



**BACHELOR OF FINANCIAL SERVICES**  
**END OF SEMESTER EXAMS**  
**BFS 2201: REGULATION OF FINANCIAL SERVICES**

**Date:** Friday, 14<sup>th</sup> January 2022

**Time:** 2 hours

**INSTRUCTION:**

1. Question One is compulsory
2. Choose two questions out of four from questions two to five

**QUESTION ONE (30 Marks)**

- (a) Discuss FIVE main objectives of regulating financial services (10 Marks)
- (b) Assume that you work for the Central Bank, in the banking supervision department. You obtain the following data about 5 banks.:

Metric	Statutory	A	B	C	D	E
Core Capital (sh.b)	1.00	4.00	5.00	10.00	3.00	0.90
Supplementary Capital (sh.b)		8.00	6.00	8.00	3.00	4.00
Total Capital (sh.b)		12.00	11.00	18.00	6.00	4.90
Total Risk-Weighted Assets (sh.b)		50.00	40.00	45.00	30.00	20.00
Total Deposits (sh.b)		30.00	45.00	50.00	40.00	35.00
Core capital/Total Deposits	8.00%	13.33%	11.11%	20.00%	7.50%	2.57%
Core capital/Total Risk Weighted Assets	10.50%	8.00%	12.50%	22.22%	10.00%	4.50%
Total Capital/Total Risk Weighted Assets	14.50%	24.00%	27.50%	40.00%	20.00%	24.50%
Liquidity ratio	20.00%	18.00%	22.00%	25.00%	22.00%	23.00%

Explain the meaning of the following regulatory metrics and the implication of noncompliance by the relevant bank:

- |   |           |
|---|-----------|
| (i) Core capital                              | (2 Marks) |
| (ii) Core capital/Total Deposits              | (2 Marks) |
| (iii) Core capital/Total Risk-Weighted Assets | (2 Marks) |
| (iv) Total Capital/Total Risk-Weighted Assets | (2 Marks) |
| (v) Liquidity Ratio                           | (2 Marks) |

(c) The Insurance Regulatory Authority issues prudence guidelines as part of the regulation of the insurance sector in Kenya. The guidelines are based on the philosophy of the Solvency II regulatory framework.

**Required**

Briefly explain Solvency II and the Three Pillars (10 Marks)

**QUESTION TWO (20 Marks)**

(a) Banks, insurance companies and SACCOs have attempted to minimize state regulation by setting up individual bodies such as the Kenya Association of Banks (KAB), Association of Kenya Insurance (AKI) and Kenya Union of Savings and Credit Unions (KUSCO).

Briefly explain FIVE roles of such bodies in promoting self-regulation (5 Marks)

(b) Explain FIVE ways upon which RegTech aids financial institutions meet regulatory compliance (5 Marks)

(c) Due to the role played by investment firms, regulators are keen to ensure that investors do not lose their money. Discuss FIVE ways in which the Capital Markets Authority facilitates the regulation of investment. (5 Marks)

(d) Due to the wider acceptance of Islamic Finance in banking, insurance, investment and other related areas, the majority of regulators are members of the Islamic Financial Services Board (IFSB). The IFSB serves as an international standard-setting body of regulatory and supervisory agencies that promotes the soundness and stability of the Islamic financial services industry, which includes banking, capital market, and insurance.

Discuss FIVE roles of IFSB in the regulation of Islamic Finance: (5 Marks)

**QUESTION THREE (20 Marks)**

(a) Explain briefly the sector-specific rationale of regulating

(i) Banks (2 Marks)

(ii) Insurance companies (2 Marks)

(iii) Pension Funds (2 Marks)

(b) Discuss EIGHT ways in which Investment firms are regulated (8 Marks)

(c) Using suitable examples, discuss THREE challenges that regulators like Capital Markets Authority face when regulating capital markets (6 Marks)

**QUESTION FOUR (20 Marks)**

(a) Compare and contrast the regulation of the following:

(i) Banks and Microfinance banks (4 Marks)

(ii) Banks and deposit-taking SACCOs (4 Marks)

(b) Fintech is the technology that supports financial services. Highlight SIX laws and regulations that apply to fintechs in Kenya. (6 Marks)

(c) Discuss THREE reasons why regulators like Central Bank in Kenya are facing challenges in regulating digital currencies such as the cryptos. (6 Marks)

**QUESTION FIVE (20 Marks)**

(a) One of the main reasons why financial services are regulated is to avoid market failure. Explain what is market failure and Five factors that cause market failure (5 Marks)

(b) Despite the benefits of regulating financial services, the costs can be significantly higher. By 2008 it was estimated that more than \$181 billion has been spent by financial services in compliance, which are mainly operational costs and opportunity costs.

Highlight FIVE components of operational costs (5 Marks)

(c) Discuss the following problems in financial services and how regulators are working to minimize them:

(i) Financial Crimes (3 Marks)

(ii) Money Laundering (4 Marks)

(iii) Cybercrimes and threats (3 Marks)