment that the bank had become unviable. The term receivership is used to refer to situations in which a person may be appointed as a receiver by the court, under statute, or by a legal or natural person to protect, manage or realize the value of property.⁴³¹

The roots of receivership lie in property law whereby mortgagees secure their investments through the appointment of a receiver in the event of default on the part of the mortgagor.⁴³²

There is a stigma associated with the term 'receivership', which is rooted in its corporate law consequence whereby secured creditors, particularly a floating charge holder, in the process of enforcing their security, sweep up all the assets to the detriment of other creditors.⁴³³

⁴³⁰ Kenya Deposit Insurance Corporation, Press Release, 16th April 2021, —<[PRESS RELEASE- COMMENCEMENT OF PAYMENT OF PROTECTED DEPOSITS FOR CHASE BANK LIMITED IN LIQUIDATION AND LODGING OF CLAIMS BY CREDITORS. | Kenya Deposit Insurance Corporation \(kdic.go.ke\)](#)> on 25th July 2022.

⁴³¹ Akintola k & Milman D, 'The Rise, Fall and Potential for a Rebirth of Receivership in UK Corporate Law,' 20 Journal of Corporate Law Studies, 1, (2020), 99.

⁴³² Akintola k & Milman D, 'The Rise, Fall and Potential for a Rebirth of Receivership in UK Corporate Law,' 101.

⁴³³ Finch V, Milman D, *Corporate Insolvency Law: Perspectives and Principles*, 3rd ed Cambridge University Press, United Kingdom, 2017, 275.

Justice Ringera stated in *Jambo Biscuits v Barclays Bank and 2 others*⁴³⁴, “I think it is a notorious fact of which judicial notice may be taken that receiverships in the country tend to give the kiss of death to many a business.”

However, in banking, the sole purpose of receivership is not only to realize the assets on behalf of the creditors but to ensure the orderly resolution of the non-viable bank.⁴³⁵ The KDIC advises the CBK on the most viable resolution mechanism to reopen the bank within the shortest time.

Banks cannot be made fail-safe but they can be made safe to fail through resolution.⁴³⁶ Bank resolution entails the restructuring of a bank by an authorized party through the use of resolution mechanisms to safeguard the public interest, including ensuring continuity of the critical functions of the bank, financial stability and minimizing reliance on public financial support.⁴³⁷

Resolution occurs at the point where the authorities determine that a bank is Failing or Likely to Fail (FOLTF), that is, there is no other supervisory or private sector intervention that can restore the institution to viability for example, by applying a recovery plan which all banks are required to have,⁴³⁸ under part 3 of the prudential guidelines.⁴³⁹

Resolution mechanisms were created due to the crucial role of banks on the economy, to avoid the use of taxpayers’ money to bail out unviable banks, to restore trust in the financial system and to avoid contagion.⁴⁴⁰

⁴³⁴ *Jambo Biscuits (K) Ltd. v Barclays Bank of Kenya Ltd and 2 Others* (2001) eKLR.

⁴³⁵ Kenya Deposit Insurance Corporation, —<[DEPOSIT INSURANCE | Kenya Deposit Insurance Corporation \(kdic.go.ke\)](#)> on 8th April 2022.

⁴³⁶ Sustainable Architecture for Finance in Europe (SAFE), ‘How to Make Banks Safe to Fail,’ 3rd July 2013, —< [How to make banks safe to fail \(safe-frankfurt.de\)](#)> on 11th August 2022.

⁴³⁷ Single Resolution Board, ‘What is Bank Resolution,’ —< [What is a bank resolution? | Single Resolution Board \(europa.eu\)](#)> on 26th July 2022.

⁴³⁸ Single Resolution Board, ‘What is Bank Resolution,’ —< [What is a bank resolution? | Single Resolution Board \(europa.eu\)](#)> on 26th July 2022.

⁴³⁹ Part 3.1.1.1. Central Bank of Kenya, *Prudential Guidelines for Institutions Licensed Under the Banking Act, 2013*, 336.

⁴⁴⁰ Single Resolution Board, ‘What is Bank Resolution,’ —< [What is a bank resolution? | Single Resolution Board \(europa.eu\)](#)> on 26th July 2022.

Bank resolution needs to be swift, orderly and efficient, avoiding undue disruption to the bank's activities and the rest of the economy.⁴⁴¹ Resolution is applicable whereby normal insolvency proceedings would adversely affect stakeholder interests, inflict damage on the economy and cause financial instability.

The KDIC has outlined the resolution mechanisms in Kenya these include; Open Bank Assistance (OBA) whereby a failing bank receives financial assistance via loan or contribution by the deposit insurer, the government, or the CBK, this may include management changes and the KDIC must ensure that this mechanism is the least costly to the Deposit Insurance Fund.⁴⁴²

Mergers and Acquisitions entail a failing bank merging its balance sheets with that of a strong bank or being taken over by an investor seeking to hold a significant controlling interest or acquiring the bank as a whole.⁴⁴³

Acquisitions have been globally used as a turnaround strategy to bail out distressed firms and their stakeholders.⁴⁴⁴ The acquisition of CBL pioneered the successful private-sector-driven resolution strategy.

Additionally, there is the bridge bank mechanism which entails the deposit insurer forming an institution to assume the troubled bank as it continues to find a solution or an acquirer for the troubled bank for purposes of avoiding systemic risk and providing an orderly transition and circumventing the likelihood of a bank run.⁴⁴⁵

⁴⁴¹ Single Resolution Board, 'What is Bank Resolution,' —< [What is a bank resolution? | Single Resolution Board \(europa.eu\)](https://www.europa.eu/what-is-a-bank-resolution/)> on 26th July 2022.

⁴⁴² Kenya Deposit Insurance Corporation, —<[DEPOSIT INSURANCE | Kenya Deposit Insurance Corporation \(kdic.go.ke\)](https://www.kdic.go.ke/)> on 8th April 2022.

⁴⁴³ Kenya Deposit Insurance Corporation, 'Resolution' —<[DEPOSIT INSURANCE | Kenya Deposit Insurance Corporation \(kdic.go.ke\)](https://www.kdic.go.ke/)> on 8th April 2022.

⁴⁴⁴ Koech A, 'Effects of Acquisition on Performance of Distressed Commercial Banks in Kenya a Case of Chase Bank Kenya Limited,' Unpublished Masters in Business Administration (MBA) Thesis, United States International University-Africa, Nairobi, 2019, 3.

⁴⁴⁵ Kenya Deposit Insurance Corporation, 'Resolution' —<[DEPOSIT INSURANCE | Kenya Deposit Insurance Corporation \(kdic.go.ke\)](https://www.kdic.go.ke/)> on 8th April 2022.

Lastly, liquidation also referred to as the pay-out mechanism,⁴⁴⁶ is the process whereby the non-viable bank is closed and depositors are promptly paid their insured deposits. The liquidator engages in the process of realizing the assets of resolution to distribute to depositors and creditors as and when sufficient funds are available.⁴⁴⁷

In the case of CBL, the regulators pursued several strategies. In the first instance a proposed acquisition between KCB and CBLIR. Moreover, KCB and CBK offered liquidity support pending the completion of the acquisition process.⁴⁴⁸

After the deal between KCB and CBLIR fell through, the regulators moved forward with a second proposed acquisition of CBLIR by SBM Kenya which was successful. Following the successful completion of the acquisition, the regulators assessed that the best option for the remainder of CBLIR would be to enter into liquidation and to realize the assets to distribute to depositors and creditors if sufficient funds remain from the liquidation process.⁴⁴⁹

The bank resolution strategies pursued by the regulators may have averted the initial crisis, restored consumer confidence in the financial sector and ensured the continuity of business, however, it kept an unviable bank in the market as a going concern longer than necessary.

Moreover, the time and resources spent resolving the bank is wanting. A whopping five-year time frame exists from the date CBL was placed under receivership to the date it was finally placed under liquidation leaving stakeholders in limbo.

⁴⁴⁶ Kenya Deposit Insurance Corporation, 'Resolution' —<[DEPOSIT INSURANCE | Kenya Deposit Insurance Corporation \(kdic.go.ke\)](#)> on 8th April 2022.

⁴⁴⁷ Kenya Deposit Insurance Corporation, 'Resolution' —<[DEPOSIT INSURANCE | Kenya Deposit Insurance Corporation \(kdic.go.ke\)](#)> on 26th July 2022.

⁴⁴⁸ Central Bank of Kenya, Press Release, 20th April 2016, —< [ChaseBankLimited-20042016.pdf \(centralbank.go.ke\)](#)> on 18th July 2022.

⁴⁴⁹ Central Bank of Kenya, Press Release, 16th April 2021, —< [706595395 Press Release - Chase Bank - Liquidation.pdf \(centralbank.go.ke\)](#)>on 26th July 2022.

4.5. The Effects of Bank Failure on Key Stakeholders

Post-GFC empirical research tends toward embracing the stakeholder principle because it fosters long-term stability rather than short-term profits.⁴⁵⁰ Current bank reform initiatives place great emphasis on value creation for stakeholders to ensure the safety of the banking sector.⁴⁵¹ Bank failure adversely affects several stakeholders including;

i. The Government

Governments hold a dominant position in the financial services industry through regulation and supervision, however, their failure to adequately monitor financial institutions CG gives rise to the push toward a more stakeholder-friendly regime that provides legal rights to stakeholders.⁴⁵²

The role of the state in banks was magnified by the GFC due to the necessity for bailouts precipitated by massive bank failures that disrupted the economy.⁴⁵³ The government's role as regulator amplifies the need for their involvement in bank governance particularly due to their LOLR and deposit insurers roles.

Additionally, as the LOLR and deposit insurer, the government through the regulators provides liquidity to failing banks whose illiquidity is likely to affect the economy.⁴⁵⁴ The purpose of the LOLR is to protect depositors by providing temporary liquidity to a failing bank to sustain its operations. This function has been criticized for fostering additional risk-taking by bank executives.⁴⁵⁵

⁴⁵⁰ Leung W, Song W &Chen J, 'Does Bank Stakeholder Orientation Enhance Financial Stability?' Journal of Corporate Finance, 2019, 39, —<https://doi.org/10.1016/j.jcorpfin.2019.01.003> on 10th August 2022.

⁴⁵¹ Leung W, Song W &Chen J, 'Does Bank Stakeholder Orientation Enhance Financial Stability?' 39.

⁴⁵² Kim H-J 'Financial Regulation and Supervision in Corporate Governance of Banks,' 716.

⁴⁵³ Kim H-J 'Financial Regulation and Supervision in Corporate Governance of Banks,' 716.

⁴⁵⁴ Corporate Finance Institute 'Lender of Last Resort,' Corporate Finance Institute, 22nd March 2022, —< [Lender of Last Resort - How Lenders of Last Resort Ensure Liquidity \(corporatefinanceinstitute.com\)](https://corporatefinanceinstitute.com)> on 14th September 2022.

⁴⁵⁵ Corporate Finance Institute 'Lender of Last Resort,' Corporate Finance Institute, 22nd March 2022, —< [Lender of Last Resort - How Lenders of Last Resort Ensure Liquidity \(corporatefinanceinstitute.com\)](https://corporatefinanceinstitute.com)> on 14th September 2022.

Moreover, explicit deposit insurance on the one hand may significantly reduce or altogether stop the likelihood of bank runs while on the other hand, it can fuel bank crises by giving perverse incentives to bank executives, to take excessive risks.⁴⁵⁶

In 1933 President Franklin Delano Roosevelt opposed the adoption of explicit deposit insurance in the US famously quoting that the adoption of the same “would put a premium on unsound banking in the future.”⁴⁵⁷

Be that as it may, a good deposit insurance scheme; incorporates risk-reducing features, provides stakeholders incentive to monitor their banks and ensures regulatory enforcement.⁴⁵⁸

ii. Depositors

Depositors are generally risk averse. In a free market system, market discipline relies on stakeholders such as depositors to monitor and prevent risk-taking by banks.⁴⁵⁹ However, post-GFC literature frowns upon market discipline as a tool for banking supervision due to its light-touch nature that contributed to the crisis, to begin with.⁴⁶⁰

With the growing acceptance of deposit insurance, depositors have little incentive to engage in monitoring ex-ante due to the guaranteed bailout through deposit insurance.⁴⁶¹ Deposit insurance is necessary to protect depositor interests because banks use

⁴⁵⁶ McCoy P, ‘The Moral Hazard Implications of Deposit Insurance: Theory and Evidence,’ 1.

⁴⁵⁷ McCoy P, ‘The Moral Hazard Implications of Deposit Insurance: Theory and Evidence,’ 9.

⁴⁵⁸ McCoy P, ‘The Moral Hazard Implications of Deposit Insurance: Theory and Evidence,’ 13.

⁴⁵⁹ Lamers M, ‘Depositor Discipline and Bank Failures in Local Markets During the Financial Crisis,’ University of Groningen, Research Report (15007-EEF), 2015, 1, —<<https://www.aeaweb.org/conference/2016/retrieve.php?pdfid=14379&tk=i2d7GEeK>> on 11th August 2022.

⁴⁶⁰ Lamers M, ‘Depositor Discipline and Bank Failures in Local Markets During the Financial Crisis,’ 1.

⁴⁶¹ Lamers M, ‘Depositor Discipline and Bank Failures in Local Markets During the Financial Crisis,’ 1.

depositor funds to run their business and earn profits, yet, depositors are not included in the operations or the decision-making process of banks.⁴⁶²

Arguably, however, the capped insured amount provided by the KDIC is insufficient to protect the depositor's interest on losses incurred during a bank failure.⁴⁶³

Furthermore, the successful acquisition and carve-out of CBLIR only dealt with 75 percent of the moratorium deposits while the fate of the remaining 25 percent remains in the unviable bank and their prospects of recovery depend on whether there will be sufficient funds after the liquidation is complete.⁴⁶⁴

Additionally, the criteria for choosing which depositors/creditors will be transferred to SBM Kenya is unspecified, creating a lacuna in the law as evidenced by recent case laws.

In *Afrasia Bank v SBM Bank (Kenya)*,⁴⁶⁵ the plaintiff deposited \$7,500,000 in a fixed deposit account with CBL starting 18th March 2016 before the bank's collapse, which was set to mature within a month. CBL was placed under receivership on 7th April 2016 before the date of maturity and the defendant acquired the assets and liabilities of CBLIR, which transfer took effect on 17th August 2018.⁴⁶⁶

The plaintiff averred that the defendant failed to publish a Notice of the acquisition as stipulated by Section 3(1) of the Transfer of Business Act which stipulates that the transferee of a business is to be liable for liabilities of the transferor unless notice is given in the Kenya Gazette and newspapers with wide circulation within Kenya.⁴⁶⁷

⁴⁶² Omayo C, 'Protection of Depositors' Interests Within the Banking Sector in Kenya- An Analysis of Directors' Duty to Promote the Success of the Company and the Suitability of the Compensation Fund When the Bank Fails,' Unpublished LL.M Thesis, Strathmore University, Nairobi, (2021), 3.

⁴⁶³ Omayo C, 'Protection of Depositors' Interests Within the Banking Sector in Kenya- An Analysis of Directors' Duty to Promote the Success of the Company and the Suitability of the Compensation Fund When the Bank Fails,' 4.

⁴⁶⁴ Amadala V, 'Those Who Collapsed Chase Bank Will Pay-CBK Governor,' The Star, 18th February 2019, —< [Those who collapsed Chase Bank will pay - CBK Governor \(the-star.co.ke\)](https://www.the-star.co.ke/news/2019/02/18/those-who-collapsed-chase-bank-will-pay-cbk-governor) > on 27th July 2022.

⁴⁶⁵ *Afrasia Bank v SBM Bank (Kenya)* (2019) eKLR.

⁴⁶⁶ *Afrasia Bank v SBM Bank (Kenya)* (2019) eKLR.

⁴⁶⁷ Section 3, *Transfer of Business Act* (CAP 500)

The defendant disputed this claim asserting that the Transfer of Business Act was not applicable and that the acquisition of CBL was subject to the Banking Act and the Kenya Deposit Act only.⁴⁶⁸ The defendant further argued that the \$7,500,000 was excluded from the assets and liabilities that the defendants acquired.

In the first instance, the court dismissed both claims.⁴⁶⁹ however, in 2022, the court ordered SBM Bank (Kenya) to pay Afrasia Bank, finding that SBM is culpable for all liabilities of Chase Bank which it acquired in 2018.⁴⁷⁰

In *SBM Bank (Kenya) Limited v Singh (Civil Case E503 of 2020)*,⁴⁷¹ The defendant entered into an agreement with CBL on 31st November 2015, for the provision of banking services for two bank accounts. The accounts were overdrawn to a sum of 530,692.91 Euros and 367,688 Kenya Shillings respectively as of 17th September 2020 and the same continues to accrue interest.⁴⁷²

The plaintiff averred that KDIC confirmed the defendant's accounts rest with SBM Bank Kenya following the plaintiff's inquiry to the regulator vide a letter dated 17th August 2021.⁴⁷³ Conversely, the defendant claimed that the plaintiff lacked locus standi in recovering the debt as it failed to produce evidence showing the defendant's accounts were indeed transferred from CBLIR to SBM Kenya.

The defendant further submitted that, the issue of privilege does not arise in the case and that he was specifically interested in the evidence of his accounts' transfer.⁴⁷⁴ The court ruled in his favor and directed the plaintiff to disclose information on the defendant's accounts only, to avoid issues of breach of confidentiality and to establish its locus standi in the debt recovery.

⁴⁶⁸ *Afrasia Bank v SBM Bank (Kenya) (2019)* eKLR.

⁴⁶⁹ *Afrasia Bank v SBM Bank (Kenya) (2019)* eKLR.

⁴⁷⁰ Kiplagat S, 'Court Orders SBM to Settle Sh892m Chase Bank Debt,' Business Daily Africa, August 3rd 2022, —< [Court orders SBM to settle Sh892m Chase Bank debt - Business Daily \(businessdailyafrica.com\)](https://www.businessdailyafrica.com/court-orders-sbm-to-settle-sh892m-chase-bank-debt)> on August 11th 2022.

⁴⁷¹ *SBM Bank (Kenya) Limited v Singh (2020)* eKLR.

⁴⁷² *SBM Bank (Kenya) Limited v Singh (2020)* eKLR.

⁴⁷³ *SBM Bank (Kenya) Limited v Singh (2020)* eKLR.

⁴⁷⁴ *SBM Bank (Kenya) Limited v Singh (2020)* eKLR.

Following the plaintiff's disclosure, the court ruled in their favor stating that the issue of locus standi will be dealt with as part of the issues for resolution as the defendant did not dispute his relationship with CBL.⁴⁷⁵

Although the court ruled in favor of SBM Bank Kenya in this case, the defendant raised the critical issue of the opaque nature of the transfer of assets and liabilities of CBLIR to SBM Bank Kenya which is bound to come up in future case law.

iii. Shareholders and Directors

Bank shareholders stand to benefit from taking larger risks at the expense of creditors due to the peculiarities of banking business that make them highly leveraged institutions.⁴⁷⁶

Additionally, post-GFC, regulation seems to reflect prudential regulation that involves the CG of banks the purpose of which is to ensure banks' directors and managers cater to broader interests and by doing so, decrease the divergence between private and public interests.⁴⁷⁷

The CBL debacle illustrates the consequences of failed internal CG mechanisms as well as lax regulation. The CBK indicated that one director who was also a significant shareholder advanced a total of 7.9 Billion Kenya Shillings mostly without registered collateral.⁴⁷⁸

Furthermore, the bank's auditors, Deloitte, revealed that the ousted chairman of CBL Mr. Zafrullah Khan was the largest beneficiary of some 11 Billion Kenya Shillings looted from the lender.⁴⁷⁹ The cash was allegedly siphoned into companies he co-owned with the

⁴⁷⁵ *SBM Bank (Kenya) Limited v Singh* (2020) eKLR.

⁴⁷⁶ Armour J, Awrey D, Davies P, Enriques L, Gordon J, Mayer C, Payne J, 'Bank Governance,' 374.

⁴⁷⁷ Kim H-J 'Financial Regulation and Supervision in Corporate Governance of Banks,' 719.

⁴⁷⁸ Business Daily Africa, 'How Chase Bank Director Lent Himself Sh.7.9 Billion,' Business Daily Africa, 7th April 2016, —< [How Chase Bank director lent himself Sh7.9 billion - Business Daily \(businessdailyafrica.com\)](https://www.businessdailyafrica.com/news/how-chase-bank-director-lent-himself-sh7.9-billion)> on 26th July 2022.

⁴⁷⁹ Business Daily Africa, 'Ousted Chase Bank Chairman Was Architect of Sh11bn Loot,' Business Daily Africa, 5th May 2016, —< [Ousted Chase Bank chairman was architect of Sh11bn loot - Business Daily \(businessdailyafrica.com\)](https://www.businessdailyafrica.com/news/ousted-chase-bank-chairman-was-architect-of-sh11bn-loot)> on 26th July 2022.

suspended Managing Director (MD), Mr. Daniel Kabui. 90 percent of the ownership was the chairman's while 10 percent was owned by the MD.⁴⁸⁰

Mr. Zafrullah Khan was one of the founders of CBL who was first appointed as the group MD before holding the position of chairman.⁴⁸¹ His shareholdership in the bank was held through Sheghas Ltd, the second largest shareholder of CBL with a 13.9 percent stake. The funds were pumped into real estate investments in Nairobi and abroad.⁴⁸²

Moreover, there were exorbitant interest-free loans disguised as 'Musharakah,' a sharia-compliant financing tool, used by Islamic banks whereby, partners form joint ventures to co-own assets and share profits and losses in a mutually agreed ratio.⁴⁸³

The looting of funds by the errant executives wiped out the lender's core capital of 9.6 Billion Kenya Shillings as of December 2015.⁴⁸⁴ The CBK disclosed that their seizure of assets worth 7.9 Billion Kenya Shillings from Mr.Khan and Mr. Kabui allowed the re-opening of CBL branches.⁴⁸⁵

Deloitte stated that a further 3.1 Billion Kenya Shillings was stolen from CBL, which Mr. Khan attributed to theft by the finance manager, Mr. Makarios Agumbi and credit

⁴⁸⁰ Business Daily Africa, 'Ousted Chase Bank Chairman Was Architect of Sh11bn Loot,' Business Daily Africa, 5th May 2016, —< [Ousted Chase Bank chairman was architect of Sh11bn loot - Business Daily \(businessdailyafrica.com\)](#)> on 26th July 2022.

⁴⁸¹ Business Daily Africa, 'Ousted Chase Bank Chairman Was Architect of Sh11bn Loot,' Business Daily Africa, 5th May 2016, —< [Ousted Chase Bank chairman was architect of Sh11bn loot - Business Daily \(businessdailyafrica.com\)](#)> on 26th July 2022.

⁴⁸² Business Daily Africa, 'Ousted Chase Bank Chairman Was Architect of Sh11bn Loot,' Business Daily Africa, 5th May 2016, —< [Ousted Chase Bank chairman was architect of Sh11bn loot - Business Daily \(businessdailyafrica.com\)](#)> on 26th July 2022.

⁴⁸³ Business Daily Africa, 'Ousted Chase Bank Chairman Was Architect of Sh11bn Loot,' Business Daily Africa, 5th May 2016, —< [Ousted Chase Bank chairman was architect of Sh11bn loot - Business Daily \(businessdailyafrica.com\)](#)> on 26th July 2022.

⁴⁸⁴ Business Daily Africa, 'Ousted Chase Bank Chairman Was Architect of Sh11bn Loot,' Business Daily Africa, 5th May 2016, —< [Ousted Chase Bank chairman was architect of Sh11bn loot - Business Daily \(businessdailyafrica.com\)](#)> on 26th July 2022.

⁴⁸⁵ Business Daily Africa, 'Ousted Chase Bank Chairman Was Architect of Sh11bn Loot,' Business Daily Africa, 5th May 2016, —< [Ousted Chase Bank chairman was architect of Sh11bn loot - Business Daily \(businessdailyafrica.com\)](#)> on 26th July 2022.

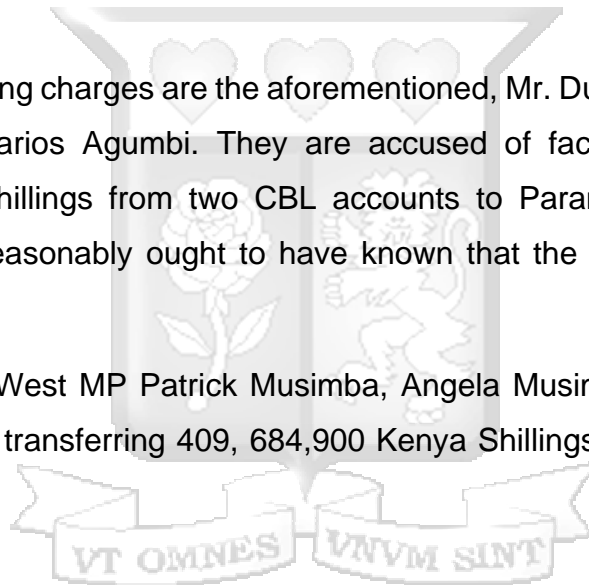
manager, Mr. James Mwaura.⁴⁸⁶ However, the auditors strongly believe that the chairman was the beneficiary of the heist.

It was reported in 2021, that additional charges were levied on seven persons among them the former chairman of the collapsed bank face charges in the Senior Principal Magistrates Court.⁴⁸⁷

Mr. Zafrullah Khan has been charged with the theft of 1.1 Billion Kenya Shillings as well as conspiracy to steal and money laundering after he transferred several amounts to Paramount Universal Bank knowing or with reason to believe that the money formed part of the proceeds of crime.⁴⁸⁸ He is further charged with using his position as a director to steal.

Other bank officers facing charges are the aforementioned, Mr. Duncan Kabui, Mr. James Mwenja and Mr. Makarios Agumbi. They are accused of facilitating the transfer of 740,442,687 Kenya Shillings from two CBL accounts to Paramount Universal Bank, knowingly or having reasonably ought to have known that the money was part of the proceeds of crime.⁴⁸⁹

Furthermore, Kibwezi West MP Patrick Musimba, Angela Musimba and Lucien Sunter have been accused of transferring 409, 684,900 Kenya Shillings from CBL to KCB, yet



⁴⁸⁶ Business Daily Africa, 'Ousted Chase Bank Chairman Was Architect of Sh11bn Loot,' Business Daily Africa, 5th May 2016, —< [Ousted Chase Bank chairman was architect of Sh11bn loot - Business Daily \(businessdailyafrica.com\)](https://www.businessdailyafrica.com/news/2016/05/05/050516-414141-1)> on 26th July 2022.

⁴⁸⁷ Kiplagat S, 'Seven Face More Charges in Chase Bank Fraud Suit,' Business Daily Africa, 18th February 2021, —<[Seven face more charges in Chase Bank fraud suit - Business Daily \(businessdailyafrica.com\)](https://www.businessdailyafrica.com/news/2021/02/18/021821-414141-1)> on 17th August 2022.

⁴⁸⁸ Kiplagat S, 'Seven Face More Charges in Chase Bank Fraud Suit,' Business Daily Africa, 18th February 2021, —<[Seven face more charges in Chase Bank fraud suit - Business Daily \(businessdailyafrica.com\)](https://www.businessdailyafrica.com/news/2021/02/18/021821-414141-1)> on 17th August 2022.

⁴⁸⁹ Kiplagat S, 'Seven Face More Charges in Chase Bank Fraud Suit,' Business Daily Africa, 18th February 2021, —<[Seven face more charges in Chase Bank fraud suit - Business Daily \(businessdailyafrica.com\)](https://www.businessdailyafrica.com/news/2021/02/18/021821-414141-1)> on 17th August 2022.

they ought to have known that the money formed part of the proceeds of crime.⁴⁹⁰ There is yet to be a final decision as the case is still ongoing.

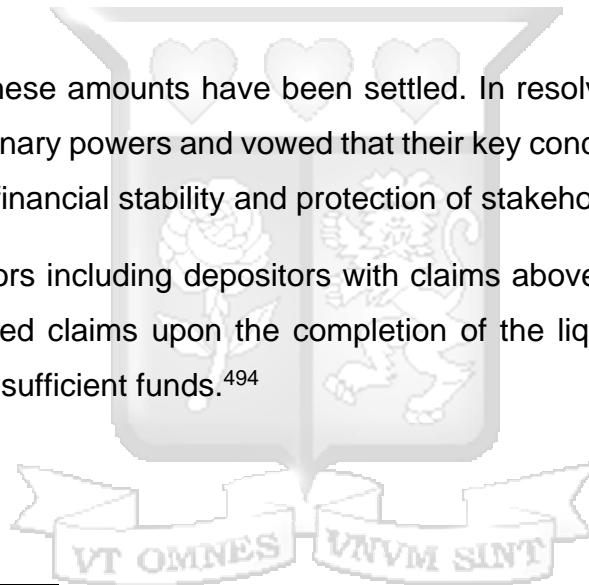
iv. Creditors and Employees

The case of CBL clearly illustrates the effects of failure on creditors. For example, the Kenyan government, through the National Treasury, was among the lenders whose money was tied up in CBL upon its being placed on receivership.⁴⁹¹

Additionally, global institutional lenders including, the French government, Deutsche Bank Investment Fund, European Investment Bank (EIB), PTA Bank, Proparco and Shelter Afrique were also among the biggest losers as CBL owed them an estimated 100 million U.S Dollars.⁴⁹²

It is unclear whether these amounts have been settled. In resolving the bank, the CBK and KDIC had discretionary powers and vowed that their key concern was ensuring asset recovery for creditors, financial stability and protection of stakeholder interests.⁴⁹³

Moreover, other creditors including depositors with claims above the insured threshold, are to recover their fixed claims upon the completion of the liquidation process, if the liquidator accumulates sufficient funds.⁴⁹⁴



⁴⁹⁰ Kiplagat S, 'Seven Face More Charges in Chase Bank Fraud Suit,' Business Daily Africa, 18th February 2021, —<[Seven face more charges in Chase Bank fraud suit - Business Daily \(businessdailyafrica.com\)](https://www.businessdailyafrica.com)> on 17th August 2022.

⁴⁹¹ The East African, 'Kenya Government Among Losers in Chase Bank Fall After Pumping in \$2m for SMEs,' The East African, 9th April 2016, —< [Kenya govt among losers in Chase Bank fall after pumping in \\$2m for SMEs - The East African](#)> on 21st July 2022.

⁴⁹² The East African, 'Kenya Government Among Losers in Chase Bank Fall After Pumping in \$2m for SMEs,' The East African, 9th April 2016, —< [Kenya govt among losers in Chase Bank fall after pumping in \\$2m for SMEs - The East African](#)> on 21st July 2022.

⁴⁹³ Central Bank of Kenya, Press Release, 9th November 2018, —< [854813240 Press Release - Chase Bank Creditors' Meeting - November 2018.pdf \(centralbank.go.ke\)](#)>on 17th August 2022.

⁴⁹⁴ Kenya Deposit Insurance Corporation, Press Release, 16th April 2021, —<[PRESS RELEASE- COMMENCEMENT OF PAYMENT OF PROTECTED DEPOSITS FOR CHASE BANK LIMITED IN LIQUIDATION AND LODGING OF CLAIMS BY CREDITORS. | Kenya Deposit Insurance Corporation \(kdic.go.ke\)](#)> on 17th August 2022.

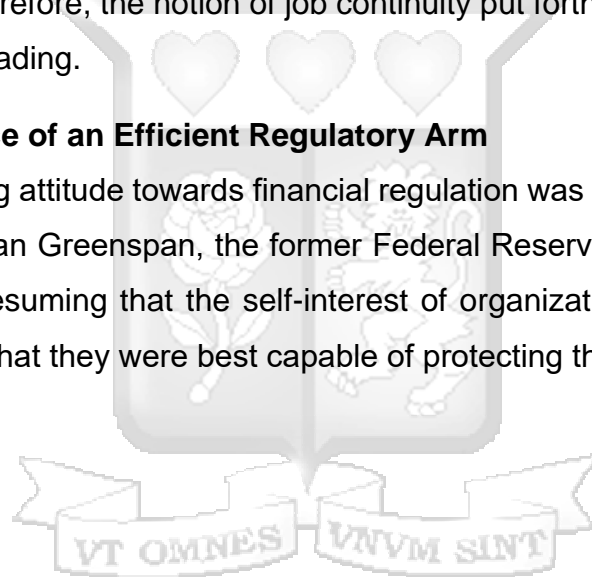
As it pertains to the employees, their interests were stated by the regulators to be protected by the successful carve-out which entailed the retention of a vast majority of the employees and ensured employment continuity.⁴⁹⁵

Since the takeover, however, SBM has sent home several employees in a mass layoff.⁴⁹⁶ The lender in October 2021 announced a voluntary exit scheme followed by redundancies after it failed to meet its targeted savings.

The Competition Authority of Kenya (CAK) has tried to force companies to retain employees for at least a year post-acquisition.⁴⁹⁷ This is however unrealistic because acquisitions lead to the retrenchment of workers, to avoid duplications of roles and reduction of costs. Therefore, the notion of job continuity put forth by the CBK, KDIC and SBM Kenya was misleading.

4.6. The Importance of an Efficient Regulatory Arm

Pre-GFC, the prevailing attitude towards financial regulation was that; “the market knows best.”⁴⁹⁸ Post-GFC, Alan Greenspan, the former Federal Reserve chairman admitted, “I made a mistake in presuming that the self-interest of organizations, specifically banks and others, was such that they were best capable of protecting their shareholders.”⁴⁹⁹



⁴⁹⁵ SBM Group, ‘SBM Holdings Ltd Completes Acquisition of Chase Bank Kenya Ltd (In Receivership),’ 23rd August 2018, —< [SBM Holdings Ltd completes acquisition of Chase Bank Kenya Ltd \(In Receivership\) | SBM Group](#)> on 17th August 2022.

⁴⁹⁶ Guguyu O, ‘SBM Bank Sends Home More Staff,’ Business Daily Africa, 9th December 2021, —< [SBM Bank sends home more staff - Business Daily \(businessdailyafrica.com\)](#)> on 9th September 2022.

⁴⁹⁷ Guguyu O, ‘SBM Bank Sends Home More Staff,’ Business Daily Africa, 9th December 2021, —< [SBM Bank sends home more staff - Business Daily \(businessdailyafrica.com\)](#)> on 9th September 2022.

⁴⁹⁸ Beattie A & Politi J, ‘I Made a Mistake,’ Admits Greenspan,’ Financial Times, 23rd October 2008, —< [‘I made a mistake,’ admits Greenspan | Financial Times \(ft.com\)](#)> on 19th August 2022.

⁴⁹⁹ Beattie A & Politi J, ‘I Made a Mistake,’ Admits Greenspan,’ Financial Times, 23rd October 2008, —< [‘I made a mistake,’ admits Greenspan | Financial Times \(ft.com\)](#)> on 19th August 2022.

Due to their critical role in economic sustainability at a national and global level, banks receive special attention from governments and are highly regulated to ensure they undertake their business in a controlled framework.⁵⁰⁰

Bank regulation is important for the prevention of systemic risk. Systemic risk denotes, the default of one institution spilling over to other institutions.⁵⁰¹ Empirical evidence suggests that systemic risk becomes a banking crisis. Systemic risk may arise from interbank linkages or the public perception that other banks are in a similar position as the failed bank which may lead to a run.⁵⁰²

Furthermore, regulation aids in the prevention of insider and outsider fraud, money laundering and terrorist financing.⁵⁰³ Insider fraud as was detected in CBL entails insiders siphoning off funds through phony or nominee borrowers in which case, auditors have an enhanced task of monitoring bank activities.⁵⁰⁴

Whereas, outsider fraud includes cheque, credit card, mortgage or wire fraud to name but a few.⁵⁰⁵ Fraud and other crimes by outsiders can involve the use of the banking system to facilitate criminal enterprises such as money laundering,⁵⁰⁶ which in broad terms denotes the concealment of the true source of money which may later reappear in 'legitimate' investments and terrorist financing.⁵⁰⁷ Regulation also assists in maintaining a robust and competitive financial market.⁵⁰⁸

Prudential regulation traditionally focused on financial metrics such as capital adequacy, liquidity standards, proper risk management and efficient internal control systems.

⁵⁰⁰ Mwangi G, 'Preventing Bank Failure: An Assessment of the Risk Regulatory Framework for Banks in Kenya,' Unpublished LLM Thesis, Strathmore University, Nairobi, 2021, 1.

⁵⁰¹ Cranston R, *Principles of Banking Law*, 2nd ed, Oxford University Press, United Kingdom, 2002, 66.

⁵⁰² Cranston R, *Principles of Banking Law*, 67.

⁵⁰³ Cranston R, *Principles of Banking Law*, 68.

⁵⁰⁴ Cranston R, *Principles of Banking Law*, 68.

⁵⁰⁵ Cranston R, *Principles of Banking Law*, 68.

⁵⁰⁶ Cranston R, *Principles of Banking Law*, 69.

⁵⁰⁷ Cranston R, *Principles of Banking Law*, 71.

⁵⁰⁸ Cranston R, *Principles of Banking Law*, 80.

However, post-GFC prudential regulation is geared towards CG, more particularly, poor remuneration practices, and lack of accountability.⁵⁰⁹

Lax prudential regulation has been viewed by many as being responsible for crises around the world, particularly the GFC.⁵¹⁰ The importance of regulation came to be appreciated post-crisis, as fire extinguishing regulations were passed to prevent contagion. Micro and macro-prudential regulation gained global acceptance among regulators and supervisors.⁵¹¹

While macro-prudential regulation takes into account the overall stability of the whole financial system, micro-prudential regulation is concerned with the safety and soundness of individual institutions.⁵¹²

Micro-prudential regulation has three key components; Risk-Based Supervision (RBS), deposit insurance and Financial Consumer Protection (FCP).⁵¹³ RBS enables supervisors to allocate resources to banks with the highest risks or high-risk sectors within a single bank, as well as to assess the supervised entity's business model to identify any potential inherent risks in the business plan.⁵¹⁴

Additionally, RBS enables managers to evaluate each institution's financial health and rate its strengths in relation to its capacity to bear the risk associated with its operations.⁵¹⁵

⁵⁰⁹ Australian Prudential Regulatory Authority 'What is Prudential Regulation,'—< [What is prudential regulation? | APRA](#)> on 21st July 2022.

⁵¹⁰ Ekpu V, 'Micro-Prudential vs. Macro-Prudential Approaches to Regulation and Supervision,' Lecture Presented at a Regional Course on Advanced Banking Supervision and Financial Stability for members of the College of Supervisors of the West African Monetary Zone (CSWAMZ), Lagos, 2016, 5.

⁵¹¹ Ekpu V, 'Micro-Prudential vs. Macro-Prudential Approaches to Regulation and Supervision,' 7.

⁵¹² Ekpu V, 'Micro-Prudential vs. Macro-Prudential Approaches to Regulation and Supervision,' 7.

⁵¹³ Ekpu V, 'Micro-Prudential vs. Macro-Prudential Approaches to Regulation and Supervision,' 50.

⁵¹⁴ Ekpu V, 'Micro-Prudential vs. Macro-Prudential Approaches to Regulation and Supervision,' 50.

⁵¹⁵ Ekpu V, 'Micro-Prudential vs. Macro-Prudential Approaches to Regulation and Supervision,' 50.

As discussed in Chapter 3 and this case study, effective deposit insurance promotes public confidence and the stability of the financial system.⁵¹⁶

On the other hand, FCP entails empowering customers through financial education by offering both general and transactional information, simplifying the use of goods, and enhancing the quality of financial advice.⁵¹⁷

FCP also includes product regulation which encourages institutions to create safe and simple products, reducing the consumer's need to obtain costly financial advisory services.⁵¹⁸

Robust prudential regulation encompasses both preventive and protective measures. Preventive regulation entails taking steps to forestall crises by reducing the risk factors that affect banks.⁵¹⁹ Conversely, protective regulation entails providing support to banks once there is a threat of a crisis. In this case LOLR facilities offer immediate benefits but ultimately rescue operations may become necessary.⁵²⁰

Effective prudential regulation should be designed to prevent emerging problems rather than take action after they arise.⁵²¹ The wisdom of this preemptive approach is that it is less expensive to prevent a crisis or to mitigate its severity than to clean up after the fact.

4.7. Conclusion

Several factors have been enumerated as the cause of the failure of CBL including, social media rumors that precipitated a bank run, the bank's failure to adequately respond to

⁵¹⁶ Ekpu V, 'Micro-Prudential vs. Macro-Prudential Approaches to Regulation and Supervision,' 50.

⁵¹⁷ Ekpu V, 'Micro-Prudential vs. Macro-Prudential Approaches to Regulation and Supervision,' 51.

⁵¹⁸ Ekpu V, 'Micro-Prudential vs. Macro-Prudential Approaches to Regulation and Supervision,' 51.

⁵¹⁹ Cranston R, *Principles of Banking Law*, 82.

⁵²⁰ Cranston R, *Principles of Banking Law*, 82.

⁵²¹ Australian Prudential Regulatory Authority 'What is Prudential Regulation,'—< [What is prudential regulation? | APRA](#)> on 21st July 2022.

distressed consumer concerns and CBK ‘jumping the gun’ and placing the bank under receivership based on the rumors.⁵²²

What is less frequently discussed is the abysmal performance of the bank’s CG mechanism that inevitably led to its collapse.⁵²³ This is evidence of the need to probe the same.

As was the case in the GFC, the crisis was not orchestrated by the aberrant schemes of rogue individuals but by highly acclaimed financial corporations engaging in predatory lending and outright fraud.⁵²⁴ As illustrated by the case study, the collapse was occasioned by errant executives who defrauded the bank.⁵²⁵

With modern CG regulation being at its golden age, banks being compliant and boards being highly independent, consisting of directors with stellar credentials, it is curious that poor CG still contributes to corporate collapse.⁵²⁶

Moreover, William Donaldson’s words reign true... “A ‘check the box’ approach to good corporate governance will not inspire a true sense of ethical obligation. It could merely lead to an array of inhibiting ‘politically correct’ dictates...”⁵²⁷ CBL not only adhered to regulations in some instances like the minimum capital requirements, it exceeded them.⁵²⁸

⁵²² Ogutu O, ‘Influence of Social Media on Public Relations Practice in Kenya Banking Industry: A Case of Chase Bank Kenya,’ 4(9) *International Journal of Innovative Science and Research Technology*, 2019, 449.

⁵²³ Ogutu O, ‘Influence of Social Media on Public Relations Practice in Kenya Banking Industry: A Case of Chase Bank Kenya,’ 449.

⁵²⁴ Fligstein N. & Roehrkasse A. ‘The Causes of Fraud in the Financial Crisis of 2007 to 2009: Evidence from the Mortgage-Backed Securities Industry,’ 620-621.

⁵²⁵ Business Daily Africa, ‘How Chase Bank Director Lent Himself Sh.7.9 Billion,’ Business Daily Africa, 7th April 2016, —< [How Chase Bank director lent himself Sh7.9 billion - Business Daily \(businessdailyafrica.com\)](#)> on 26th July 2022.

⁵²⁶ Pargendler M, ‘The Corporate Governance Obsession,’ 383.

⁵²⁷ Monks R & Minow N, *Corporate Governance*, xxiv.

⁵²⁸ The East African, ‘Kenya Government Among Losers in Chase Bank Fall After Pumping in \$2m for SMEs,’ The East African, 9th April 2016, —< [Kenya govt among losers in Chase Bank fall after pumping in \\$2m for SMEs - The East African](#)> on 21st July 2022.

The case study further revealed the regulator's failure in their supervisory mandate which allowed the unviable bank to continue business despite the glaringly obvious CG issues that fostered insider fraud, theft and money laundering to go unchecked.⁵²⁹

The regulator is crucial in maintaining financial stability and correcting market failures. Efficient regulation brings about wealth creation, benefiting both banks and the public interest.⁵³⁰ For regulation to function well, the regulators must be independent, coordinate amongst themselves and be willing to enforce their mandate.

More than the law on paper, enforcement is key to effective CG.⁵³¹ They are intrinsically linked as they determine a bank's commitment to its stakeholders. A poor enforcement environment leads to poor CG mechanisms.⁵³² Regulation must be backed by a credible threat of enforcement.⁵³³



⁵²⁹ Kiplagat S, 'Seven Face More Charges in Chase Bank Fraud Suit,' Business Daily Africa, 18th February 2021, —<[Seven face more charges in Chase Bank fraud suit - Business Daily \(businessdailyafrica.com\)](https://www.businessdailyafrica.com)> on 17th August 2022.

⁵³⁰ Goo S.H, 'An Economic Efficiency Approach to Reforming Corporate Governance: The Case of Multiple Stakeholder Boards,' 390.

⁵³¹ Berglof E & Claessens S, 'Corporate Governance and Enforcement,' World Bank Policy Research Paper Number 3409, 2004, 1 —< [Microsoft Word - Enforcement and Corporate Governance final0909.doc \(ssrn.com\)](https://ssrn.com/abstract=10909)> on 14th October 2022.

⁵³² Berglof E & Claessens S, 'Corporate Governance and Enforcement,' 1.

⁵³³ Clarke B, 'Duty of Care Skill and Diligence- Form Warm Baths to Hot Water,' 160.

5. CHAPTER FIVE: RESEARCH FINDINGS, CONCLUSIONS AND RECOMMENDATIONS

5.1. Introduction

This chapter entails a summary of my study findings and concludes by giving recommendations on the way forward on CG of banking institutions in Kenya.

5.2. Findings on the framework of corporate governance of banking institutions in Kenya

Generally, Kenya being a commonwealth country adopts the Anglo-American model of CG, the bedrock of which is a general assembly of shareholders, a BOD and executive management.⁵³⁴ Furthermore, the model is primarily shareholder centric.

As elucidated throughout my study, banks are unique and their failure has a significant societal cost, therefore, they require a different approach to governance.⁵³⁵ For example, the failure of the UK's Northern Rock sent shocks throughout the market and was a lesson to all participants of how quickly a problem in a small bank can spread to larger institutions and have serious economic repercussions.⁵³⁶

Post-GFC, the shareholder-centric nature of the Anglo-American model was argued to be inadequate for bank governance.⁵³⁷ This led to global regulatory reforms to address the stakeholder concern, the same has however been on a principle basis.

The Anglo-American model is considered the superior of the three models analysed, due to its longevity, certainty and predictability.⁵³⁸ However, the globalization of enterprise has sparked conversations towards convergence to a more stakeholder-centric model to

⁵³⁴ Ntim C, 'Defining Corporate Governance: Shareholder versus Stakeholder Models,' 1.

⁵³⁵ Hopt K 'Corporate Governance of Banks and Financial Institutions: Economic Theory, Supervisory Practice, Evidence and Policy,' 16.

⁵³⁶ Tomasic R, 'Corporate Governance Failure: The Role of Internal and External Gatekeepers in UK Banks and Financial Institutions,' 10(1) *International Journal for Enhanced Board Performance*, 2010, 4-5.

⁵³⁷ Hopt K 'Corporate Governance of Banks and Financial Institutions: Economic Theory, Supervisory Practice, Evidence and Policy,' 13.

⁵³⁸ Onuk M, 'Corporate Governance Models and the Possibility of Future Convergence,' 31.

resolve the stakeholder conflict. Incorporating a hybrid model that inscribes stakeholder concerns within it may be the key to curbing future bank failures.⁵³⁹

5.3. Findings on the legislative and regulatory framework of bank governance in Kenya

Bank governance in Kenya is regulated by its own set of laws and regulations. Primarily, the Banking Act Chapter 488 and the Prudential Guidelines for Institutions Licensed under the Banking Act, 2013.

There are additional legislations and regulations incidental to these including; the Constitution of Kenya 2010; the Central Bank of Kenya Act (CAP 491); the Kenya Deposit Insurance Act, No. 10 of 2012; the Companies Act, No. 17 of 2015; the Capital Markets Act (Cap 485A) and the Code of Corporate Governance Practices for Issuers of Securities to the Public, 2015.

The legislative and regulatory framework is versatile because their jurisdiction extends beyond shareholders to include other key stakeholders such as; depositors, creditors, employees and regulators.⁵⁴⁰

Their mandate extends beyond profit maximization for shareholders and entails promoting safety and soundness in the financial system and promoting economic growth.⁵⁴¹

The regulation appreciates stakeholder protection however, the same remains on a principle basis. Furthermore, the law provides for bank stakeholders through the LOLR and deposit insurance mechanisms. These have however been criticized for increasing moral hazard by turning private issues into public policy concerns as it shifts the burden of risk from the bank to the government.⁵⁴²

⁵³⁹ Onuk M, 'Corporate Governance Models and the Possibility of Future Convergence,' 31.

⁵⁴⁰ Abata M, Tijani O & Odutola O, 'Corporate Governance Practices in Holding and Non-Holding Operating Structured Banks in Nigeria,' 58.

⁵⁴¹ Min D, 'Balancing the Governance of Financial Institutions,' 744-746.

⁵⁴² Djelic M & Bothello J, 'Limited Liability and its Moral Hazard Implications: The Systemic Inscription of Instability in Contemporary Capitalism, 596.

As stated previously, adopting a hybrid model that etches stakeholder concerns in the legal and regulatory framework may avert future failures.⁵⁴³

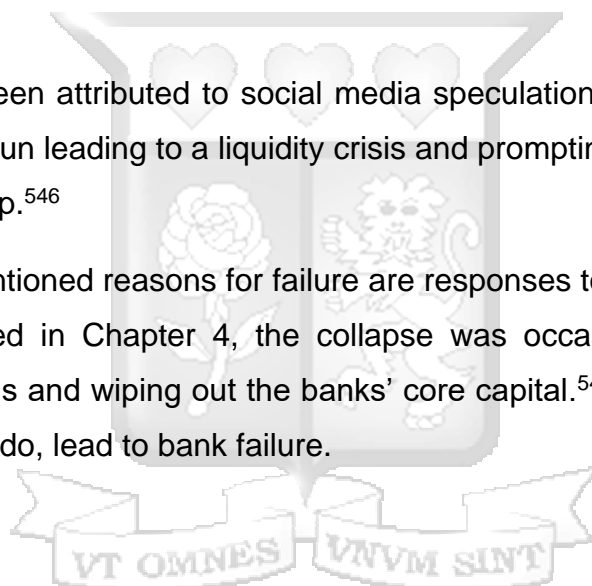
5.4. Findings on the role of corporate governance in the failure of Chase Bank Limited

The failure of the bank has been attributed to several factors. Before the collapse, insiders alleged that intense personal rivalries and power plays between bank executives came to a head with a whistleblower report revealing the reckless insider lending.⁵⁴⁴

It has further been established, that the bank auditor's qualified opinion, unearthed the insider lending that was disguised as a mode of Islamic banking as described in Chapter 4.⁵⁴⁵

The failure has also been attributed to social media speculation which caused a panic and an eventual bank run leading to a liquidity crisis and prompting the CBK to place the bank under receivership.⁵⁴⁶

However, the aforementioned reasons for failure are responses to a larger issue, that is, poor CG. As discussed in Chapter 4, the collapse was occasioned by errant bank executives looting funds and wiping out the banks' core capital.⁵⁴⁷ This shows that poor CG practices can, and do, lead to bank failure.



⁵⁴³ Onuk M, 'Corporate Governance Models and the Possibility of Future Convergence,' 31.

⁵⁴⁴ Daily Nation, 'How Whistleblower's Secret Note to Investors Brought Chase Bank to its Knees,' Daily Nation, 9th April 2016, —< [How whistleblower's secret note to investors brought Chase Bank to its knees | Nation](#)> on 23rd August 2022.

⁵⁴⁵ Business Daily Africa, 'Ousted Chase Bank Chairman Was Architect of Sh11bn Loot,' Business Daily Africa, 5th May 2016, —< [Ousted Chase Bank chairman was architect of Sh11bn loot - Business Daily \(businessdailyafrica.com\)](#)> on 23rd August 2022.

⁵⁴⁶ Daily Nation, 'How Whistleblower's Secret Note to Investors Brought Chase Bank to its Knees,' Daily Nation, 9th April 2016, —< [How whistleblower's secret note to investors brought Chase Bank to its knees | Nation](#)> on 23rd August 2022.

⁵⁴⁷ Business Daily Africa, 'Ousted Chase Bank Chairman Was Architect of Sh11bn Loot,' Business Daily Africa, 5th May 2016, —< [Ousted Chase Bank chairman was architect of Sh11bn loot - Business Daily \(businessdailyafrica.com\)](#)> on 23rd August 2022.

Additionally, the regulator's failure in their supervisory mandate also contributed to the bank's collapse.⁵⁴⁸ For regulation to be effective it must be backed by a credible threat of enforcement.⁵⁴⁹

5.5. Conclusion and Recommendations

Undoubtedly, CG and external regulation needs to be coordinated but the main responsibility for effective regulation of banks lay within the institutions themselves.⁵⁵⁰

Internal regulation through sound CG practices and processes needs to be backed by effective external regulatory mechanisms.

i. Gatekeeper accountability

Gatekeepers are crucial to effective CG both inside and outside the corporation.⁵⁵¹ Internal gatekeepers include; the board, the CEO, the legal team (which could also be externally outsourced), as well as the general meeting, while external gatekeepers include; auditors, credit rating agencies and regulators.⁵⁵²

In the case of CBL, both internal and external gatekeepers failed. The internal gatekeepers were at odds with each other while passing off the appearance of strong CG and complying with the regulatory standards of 'best practice while the external gatekeepers failed in their supervisory mandate which gave way to fraudulent activities within the bank.⁵⁵³

⁵⁴⁸ Business Daily Africa, 'Ousted Chase Bank Chairman Was Architect of Sh11bn Loot,' Business Daily Africa, 5th May 2016, —< [Ousted Chase Bank chairman was architect of Sh11bn loot - Business Daily \(businessdailyafrica.com\)](#)> on 26th July 2022.

⁵⁴⁹ Clarke B, 'Duty of Care Skill and Diligence- Form Warm Baths to Hot Water,' 160.

⁵⁵⁰ Tomasic R, 'Corporate Governance Failure: The Role of Internal and External Gatekeepers in UK Banks and Financial Institutions,' 1.

⁵⁵¹ Tomasic R, 'Corporate Governance Failure: The Role of Internal and External Gatekeepers in UK Banks and Financial Institutions,' 3.

⁵⁵² Tomasic R, 'Corporate Governance Failure: The Role of Internal and External Gatekeepers in UK Banks and Financial Institutions,' 3.

⁵⁵³ The East African, 'Court Case Lifts Lid off Chase Bank's Shady Deals,' The East African, 17th April 2017—< [Court case lifts lid off Chase Bank's shady deals - The East African](#)> on 18th October 2022.

Furthermore, post-collapse, the gatekeepers engaged in a blame game with none taking accountability. Moreover, the regulator, that is, the CMA issued fines to bank executives and the bank's auditor Deloitte and Touché over their alleged role in the issuance of the 10 Billion Kenya Shilling Bond six years after the fact as discussed in Chapter 3.⁵⁵⁴

The lag time between the offense and the punishment is disconcerting and deficient. For a well-rounded regulatory regime, gatekeepers must be held accountable in a timely fashion for their actions and/or inactions that contribute to banks' failures.⁵⁵⁵

ii. Regulatory Independence

Regulators are market referees that help ensure access to quality public services, facilitate the management of infrastructure and enhance market efficacy.⁵⁵⁶ As referees, they must always balance the competing interests of different actors in the market through good governance.

"Independence does not mean that regulators are anonymous, silent, above, over or beyond the system."⁵⁵⁷ They are key actors in the policy arena who must interact with other actors in policy development.

As stated in chapter one, regulatory independence is linked to regulatory efficacy.⁵⁵⁸ The regulator's role can be influenced by the government, politicians, or outside interest

⁵⁵⁴ Ndege A, 'CMA Fines ex-Chase Bank Bosses, Deloitte over Sh10bn Loan,' Business Daily Africa, 3rd August 2022, —< [CMA fines ex-Chase Bank bosses, Deloitte over Sh10bn loan | Business Daily \(businessdailyafrica.com\)](http://www.businessdailyafrica.com/news/cma-fines-ex-chase-bank-bosses-deloitte-over-sh10bn-loan)> on 9th September 2022.

⁵⁵⁵ Tomasic R, 'Corporate Governance Failure: The Role of Internal and External Gatekeepers in UK Banks and Financial Institutions,' 13.

⁵⁵⁶ OECD, 'The Governance of Regulators: Being an Independent Regulator,' 2016, 3 —<<http://dx.doi.org/10.1787/9789264255401-en>> on 21st October 2022.

⁵⁵⁷ OECD, 'The Governance of Regulators: Being an Independent Regulator,' 2016, 16 —<<http://dx.doi.org/10.1787/9789264255401-en>> on 21st October 2022.

⁵⁵⁸ Coen D and Salter J-P, 'Multilevel Regulatory Governance: Establishing Bank-Regulator Relationships at the European Banking Authority,' 117.

groups.⁵⁵⁹ Independence cannot however come at the price of accountability but regulators must operate in a well-functioning and transparent governance ecosystem.

In Kenya, the Ministry of Finance (Treasury) is the most coveted because it is responsible for the most prestigious and highest-paying state corporations, such as the CBK, the CMA the KDIC among others.⁵⁶⁰ There is, therefore, significant political influence stifling the independence of these corporations.

“It is important that regulatory decisions and functions are conducted with the utmost integrity to ensure confidence in the regulatory regime.”⁵⁶¹ Establishing independence lets regulated entities know the commitment of the government to foster an environment of objective and transparent administration and enforcement of regulation.⁵⁶²

Furthermore, a lack of political influence is likely to foster consistent and predictable decision-making, alleviate potential conflicts of interest and develop reliable regulatory expertise.⁵⁶³

iii. Regulatory Coordination



⁵⁵⁹ OECD, ‘Independence of Regulators and Protection Against Undue Influence,’ —< [Independence of Regulators and Protection against Undue Influence - OECD](#)> on 21st October 2022.

⁵⁶⁰ Gakeri J, ‘Financial Services Regulatory Modernization in East Africa: The Search for a New Paradigm for Kenya,’ 1(16) *International Journal of Humanities and Social Sciences*, 2011, 171.

⁵⁶¹ OECD ‘The Governance of Regulators: Creating a Culture of Independence: Practical Guidance Against Undue Influence,’ 4, —< [Culture-of-Independence-Eng-web.pdf \(oecd.org\)](#)> on 21st October 2022.

⁵⁶² OECD ‘The Governance of Regulators: Creating a Culture of Independence: Practical Guidance Against Undue Influence,’ 6, —< [Culture-of-Independence-Eng-web.pdf \(oecd.org\)](#)> on 21st October 2022.

⁵⁶³ OECD ‘The Governance of Regulators: Creating a Culture of Independence: Practical Guidance Against Undue Influence,’ 6, —< [Culture-of-Independence-Eng-web.pdf \(oecd.org\)](#)> on 21st October 2022.

Kenya's regulatory model is a medley of institutional and functional regulation.⁵⁶⁴ Private commercial banks are supervised and regulated by the CBK which regulates financial institutions and the CMA which regulates the securities market.⁵⁶⁵

The current regulatory arrangement is a result of piecemeal reform and gradual changes as opposed to deliberate planning.⁵⁶⁶ Detractors of this fragmented regulatory approach posit that multiple regulatory agencies are wrought with gaps, duplication and overlap of mandates, contradictory regulations and cost ineffectiveness.⁵⁶⁷ Furthermore, the regulatory framework is complex, confusing and ineffective.

There has been a shift in many jurisdictions towards a more unified regulatory approach.⁵⁶⁸ For example, before it adopted the Twin Peak system, UK's financial service sector was described as an "alphabet soup" of regulators that led to conflicts of interest, confusion and damage.⁵⁶⁹

As described in chapter one, the twin peak system denotes two independent bodies, one charged with safety and soundness and the other with preventing market misconduct and consumer protection in the financial services industry.⁵⁷⁰ Regulatory architecture however must be coupled with enforcement.⁵⁷¹

⁵⁶⁴ Gakeri J, 'Financial Services Regulatory Modernization in East Africa: The Search for a New Paradigm for Kenya,' 165.

⁵⁶⁵ Gakeri J, 'Financial Services Regulatory Modernization in East Africa: The Search for a New Paradigm for Kenya,' 166.

⁵⁶⁶ Gakeri J, 'Financial Services Regulatory Modernization in East Africa: The Search for a New Paradigm for Kenya,' 166.

⁵⁶⁷ Gakeri J, 'Financial Services Regulatory Modernization in East Africa: The Search for a New Paradigm for Kenya,' 167.

⁵⁶⁸ Gakeri J, 'Financial Services Regulatory Modernization in East Africa: The Search for a New Paradigm for Kenya,' 161.

⁵⁶⁹ Schmulow A. 'Financial Regulatory Governance in South Africa: The Move Toward Twin Peaks,' 394.

⁵⁷⁰ Schmulow A. 'Financial Regulatory Governance in South Africa: The Move Toward Twin Peaks,' 393.

⁵⁷¹ Schmulow A. 'Financial Regulatory Governance in South Africa: The Move Toward Twin Peaks,' 401.

Much of the current conversation about regulatory cooperation in contemporary literature, is focused on international regulatory coordination. In the aftermath of the GFC and the recent COVID-19 pandemic that brought the global health, economic and governance systems to a grinding halt, the need for a paradigm shift was made evident.⁵⁷²

The Organisation for Economic Cooperation and Development (OECD) published the OECD Best Practice Principles for Regulatory Policy: International Regulatory Coordination in 2021 to provide practical guidance to policymakers and civil servants in adapting frameworks to the interconnected reality.⁵⁷³

The purpose of these guidelines is to bridge the gap that domestic regulatory frameworks fail to meet due to increasing cross-boundary policy concerns.⁵⁷⁴ National jurisdictional boundaries constrain the growing transboundary policy changes.

The need for a more unified and integrated regulatory approach in Kenya cannot be overstated.⁵⁷⁵ A system that would be less duplicative, more efficient and responsive to national and international market changes.

However, the current regulatory shortfalls can be cured by enhancing the quality of enforcement and compliance, information sharing and coordination between the current regulatory bodies and strengthening the regulatory rules to do away with duplicity and conflicts of interest.⁵⁷⁶

iv. Enforcement

⁵⁷² OECD, 'Best Practice Principles for Regulatory Policy: International Regulatory Coordination,' 2021 —< [International Regulatory Co-operation | en | OECD](#) > on 25th October 2022.

⁵⁷³ OECD, 'Best Practice Principles for Regulatory Policy: International Regulatory Coordination,' 2021 —< [International Regulatory Co-operation | en | OECD](#) > on 25th October 2022.

⁵⁷⁴ OECD, 'Best Practice Principles for Regulatory Policy: International Regulatory Coordination,' 2021 —< [International Regulatory Co-operation | en | OECD](#) > on 25th October 2022.

⁵⁷⁵ Gakeri J, 'Financial Services Regulatory Modernization in East Africa: The Search for a New Paradigm for Kenya,' 172.

⁵⁷⁶ Gakeri J, 'Financial Services Regulatory Modernization in East Africa: The Search for a New Paradigm for Kenya,' 172.

Ideally, enforcement is meant to be a persuasive deterrent to future crimes.⁵⁷⁷ It is often thought to entail the imposition of formal legal sanctions such as; monetary damages, fines, or imprisonment. In the context of financial regulation, enforcement tools are supplemented with a wider range of informal sanctions for example; warning letters and suasions, increased regulatory scrutiny, business restrictions, and suspension or revocation of licenses.⁵⁷⁸

Where enforcement is low or sanctions imposed are not meaningful, regulation will unlikely be a credible deterring factor.⁵⁷⁹ This inadvertently affects stakeholder protection, prevention of financial crimes and financial stability.

Enforcement can either be public, that is; initiated by state organs/ regulatory authorities, private; initiated by plaintiffs such as investors or counterparties suing under private rights of action,⁵⁸⁰ and market-based or reputational sanctions which have been exacerbated by social media as seen in the case of CBL.⁵⁸¹

Enforcement is key to effective CG. When the enforcement environment is weak CG mechanisms are ineffective.⁵⁸² In developing countries such as Kenya, the intermingling of business and politics often prevents improvements in the general enforcement environment.

In developed economies, bottom-up approaches to improve enforcement are more effective than top-down efforts, meaning, private-sector efforts to enhance enforcement prove to be more effective than government-led efforts.⁵⁸³ However, the two are complementary.

⁵⁷⁷ Armour J, Awrey D, Davies P, Enriques L, Gordon J, Mayer C, Payne J, *Principles of Financial Regulation*, 1st ed, Oxford University Press, United Kingdom, 2016, 836.

⁵⁷⁸ Armour J *et al*, *Principles of Financial Regulation*, 836.

⁵⁷⁹ Armour J *et al*, *Principles of Financial Regulation*, 844.

⁵⁸⁰ Armour J *et al*, *Principles of Financial Regulation*, 844.

⁵⁸¹ Armour J *et al*, *Principles of Financial Regulation*, 847.

⁵⁸² Berglof E & Claessens S, 'Corporate Governance and Enforcement,' 1.

⁵⁸³ Berglof E & Claessens S, 'Corporate Governance and Enforcement,' 41.

Enforcement is crucial and complementary to effective supervision.⁵⁸⁴ Effective supervision relies on the credible threat of enforcement and successful enforcement depends on the existence of expert and well-informed regulatory personnel who are independent and willing to employ the mandate handed to them.⁵⁸⁵

Success in curbing future bank failures will be based on the regulator's ability to foresee the unforeseeable and regulate accordingly and their willingness to enforce already existing laws.⁵⁸⁶

5.6. Conclusion

Banks' governance came under scrutiny post-GFC when weaknesses in governance, such as the misconduct of bank executives and excessive risk-taking were identified as some of the root causes of the crisis, leading to mass regulatory reforms in a bid to strengthen the sound and prudent management of banks and ensure that bank strategies do not merely serve shareholder-concerns.⁵⁸⁷

The Kenyan regulatory framework mirrors the global effort to include stakeholder interests in bank governance. However, the same is on a principle basis which, as stated in Chapter 3, works better in developed nations that have well-established capital markets and judicial systems as opposed to developing nations that are plagued by corruption, poor regulatory independence and coordination.⁵⁸⁸

A well-established CG structure provides the necessary checks and balances, counters excessive risk-taking and ensures sustainable decision-making.⁵⁸⁹ Moreover, the bank's

⁵⁸⁴ Armour J *et al*, *Principles of Financial Regulation*, 850.

⁵⁸⁵ Armour J *et al*, *Principles of Financial Regulation*, 850.

⁵⁸⁶ Schmulow A. 'Financial Regulatory Governance in South Africa: The Move Toward the Twin Peaks,' 401.

⁵⁸⁷ Elderson F, 'Supervising Banks' Governance: Structure, Behavior and Culture,' European Central Bank, 11th June 2022 –<[Supervising banks' governance: structure, behaviour and culture \(europa.eu\)](https://www.ecb.europa.eu/press/pr/date/2022/html/ecb.pr220611_1_en.htm)> on 15 March 2023.

⁵⁸⁸ Ordu L, 'The Enforcement of Corporate Governance Practices on Nigerian Banks,' 42-43

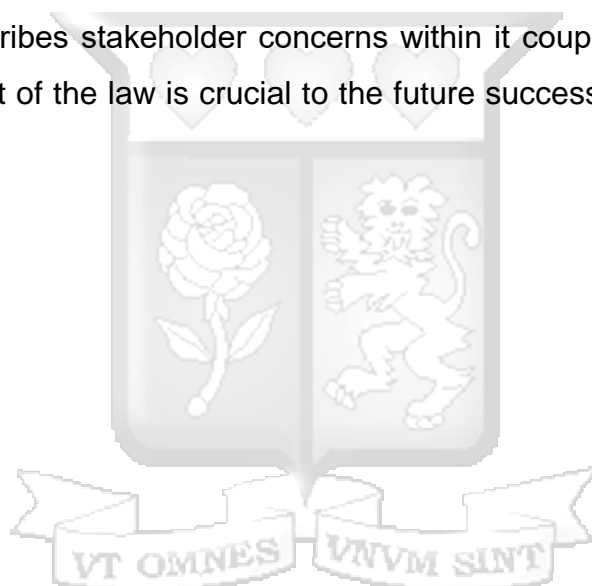
⁵⁸⁹ Elderson F, 'Supervising Banks' Governance: Structure, Behavior and Culture,' European Central Bank, 11th June 2022 –<[Supervising banks' governance: structure, behaviour and culture \(europa.eu\)](https://www.ecb.europa.eu/press/pr/date/2022/html/ecb.pr220611_1_en.htm)> on 15 March 2023.

board and management control the risk appetite, formulate and implement the bank's strategies and monitor, identify and mitigate potential problems.

Nevertheless, a bank can have a robust governance framework with all the necessary risk control mechanisms and be mired in a scandal, whereby, the internal corporate behavior and culture foster misconduct.⁵⁹⁰ Such was the case for CBL.

Fraudulent bank executives do not simply defeat regulatory controls; they suborn them, turning them into allies.⁵⁹¹ CBL had blatantly obvious CG issues, was involved in criminal behavior and had gaping accounting discrepancies, yet neither one of the gatekeepers was seemingly able to deduce the same until the bank was placed under receivership.⁵⁹²

A CG regime that inscribes stakeholder concerns within it coupled with the regulator's unfettered enforcement of the law is crucial to the future success of banking institutions in Kenya.



⁵⁹⁰ Elderson F, 'Supervising Banks' Governance: Structure, Behavior and Culture,' European Central Bank, 11th June 2022 –<[Supervising banks' governance: structure, behaviour and culture \(europa.eu\)](#)> on 15 March 2023.

⁵⁹¹ Black W, *The Best Way to Rob a Bank is to Own One: How Executives and Politicians Looted the S&L Industry*, University of Texas Press, Austin, 2005, XIV.

⁵⁹² The East African, 'Court Case Lifts Lid off Chase Bank's Shady Deals,' The East African, 17th April 2017—<[Court case lifts lid off Chase Bank's shady deals - The East African](#)> on 18th October 2022.

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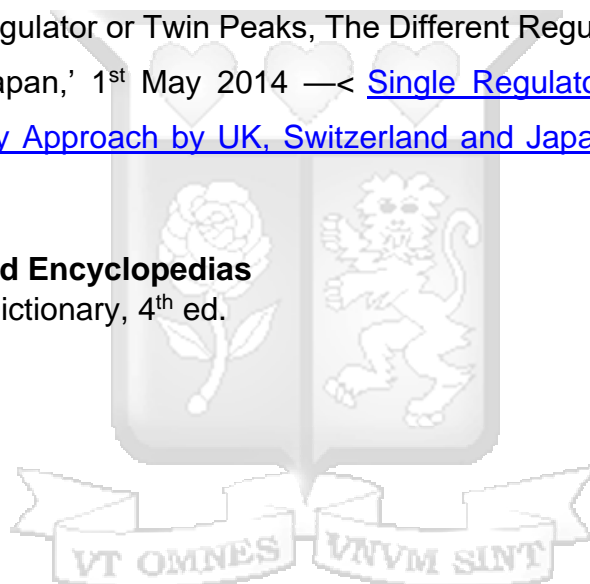
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6.9. Dictionaries and Encyclopedias

1. Merriam-Webster Dictionary, 4th ed.



7. APPENDICES

Appendix A: Similarity Report

LLM Thesis - Z			
ORIGINALITY REPORT			
14%	13%	5%	6%
SIMILARITY INDEX	INTERNET SOURCES	PUBLICATIONS	STUDENT PAPERS
PRIMARY SOURCES			
1	su-plus.strathmore.edu Internet Source	2%	
2	www.businessdailyafrica.com Internet Source	1%	
3	LexisNexis Publication	1%	
4	Submitted to Strathmore University Student Paper	<1%	
5	erepository.uonbi.ac.ke Internet Source	<1%	
6	www.microfinancegateway.org Internet Source	<1%	
7	kenyalaw.org Internet Source	<1%	
8	kdic.go.ke Internet Source	<1%	
9	link.springer.com Internet Source	<1%	

Appendix B: Ethical Clearance Confirmation



14th September 2022

Ms Arina Grace,
grace.arina@strathmore.edu

Dear Ms Arina,

RE: Analysis of the Corporate Governance Framework of Banking Institutions in Kenya

This is to inform you that SU-ISERC has reviewed and **approved** your above **SU- master's** research proposal. Your application reference number is **SU-ISERC1485/22**. The approval period is from **14th September 2022 to 13th September 2023**.

This approval is subject to compliance with the following requirements:

- i. Only approved documents including (informed consents, study instruments, MTA) will be used
- ii. All changes including (amendments, deviations, and violations) are submitted for review and approval by SU-ISERC.
- iii. Death and life-threatening problems and serious adverse events or unexpected adverse events whether related or unrelated to the study must be reported to SU-ISERC within 48 hours of notification
- iv. Any changes, anticipated or otherwise that may increase the risks or affected safety or welfare of study participants and others or affect the integrity of the research must be reported to SU-ISERC within 48 hours
- v. Clearance for export of biological specimens must be obtained from relevant institutions.
- vi. Submission of a request for renewal of approval at least 60 days prior to expiry of the approval period. Attach a comprehensive progress report to support the renewal.
- vii. Submission of an executive summary report within 90 days upon completion of the study to SU-ISERC.

Prior to commencing your study, you will be expected to obtain a research license from National Commission for Science, Technology, and Innovation (NACOSTI) <https://research-portal.nacosti.go.ke/> and obtain other clearances needed.

Yours sincerely,

for: **Dr Ben Ngoye,**
Secretary; SU-ISERC

Cc: Prof Fred Were,
Chairperson; SU-ISERC

