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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.

Caroline Apiyo Omayo

**Submitted in partial fulfilment of the requirements of the degree of Master of
Laws, at Strathmore University**

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Nairobi, Kenya

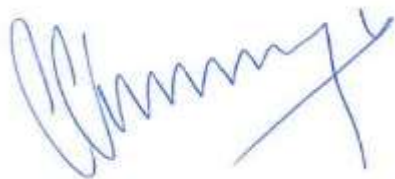
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DECLARATION

I declare that this work as not been previously submitted and approved for the award of a degree by this or any other University. To the best of my knowledge and belief, the thesis contains no material previously published or written by any other person except where due reference is made in the thesis itself.

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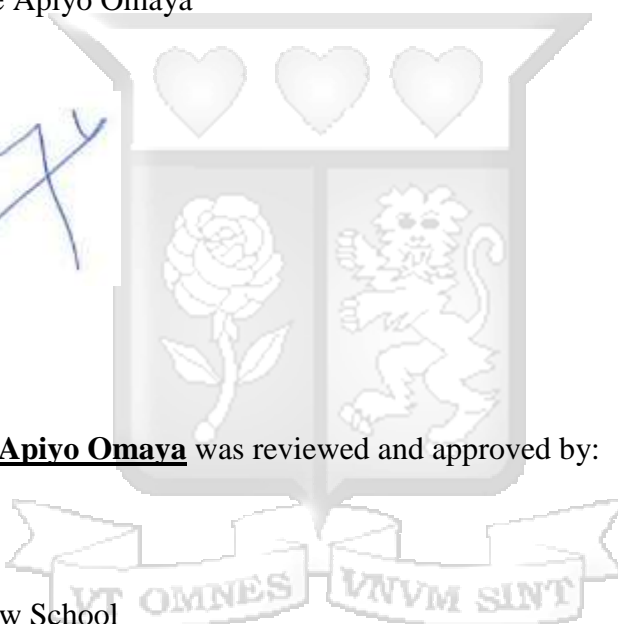
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ABSTRACT

Kenya witnessed systemic bank failures between the years 2015 and 2016. As a result, most depositors suffered financial losses given the fact that they could not have immediate access to their funds held in the bank accounts of the collapsed institutions. The failures have been partly attributed to failure by directors to efficiently carry out their duties.

The primary legislation regulating companies in Kenya, the Companies Act, Act No 17 of 2015 (CA), stipulates that the general duties are owed by directors to the company. Directors' therefore owe their duties to the owners of the company that is, the shareholders. There appears to be no primary duty owed to other stakeholders and for purposes of this study no direct duty of care is owed to the depositors. This has led to questions arising on the adequacy of protection of depositors' interests as provided in our legislation in the event of systemic bank.

In an attempt to answer this question, this study examined the existing banking and corporate legal and regulatory framework to determine whether and to what extent depositors' interests are protected in the banking institutions in Kenya. Further, the study examined the applicable banking and corporate laws in the United Kingdom and the Republic of South Africa and has made recommendations on the best practices that can be borrowed and adopted within the Kenyan context. The study focused on the directors' duty to promote the success of the company whilst fostering the company business relationships with its customers, with the aim of recommending the broadening of section 143 (1) (c) of the CA when applied to banks; to include depositors as customers of banks as one of the ways of ensuring depositor protection; additionally, the study focused on the adequacy of the compensation mechanisms to depositors, as provided by the Kenya Deposit Insurance Corporation.

From the research findings, there is need for subsidiary legislation/guidelines to be introduced so as to help directors know how best they can balance the interest of shareholders (while promoting the success of the company) and the interests of depositors (as directors try to foster the company relationships with the customers). Further as depositors' interests are protected (given the special relationship they have with banks) there is need to have sufficient and timely compensation mechanisms to cater for their interests should a systemic bank failure occur.

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ABBREVIATIONS

- BA: Banking Act, chapter 488 of the Laws of Kenya.
- CA: Companies Act, Act No. 17 of 2015.
- CBK: Central Bank of Kenya.
- CMA: Capital Markets Authority.
- FCA: Financial Conduct Authority.
- FRC: Financial Reporting Council.
- FSC: Financial Services Council.
- FSCA: Financial Sector Conduct Authority.
- FSCS: Financial Services Compensation Scheme.
- FSRA: Financial Sector Regulation Act No. 9 of 2017 of South Africa.
- ICPSK: Institute of Certified Public Secretaries Kenya.
- IRA: Insurance Regulatory Authority.
- KDIA: Kenya Deposit Insurance Act.
- KDIC: Kenya Deposit Insurance Corporation.
- OECD: Organization for Economic Cooperation and Development.
- PA: Prudential Authority.
- PG: Prudential Guideline.
- PRA: Prudential Regulation Authority.
- SARB: South African Reserve Bank.



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To my family, mentors, friends and colleagues thank you for your prayers, support and encouragement as I undertook my studies and research.



DEDICATION

I dedicate this book to my family: to my husband Eric for believing in me and encouraging me to pursue my studies, to my sons Eann and Allan for being my source of motivation and for always praying for me to do well, to my parents I appreciate your prayers and encouragement.



LIST OF CASES

1. *Commissioner of Taxation v. English, Scottish and Australian Bank Ltd* (1920) AC 683 (PC), High Court of Australia.
2. *Foley v. Hill* [1848] 2HLC 28, 9ER 1002, The United Kingdom House of Lords.
3. *Foss v. Harbottle* [1843] 2 Hare 461, The United Kingdom Court of Chancery.
4. *Re Smith and Fawcett Ltd* (1942) ch304, Court of Appeal of England and Wales.
5. *Richardson and David Limited v Kenya Deposit Insurance Corporation & Another* [2015] eKLR.
6. *The Queen on the Application of People and Planet v. HM Treasury* [2009] EWHC 3020, The United Kingdom Queens Bench Division Administrative Court.



1. CHAPTER ONE: INTRODUCTION TO THE STUDY

1.1. Background

In the recent years, Kenya has witnessed bank systemic failures which have resulted in most depositors losing their funds. This was especially witnessed in the years 2015 and 2016 when Chase Bank Limited, Dubai Bank Limited and Imperial Bank Limited were placed under statutory management and/or under receivership due to alleged poor governance and malpractices by the boards of directors of these banks as well as poor enforcement of governance mechanisms from the Central Bank of Kenya-the banking regulator. Specifically, on 14th August 2015, the Central Bank of Kenya Limited (CBK) placed Dubai Bank Kenya Limited under receivership due to liquidity/cash flow deficiencies that exposed depositors to financial losses. The Kenya Deposit Insurance Corporation (KDIC) was appointed as the receiver.¹ Similarly, on 13th October 2015, the CBK placed Imperial Bank Limited under receivership due to unsound business practices and appointed the KDIC as the receiver.² Imperial Bank Limited had an estimated fifty three thousand (53,000) customers with deposits estimated at Kenya Shillings fifty eight billion (Kshs. 58 Billion) as at the time KDIC took over its operations in its capacity as the Receiver.³ Finally on 7th April 2016, the CBK placed Chase Bank Limited under receivership and appointed the KDIC as the receiver. The press release from CBK stated that its action was done in the interest of depositors, creditors and the public at large having been necessitated by unsafe banking practices carried out in the bank.⁴ The resultant action of these three receiverships has been ongoing lengthy litigations between the bank boards of directors and the regulators.⁵ In a bid to stop these receiverships and try and recoup their deposits, some depositors have gone to court to challenge the placing of the banks under receivership but have been unsuccessful in this attempt as the court held that it lacked the expertise of management of financial institutions.⁶

Amidst all these lengthy litigations, depositors' plight of loss of their funds is yet to be resolved fully. For example, at the time Chase Bank Limited was placed under receivership Kenya Shillings Seventy-Six Billion (Kshs. 76 Billion) was locked in deposits and the repayment to the depositors

¹ -<<https://www.centralbank.go.ke/images/docs/media/2015/KDICPRESSRELEASE.pdf>> on 29 June 2021.

² -<[https://www.centralbank.go.ke/images/docs/media/Press%20Releases/Press Release - Imperial Bank.pdf](https://www.centralbank.go.ke/images/docs/media/Press%20Releases/Press%20Release%20-%20Imperial%20Bank.pdf)> on 29th June 2021.

³ Gathaiya-Robert N, 'Analysis of Issues Affecting Collapsed Banks in Kenya from Year 2015 to 2016, *International Journal of Management & Business Studies*, (2017).

⁴ <[https://www.centralbank.go.ke/images/docs/MPC%20Press%20Releases/Press Release Chase Bank Limited April 7 2016.pdf](https://www.centralbank.go.ke/images/docs/MPC%20Press%20Releases/Press%20Release%20-%20Chase%20Bank%20Limited%20April%207%202016.pdf)> on 29 June 2021.

⁵ Namely the Central Bank of Kenya as the principal regulator in the banking sector and the Capital Markets Authority due to the fact that banks are listed companies.

⁶ *Richardson and David Limited v Kenya Deposit Insurance Corporation & Another* [2015]eKLR.

would be up to a maximum of 75% of the amounts in their accounts, which payment would be staggered over a period of three years.⁷ It is not clear if all depositors were paid and/or how much they were eventually paid. As a depositor, one cannot therefore sleep comfortable that their money is safe in the bank and that they would have immediate access to the same as and when they demand for it.

Whereas Part VIII of the Banking Act provides that a customer of an insolvent banking institution, may lodge a claim with the Deposit Protection Fund Board for payment of his funds, the Kenya Deposit Insurance Act previously capped the money payable at Kenya Shillings One Hundred Thousand (Kshs. 100,000/=).⁸ This was the case even when a depositor held more than one account as these will be treated as if they were one account.⁹ This limit has since been increased to Five Hundred Thousand (Kshs. 500,000/=) effective from 1st July 2020¹⁰ (which still leaves out many who have deposits above this limit). The amount provided may keep varying depending on who is issuing the orders. Therefore, in as much as the BA and the KDIA provide for some form of compensation to the depositors, the amount of the protected deposit appears to be subjective. There is therefore the need to ensure that there is full protection of the depositor's funds and that there are proper mechanisms for depositors to recover their funds in a timely manner should a bank collapse. This is important because banks rely on depositors' funds to run their business yet the depositors do not oversee the management and activities run by the board of directors' and the management staff of these institutions and neither do they have a say on how their funds are utilized.

The primary legislation governing the banking industry in Kenya is the Banking Act (Chapter 488) of the Laws of Kenya (BA), the Central Bank of Kenya Act (Chapter 491 of the Laws of Kenya) and the Central Bank of Kenya Prudential Guidelines 2013 (PG).¹¹ Since banks in Kenya carry out their businesses in the form of a companies,¹² the Companies Act, Act No 17 of 2015 (CA) applies to banks. Specifically, for this study, the CA provides that part of the director's duty is to promote the success of the company for the benefit of its members as a whole and in so doing, the director should have regard to 'the need to foster the company's business relationships with its customers among others'.¹³ If that is what the law provides, one is left to wonder why it is that when banks

⁷ 'Pain for Chase Bank depositors gets worse' Daily Nation, 15 January 2018 <<https://www.nation.co.ke/kenya/life-and-style/smart-company/pain-for-chase-bank-depositors-gets-even-worse--3212>> on 15 January 2018.

⁸ Section 28 (1), *The Kenya Deposit Insurance Act* (2012).

⁹ Section 28 (2), *The Kenya Deposit Insurance Act* (2012).

¹⁰ Remarks given by the then acting Cabinet Secretary for National Treasury Amb. Ukur Yatani during the launch of the enhanced Deposit Coverage Limit by Kenya Deposit Insurance Corporation on 1st October 2019.

¹¹ CBK/PG/02 Guidelines on Corporate Governance (2013).

¹² Section 2 (1), *Banking Act*, cap 488 of the Laws of Kenya (2012).

¹³ Section 143 (1)(c), *Companies Act* (2015).

fail, of the many stakeholders, it is the depositors who stand to lose a lot. Generally, directors play a critical role in promoting the objectives of the company. Within the banking sector, one such objective is for the directors to ensure financial stability by having adequate levels of capital at all times¹⁴. The regulator, Central Bank of Kenya, is empowered to issue guidelines to be adhered to by the bank directors so as to maintain stable and efficient banking and financial systems.¹⁵ Studies have shown that adoption of good principles of corporate governance by banking institutions may avoid systemic risks that lead to bank failures¹⁶. There is however little literature in Kenya which have explored the protection of depositors within the banking industry; such that in the event that a systemic risk occurs, there are proper safeguards in place to cushion depositors from losing their money. This research therefore examined existing legal and regulatory framework to understand to what extent it is adequate to protect depositors from losing their funds when banks fail. What then could be said to have gone wrong with regard to enforcement of the corporate governance mechanisms as laid out in the banking legislations and the provisions of the CA?

The Kenya Deposit Insurance Corporation (KDIC) was created pursuant to the provisions of the Kenya Deposit Insurance Act 2012 (KDIA) with a mandate of protection of depositors against loss of their insured deposits in the unlikely event of a failure of a member bank.¹⁷ Section 24 (1) makes it mandatory for all banks operating in the Republic of Kenya to be members of the KDIC. Since banking institutions use depositors' funds to run their business and earn a profit out of it, yet these depositors are not involved in the day to day running of the bank and neither do they make decisions on how and/or when their monies are used, there is a need for KDIC to ensure maximum protection of the depositors' funds held in the bank accounts.

When banking institutions fail and depositors do not receive their money, many depositors elect to go to court in a bid to recover their money because there are no guidelines in the sector with regard to the modalities of compensation by the KDIC. This process may take several years for the dispute to be resolved, and even so, the depositors are not guaranteed that at the end of the court process, they will receive the whole amount they had deposited in the failed banking intuitions. The recovery process should therefore be improved to ensure that depositors are given ample information about how the compensation process works and they are able to access their funds promptly.

¹⁴ Clause 2.2, CBK/PG/03 Guidelines on Corporate Governance (2013).

¹⁵ Section 33 (4), *Banking Act*, (cap 488) of the Laws of Kenya (2012).

¹⁶ Mallin-Christine A, *Corporate Governance*, 2ed, Oxford University Press, New York, 200, 63

¹⁷ Section 5 (1), *The Kenya Deposit Insurance Act* (2012).

One may say that depositors are compensated when banks fail, however, as I have highlighted above, there is a limit on how much compensation is paid. On its face, this compensation is good. However, the amount of compensation as provided by KDIC is not sufficient to protect the depositors in terms of losses they are likely to suffer in the event of a bank failure. It is against this background that this study examined the duty owed to depositors in terms of protection and enforcement of their rights to safeguard their funds held by these banking institutions.

1.2. Statement of the problem

There are robust laws in terms of governance of the banking institutions and emphasis has been placed on the qualification, role and functions of shareholders and directors.¹⁸ For instance, to implement good governance practices, the Central Bank of Kenya (CBK) has focused primarily on the shareholders, directors and managers by setting out elaborate duties that banks boards are required to comply with under the Prudential Guidelines.¹⁹ However, there is no specific duty owed to the depositors despite the critical role they play in the banking sector. For instance without the depositors, banking business would not be possible. Also, when banking institutions fail, it is the depositors who stand to lose a substantial part of their deposits. While the law provides for compensation in the event of bank failure, the amount of compensation as provided by KDIA is not sufficient to protect the depositors of the losses they are likely to suffer in case of bank failures.

1.3. Rationale of the Study

Upon opening a bank account, one becomes a debt holder as the bank utilises his or her deposits in the bank's investments for purposes of making a profit for the shareholders benefit. The courts have opined that anyone who opens a bank account qualifies as a customer.²⁰ By opening an account with a particular bank, a contractual relationship is established between the bank and the customer.²¹ Under this contract, customers who have current accounts are entitled to demand the money in their accounts and receive payments for the same from the bank as and when they demand for the same.²² The landmark case of *Foley v. Hill*²³ defined the customer-banker relationship as that of a debtor-creditor relationship wherein banks are authorized to utilize deposits given by customers and the

¹⁸ Section 9 (A), *Banking Act*, (cap 488) of the Laws of Kenya (2012) provides that no person can be appointed as a director unless the Central Bank certifies the person as being professionally fit to manage. Part IX, *Companies Act*, (2015) stipulates the duties of directors. Article 2.3 of CBK/PG/02 Guidelines on Corporate Governance (2013) outlines the responsibility of the Board of Directors.

¹⁹ CBK/PG/02 Guidelines on Corporate Governance (2013).

²⁰ *Commissioner of Taxation v. English, Scottish and Australian Bank Ltd* (1920) AC 683 (PC), High Court of Australia.

²¹ Cranston R, *Principles of Banking Law*, 2ed, Oxford University Press 2003, 133.

²² Cranston R, *Principles of Banking Law*, 2ed, Oxford University Press 2003, 161.

²³ (1848) 2HLC 28, 9ER 1002.

obligation that arises is for the bank to return the money to the customers when the customer demands for the same.²⁴ The banker is held to be in breach of its duty if it engages in practices that place the customers' money in jeopardy. This is because the customer is not looking to do business with the bank, rather the bank simply acts as a custodian of the customer.

Since the bank is offering a public service, it is subject to regulation to ensure that customers' (depositors) interests are protected as they do not know what/how their money is utilized while in the bank due to lack of information asymmetry.²⁵ In this regard, an effective board is necessary for the success of the banks. It is therefore imperative that the duties of directors of banking institutions are well defined.²⁶ Whereas section 143 (1) (c) of the Companies Act, 2015 outlines the parameters of director's duty to promote the success of the company, it does not make specific reference to depositors (for purposes of this study depositors are looked at as customers of the bank) when they execute their duties to promote the success of the company.

Depositors are stakeholders within the banking sector and undoubtedly, they incur great financial losses when bank failures occur. Existing research points to the need for interpretation of director's fiduciary duties to take into account other stakeholders' considerations.²⁷ This is a justification for conducting the present study on the need to broaden the provisions of section 143 (1) (c) of the CA, so as to take into account the interests of the depositors.

1.4. Objectives of the Study

In light of the above argument, this study sought to interrogate the existing legal and regulatory framework to understand whether and to what extent they protect the depositors' interests. In particular, the study:

1. Interrogated the existing legal and regulatory provisions on the role of directors with regard to depositors to ascertain whether the directors owe any specific duty of care to the depositors;
2. Analysed the best practise lessons we can learn from the United Kingdom (UK) (and the Republic of South Africa (South Africa) in terms of how bank boards are operating and how their respective legislations ensure protection of depositors' funds and
3. Based on the findings, suggested possible reforms to the law so as to increase the legal protection given to depositors in the event of bank failures.

²⁴ Cranston R, *Principles of Banking Law*, 2ed, Oxford University Press 2003,161

²⁵ Cranston R, *Principles of Banking Law*, 2ed, Oxford University Press 2003, 144.

²⁶ Mallin-Christine A, *Corporate Governance*, 2ed, Oxford University Press, New York, 2007,165.

²⁷ Minal Ramnath, 'Interpreting Directors' Fiduciary Duty to Act in the Company's Best Interests Through the Prism of the Bill of Rights: Taking Other Stakeholders into Consideration' 18.

1.5. Research Questions

To achieve the above objectives, this study was guided by the following questions:

1. Is the current legal and regulatory framework adequate to protect depositors as key stakeholders in the banking sector?
2. What lessons can we learn from the operations of the bank board of directors with regard to protection of depositor's interests/funds in the jurisdictions of the UK and South Africa?
3. Based on the findings, what reforms can be done to our legal and regulatory frameworks to ensure that depositors' interests are safeguarded in the banking sector?

1.6. Hypothesis

This study is premised on the following hypothesis:

1. When banks experience systemic failures, depositors lose a lot of their funds because the existing laws do not adequately safeguard their interests.

1.7. Theoretical framework

1.7.1. The stakeholder theory

This study is anchored on the stakeholder's theory. This theory advocates for promotion of stakeholder's rights as in many jurisdictions shareholders rights are protected by law whereas stakeholders' rights are not protected by law.²⁸ Corporate governance under this theory deals with mechanisms that ensure companies take responsibility for their actions in a manner that is fair to other stakeholder groups. Stakeholder groups have been defined to mean 'people or groups that have legitimate interests in various aspects of the company's activities and include employees, suppliers, customers, and other creditors, the government or anyone whom activities of the company may have an impact on'.²⁹

If emphasis is equally placed between shareholders and stakeholders, the governance structure of the company may then provide for some form of representation for stakeholder groups which would give stakeholders more so depositors in the banking industry the comfort that their money is safe. This study shall therefore seek to expound its proposal based on this theory. This study shall focus on depositors in their capacity as bank customers given that they need an assurance of the safety of their monies.

²⁸ Mallin-Christine A, *Corporate Governance*, 2ed, Oxford University Press, New York, 2007, 63.

²⁹ Mallin-Christine A, *Corporate Governance*, 2ed, Oxford University Press, New York, 2007, 74.

The Hampel Report³⁰ stems from the United Kingdom and is a corporate governance report. It noted that directors are responsible for the relations with stakeholders but at the end of the day, they are legally accountable to shareholders. The stakeholder's theory therefore provides persuasive reasons why other groups have a legitimate claim in the company as the board and/or managers have a special fiduciary duty to act in the interest of shareholders.³¹ In as much as corporate governance codes recognise maximization of wealth for the benefit of shareholders as the main aim of the company, achievement of this objective should also factor the interests of the stakeholder.³² The Hampel Committee³³ looked at the extent to which a company should consider the interests of several of its stakeholders in implementing its objectives. The report stated that directors as a board are responsible for relations with stakeholders but accountable to the shareholders in terms of meeting their legal duty. This study would like to expound accountability of the board to stakeholders specifically depositors as bank failures adversely affect them economically.

A director is required to act in good faith and in the interest of the members of the company who are the shareholders. Directors' therefore owe a fiduciary duty only to shareholders. The question that comes about is in the event that the company offers a public service then shouldn't the directors owe a fiduciary duty to these members of the public? It is on this basis that the stakeholder theory was premised. Freeman (1984)³⁴ avers that from a legal perspective, the stakeholders hold a legitimate interest in the company as their interests are protected in one way or the other despite the fact that there are no legally binding contracts. Freeman states that whilst managers have a fiduciary duty to look after shareholder's interests, they ought to balance this with the competing interests of stakeholders for the long-term survival of the company.³⁵

In line with the stakeholder theory objective, J Murray argues that adoption of a stakeholder advisory boards in corporations would create an advantage of opening up communication between directors and stakeholders, which would make stakeholders have a voice in the affairs of the corporation and this could enhance stakeholder loyalty which in the new corporate frontier would reflect the business being run in line with the economic social and governance principles.³⁶

³⁰ Hampel Committee, Corporate Governance, *The Hampel Report on Corporate Governance*, 1998.

³¹ Crane A and Matten D, *Business Ethics: Managing Corporate Citizenship and Sustainability in the Age of Globalization*, 3rd ed, Oxford University Press, London 2010, 63.

³² Mallin-Christine A, *Corporate Governance*, 2ed, Oxford University Press, New York, 2007, 74.

³³ Hampel Committee, 'Corporate Governance', the Hampel Report on Corporate Governance, 1998, 15.

³⁴ Freeman-Edward R, *Strategic Management: A Stakeholder Approach*, Boston; Pitman 1984.

³⁵ Kim K, Nofsinger J and Mohr D, *Corporate Governance*, 3rd Edition, Pearson, New Jersey, 2010, 65-66.

³⁶ Murray-Haskell J, 'Adopting Stakeholder Advisory Boards' (2017) 54 *American Business Law Journal*, 40.

It has been argued that enforcement of this theory is difficult due to its vagueness and further that injured stakeholders lack the necessary *locus standi*.³⁷ The stakeholder theory has also been criticised for lacking clear objectives in terms of having performance measures as it is difficult to determine the measure of stakeholder welfare.³⁸

1.7.2. The New Stakeholder Theory

This theory is an enhancement of the stakeholder theory which was felt to be too broad and did not offer practical methods of implementation of its ethos. Responding to the criticism of the Stakeholder theory, Amy Lehr states that directors should ensure that the corporation establishes processes that are easily identifiable and enforceable. These processes would encourage implementation if they avoid adverse impacts on stakeholders as they tend to mitigate long-term risks for the company thereby benefitting the company and shareholders.³⁹ To make this fiduciary duty meaningful, the same needs to be enforceable and this can be done for example by having the regulator(s) empowered to enforce the law by penalising companies that do not enforce environmental social and governance (ESG) policies. The laws would also grant stakeholders a *locus* should they be adversely affected they can then enforce these duties using laws. Emphasizing this theory, Amy Lehr⁴⁰ notes that if corporate directors proactively strive to identify and address the adverse impacts that could arise in the emerging economies, they would in many instances reduce the risk of failures for the company as well as for the stakeholders. She asserts though that for efficiency and clarity purposes, fiduciary duties should be sufficiently narrowly defined.

This theory offers a concrete roadmap for directors to meet their expanded fiduciary duties and avoid company liability provided they implement the requisite process. This study will seek to look at this theory and propose to introduce specific legislation within the banking industry for stakeholders with specific reference to depositors wherein they can be owed a legal fiduciary duty by the board of directors noting that this provision is currently not available in our existing legislation.

³⁷ Kim-Kenneth A, Nofsinger-John R and Mohr-Derek J, *Corporate Governance*, 3 ed, Pearson, New Jersey, 2010,66.

³⁸ Kim-Kenneth A, Nofsinger-John R and Mohr-Derek J, *Corporate Governance*, 3 ed, Pearson, New Jersey, 2010,167.

³⁹ Lehr-Amy K, 'Fiduciary Duties for a Globalized World: Stakeholder Theory Reconceived' (2019) 27 *George Mason Law Review*,81.

⁴⁰ Lehr-Amy K, 'Fiduciary Duties for a Globalized World: Stakeholder Theory Reconceived' (2019) 27 *George Mason Law Review*,81.

If emphasis is equally placed between shareholders and stakeholders, the governance structure of the company may then provide for some form of representation for stakeholder groups which would give stakeholders more so depositors in the banking industry the comfort that their money is safe. This theory is important to this study as it will expound its proposal to include depositors' interests and voices in banking institutions.

1.8. Methodology of the study

This is a qualitative study that utilizes desktop research to analyse the existing legislation and guidelines on the banking sector. The study focuses on reviewing the written literature in text books, journal articles, thesis written on the subject matter from our local universities with a view of understanding what scholars have written and what areas can be developed further. Further, this study examines primary sources of law and establish what they encompass in terms of protection of depositor's funds and duties owed to depositors by directors.

The research shall also encompass a comparative study in other jurisdictions notably the United Kingdom given the fact that in this jurisdiction, there is a general rule that the banking organisation's obligation to its depositors takes precedence over its obligation to its shareholders.

This study shall also look at the best practises within the Republic of South Africa as it is an African country that is currently working towards developing new rules on how to handle collapsed banks as well as introduce an industry funded deposit insurance scheme to protect qualifying depositors. The study shall look at the banking legislation in these two jurisdictions with the objective of seeking to understand best practises in terms of protection of depositors' funds.

1.9. Delimitation of the Study

This was a desktop study on analysis of the existing legislation and guidelines on enforcement of director's duty to promote the success of the company while fostering the company's relationship with its customers- the depositor within the banking sector. It was limited as it only focused on protection of depositors' interests within the banking industry.

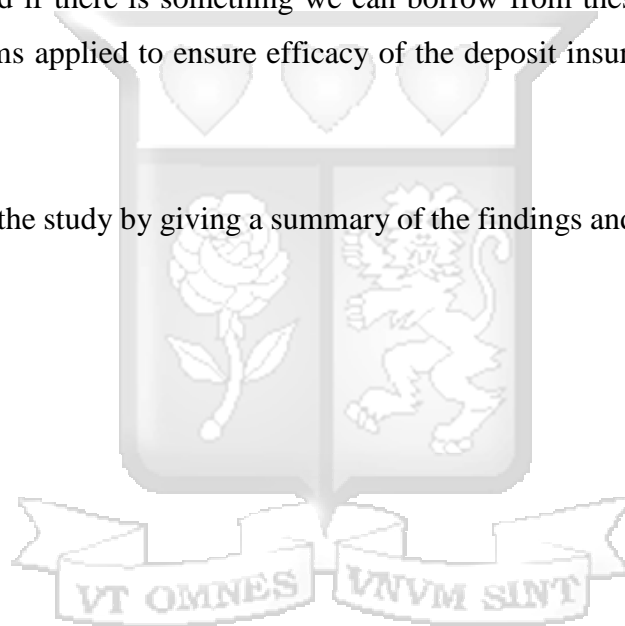
1.10. Chapter breakdown

Chapter one being an introductory chapter gives a background of the study by indicating the overview of the research topic. It highlighted the objectives of the research, outlined the research questions and the main argument of the study.

Chapter two reviews the existing literature on the topic, specifically the existing laws and what has been written on directors' duty to promote the success of the company within the banking sector. Chapter three examines the existing legal and regulatory framework. It focused on the statutory provisions of director's duty to promote the success of the company while fostering the company's relationship with its customer-the depositor; so as to have a foundation of the understanding of this duty and how the same if well implemented, would enhance protection of depositors' funds within the banking sector. This chapter also looked at the applicable statutory provisions for compensation of depositors' funds in the event of systemic failures in the banks.

Chapter four conducts a comparative analysis and looks at the best practises within the UK and the South Africa; with the aim of learning how the legislative and/or regulatory frameworks of directors duties are enshrined and if there is something we can borrow from these countries. This chapter analysed the mechanisms applied to ensure efficacy of the deposit insurance schemes when need for the same arises.

Chapter five concludes the study by giving a summary of the findings and recommendations on the way forward.



2. CHAPTER TWO: LITERATURE REVIEW

2.1. Introduction

Effective corporate governance in financial industries is essential for both shareholders and other stakeholders as it ensures business stability, profitability, increased investor confidence and protection of depositor's funds.⁴¹ The board of directors is responsible for implementation of corporate governance principles by ensuring the company is run in adherence to these principles. In this regard, the CA provides that 'the directors must have regard to the need to foster the company's business relationships with suppliers, customers and others as they effectuate their duty to promote the success of the Company'.⁴²

2.2. Corporate Governance

Corporate Governance has been defined to mean 'the manner in which power of a corporation is exercised in stewardship of the corporation's total portfolio of assets and resources with the aim of maintaining and increasing shareholder value and satisfaction of other stakeholders in the context of its corporation mission'.⁴³ The Organization for Economic Co-operation and Development (OECD) defines corporate governance as 'the system by which business corporations are directed and controlled and further asserts that the corporate governance structure must specify the distribution of rights and responsibilities among different participants in the corporation such as the board of directors, managers, shareholders and other stakeholders'.⁴⁴

Corporate law performs two general functions: first it establishes the structure of the company and housekeeping rules necessary to support this structure. Secondly, it attempts to control conflicts of interest among corporate insiders such as shareholders and top managers and outsiders such as minority shareholders or creditors.⁴⁵ For this reason, there has been a lot of focus on regulations in terms of assessing corporate governance in the banking sector and little has been written on board implementation of corporate governance policies and/or protection of third parties in the banking industry.

The board of directors are appointed by shareholders to implement their mission and vision. It is on this basis that directors owe a duty to shareholders as they are appointed to ensure protection of

⁴¹ Mallin-Christine A, *Corporate Governance*, 2ed, Oxford University Press, New York, 2007,63.

⁴² Section 143 (1) (c), *Companies Act* (2015).

⁴³ Principles for Corporate Governance in Kenya, prepared by Private Sector Initiative for Corporate Governance.

⁴⁴ Organisation for Economic Cooperation and Development, OECD, *Principles of Corporate Governance* 1999.

⁴⁵ Kraakman R, Armour J, Davies P, Enriques L, Hansmann- Henry B, Hertig G, Hopt-Klaus J, Kanda H and Rock-Edward B, *The Anatomy of Corporate Law. A Comparative and Functional Approach*, 2ed, Oxford University Press, 2009.

shareholders' interests as they conduct their engagements. Over time there has however been greater push for boards to have better structured engagement with its stakeholders and not to solely focus on protection of shareholders' interests. This is in line with the OECD principle on the role of stakeholders which states that 'the corporate governance framework should recognize the rights of stakeholders as established by law or through mutual agreements and encourage active co-operation between corporations and stakeholders in creating wealth, jobs and sustainability of financially sound enterprises' (OECD 2004). The corporate governance framework ought to assure stakeholders that they are protected and their rights as provided by the law will not be violated. In the event that their rights are violated, stakeholders should be able to freely access the legal mechanisms for redress.

According to the Organization for Economic Cooperation and Development (OECD) principles of corporate governance are non-binding on the member states and are to be used as a basic reference point to evaluate and look at improvement of legal and regulatory framework of corporate governance in the member countries. The OECD recommends that the corporate governance framework ought to recognize the rights of stakeholders established by law or through mutual agreements and encourage active co-operation between corporations and stakeholders in creating wealth, jobs and sustainability of financially sound enterprises.⁴⁶ This study ascribes to this school of thought and sheds more light on the need to recognize stakeholder rights (depositors' rights) within in the banking industry in Kenya for the good of the corporation. This concept of incorporating stakeholder interests should not be looked at as a burden to the company rather parties should seek to foster a balanced and/or win-win situation for shareholders and stakeholders.

The OECD principles encourage stakeholder's participation within a company such as employee representation in the board, governance process that involve and/or consider stakeholder views when making decisions, however this would ultimately depend on the applicable national legislation of the country in question.⁴⁷ There is push for adequate disclosure and transparency such that stakeholders should be able to easily access information to enable them actively participate and/or engage the company. Companies are therefore encouraged to easily provide material information on key issues that would affect the performance of a company that the stakeholders

⁴⁶ Organisation for Economic Cooperation and Development, *OECD Principles of Corporate Governance* (OECD) France, 2004.

⁴⁷-[https://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=C/MIN\(99\)6&docLanguage=En](https://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=C/MIN(99)6&docLanguage=En) on 30 June 2021.

need to know.⁴⁸ This study is aligned to this definition because it seeks to advocate for protection of depositors' interests within the banking industry by ensuring that our legal and regulatory framework provides for protection of depositors' interests.

2.3. Director's duty to promote the success of the company

The board of directors is responsible for governing the affairs of a company.⁴⁹ The board of directors leads and controls a company and hence an effective board is fundamental to the success of the Company.⁵⁰ It is against this background that the CA has put in place duties that directors of companies are subject to as they discharge their duties. One of such duties which is crucial for this study is the duty of directors to promote the success of the company whilst having regard to the need to foster the company's business relationships with its customers i.e. depositors for purposes of this study⁵¹. Directors are required to act in good faith as they exercise this duty which is intended to bring a long-term benefit in terms of the value of the company. The measure of this duty would entail diligent directors taking and keeping a record of their board minutes that support the reasons decisions/actions were undertaken so as to judge that the actions were undertaken in good faith.

Gitau S (2018)⁵² in her study on codification of the common law principles of duty of care and skill of directors under the provisions of the CA, looked to address whether or not the codification of Section 145 (a) and (b) of the CA had enhanced clarity and enforcement on the duty of care and skill of directors. This was due to the fact that the collapse of corporate institutions had led to the scrutiny of the effectiveness of this duty both under common law and under statute.

Her study noted the importance of codification of this duty so as bring about clarity on the scope of the duty so as to also enhance corporate governance in effectuation of the director's duty whilst having regard to other stakeholders other than the shareholder. My study looks into ways of enforcing this duty to protect the customer as a stakeholder of the banking institution.

In her analysis, Gitau noted that Section 143 (1) on directors' duty to promote the success of the company was an important codification of fiduciary duties of directors as it encompasses other stakeholders. However, while examining the extent of liability of directors in the event they are

⁴⁸ -<[https://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=C/MIN\(99\)6&docLanguage=En](https://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=C/MIN(99)6&docLanguage=En)> on 30th June 2021.

⁴⁹ Colley J, Doyle J, Logan G and Stettinius W, *Corporate Governance Business Ethics and Ethical Challenges Faced by Boards of Directors*, 1st ed, McGraw Hill Executive MBA Series, United States of America, 2003, 14.

⁵⁰ Mallin-Christine A, *Corporate Governance*, 2ed, Oxford University Press, New York, 2007, 164.

⁵¹ Section 143 (1) (c), *Companies Act* (2015).

⁵² Gitau S, 'Codification of common law principle of duty of care and skill of directors under the Companies Act 2015', The University of Nairobi, Unpublished LLM Thesis, October 2018.

held liable for the loss caused by their actions, Gitau noted that, historically, courts would apply a subjective test to assess the liability of directors breach of their duty of care by requiring them to only exhibit a degree of skill and care expected from a person of his knowledge and experience. With time however, there was introduction of the objective test that implemented corporate governance principles by making directors more accountable for their actions by looking at how an ordinary man would be required to act in the circumstances of the case presented. Further, she explored the expected standards set for directors' degree of care, skill and diligence and the remedies available for breach of these duties wherein she noted that when directors breach their fiduciary duty, the company can claim restitution as a remedy or claim for the loss suffered. She further noted that given that the remedy for breach of duty of care is damages but recoverable by the company. Although she acknowledged that negligence of directors in effectuating the duty of care caused third parties to suffer damages, her study did not recommend any solution. My study attempts to fill this gap by focusing on the depositors of banks, and how they should be protected in the event of systemic failures within banking institutions.

Gitau looked at the need to create a balance between fiduciary duty and common law duties of directors of which when breached result in corporate failures. Such failures jeopardize interests of other stakeholders' unless they are safeguarded, she however, did not make a proposal on how to do this. She recommended the abolition of section 145 of the CA due to the fact that the same is a replica of the common law duty of care and skill of directors. She further proposes that if the same is not repealed then there is need to look at ways of giving interpretation of the proper meaning of this section. She does not however delve into giving interpretation of the section. She also notes that there is need for section 148 of the CA to give precise consequences of breach of the said duties of care of directors. She does not give any examples of consequences of the said breach. There is no recommendation on how to protect third parties in such instances and this research will look into ways of protecting such third parties, particularly depositors in banking institutions, as the bank owes the depositors a fiduciary duty.

2.4. Corporate governance in the banking sector: what do we need from the board of directors

Kenya has witnessed several financial crises in the banking sector and these have partly been attributed to board malpractices.⁵³ As a result of these crises, depositors have lost their funds,

⁵³ Gathaiya-Robert N, 'Analysis of Issues Affecting Collapsed Banks in Kenya from Year 2015 to 2016, *International Journal of Management & Business Studies*, (2017).

businesses have gone down and the banking industry's credibility has been greatly questioned in the recent past.⁵⁴

In her study, Mwangeli J (2016)⁵⁵ focused on regulations in place with regard to running and management of financial institutions and the effect of such regulations on financial performance. She stated that regulations are the key determinants for stable banking. She however did not put emphasis on the role the board of directors in the banking sector plays in implementation of the said regulations and the appurtenant consequences of failure by the said boards to enforce the regulations. One such consequence would be depositors' loss of funds. At the end of my research, I hope to be able to recommend means of better protection of depositors from losing their funds such that even in the event of a bank failure, depositors are assured on prompt payment of their monies, this being a contractual obligation owed to them by the bank.

Kamau E (2019)⁵⁶ in her study on enforcement of director's duty to promote the success of a company pointed out that corporate governance is necessary and essential in a financial system so as to guarantee a sound financial system for economic development. She observed that corporate governance literature had paid little attention to issues of banking governance in developing countries. Her findings were that the major contributing factors of bank failures were: weak regulatory structures governing director's duties and weak enforcement mechanisms.

Kamau looked at the reasons behind bank failures and focused on the provisions of section 143 of the Companies Act. She also looked at the stakeholder groups whom she felt directors need to consider as they effectuate their duties. Her study focused on effectuation of corporate governance principles by bank boards as she sought to address why despite having codified the Companies Act, this had not resolved bank failures in Kenya. She however did not address how the issue affects depositors who are the biggest losers when banks fail. My research addresses how to protect depositors.

Kamau also looked at the possibilities of setting up policies and strategies between the bank Boards and the Management who are involved in the day-to-day running of the bank. She was of the view that this was critical in bank success; however, the issue of consumer protection was not addressed. Kamau's study primarily focused on the role of the board to promote the success of the company.

⁵⁴ Deniz A and Asli DK, 'Bank Runs & Moral Hazard; A Review of Deposit Insurance' *World Bank Group*, 2018.

⁵⁵ Mwangeli J, 'The effect of regulation on financial performance of commercial banks in Kenya', Unpublished MBA Thesis, The University of Nairobi, September 2016.

⁵⁶ Kamau E, 'Enforcement of Directors Duty to promote success of a Company: a focus on the banking sector', Unpublished LLM Thesis, The University of Nairobi, November 2019.

There is however need to address the nexus between the bank board's performance of its duties, success of the bank and/or the effect of a bank failure to the customer, which this study addresses.

In addition, Kamau's study analyzed the shortcomings of the existing regulations that tended to create loopholes for directors to breach bank laws and take part in unsound practices. She noted the need to compel directors to factor stakeholder interests and try and balance the needs for the company as well as the needs for stakeholder groups which comprise parties such as customers. She proposed the need for directors to establish social responsibilities and look at factors such as price reduction, offering donations and the like to create a good image for the company. She however did not mention how the board could look into protection of depositors' funds and/or ways of enhancing depositor's protection. My research expounds on this issue.

Kamau further looked at the constitution of the board and proposed having a diverse board which she opined was necessary for the success of the bank. She proposed sufficient training of director to equip them in carrying out their work

Kamau's study looked at the success of banks *vis a vis* regulation and looked at the CBK's intervention including the Kenya Deposit Insurance Corporation (KDIC) which she mentions can be appointed to manage and control a failing bank. She however noted that there was a weakness when it comes to enforcement by regulators and proposed the need to have more stringent enforcement by the regulator. The issue of how the regulator would address depositor's protection was however not discussed in her study yet these are the stakeholders who lose the most when a systemic bank failure occurs.

She further noted that in Kenya there was weak enforcement mechanisms of Section 143 of the CA with regard to enforcement of directors' duties to promote the success of the company and she recommended a balance between regulations so as to avoid overregulation that had proved to be ineffective.

In as much as she looked at the enforcement of director's duty to promote the success of the company, her focus was on enforcement of this duty. My research is be different as it focused on inclusion of stakeholders, particularly the depositors in effectuation of this duty. This is due to the fact that the relationship between a depositor and the bank is one which creates a fiduciary duty and there is need for the bank directors to have some guidance manual on how to incorporate depositors interests as they carry out their fiduciary duties; they should not permit their personal

interests/shareholders' interests to conflict with their fiduciary duty or be motivated to make secret profits at the expense of the customer.⁵⁷

Important to my research is Kamau's viewpoint that under the stewardship theory, there was recognition of a connection between the director's roles in effectuating their duties towards the success of a company as their role requires them to be good stewards who confer a benefit to all stakeholders rather than to individual shareholders. She noted that good corporate governance principles such as transparency, accountability, stakeholder engagement and board commitment were essential to reinforce profitability and success of banking institutions. Due to the fact that the board of directors is responsible with steering the banks vision, she proposed the need to have board diversification, proper scrutiny and vetting of directors by the regulator prior to their appointments being confirmed so that their qualification and standing are well ascertained. She also proposed the need to have directors undergo proper training noting their duty called them for a higher degree of scrutiny and expectation. Her study however did not give any recommendations on how stakeholders should be compensated when banks fail. To fill this gap, my study examined the how to deal with compensation of depositors funds should directors fail in implementation of their duty to promote the success of the company.

Ndalo P (2017)⁵⁸ looked at the multiple regulatory frameworks that are available in the various financial sectors namely the Banking, Insurance, Capital Markets and Retirement Benefits and Saccos) and opined that having various regulators with the broad financial sector tend to create disharmony and conflicts in terms of implementation of financial regulations. His study was aligned to having financial regulations in place that would ensure consumer protection which he felt the various legal legislations lacked. Within the banking sector he focused on the provisions of the Central Bank of Kenya Act⁵⁹ and the Banking Act (BA)⁶⁰ but failed to look at the provisions of the CA with regards to legislative regulations directors are required to comply with in terms of governance of the banking institution.

Ndalo's study also looked at the possibility of adoption of the twin peak approach to banking regulation in terms of balancing the objectives of safety and soundness regulation with the objective of consumer protection and transparency and proposed the possibility of having a unified

⁵⁷ Cranston R, *Principles of Banking Law*, 2ed, Oxford University Press 2003, 187.

⁵⁸ Ndalo T, 'Multiple Legal and Regulatory Framework in the Banking and Financial Sector: Addressing Resultant Complexities, Disharmony and Conflicts in Policy Goals, Unpublished Thesis, The University of Nairobi 2019.

⁵⁹ *Central Bank of Kenya Act*, cap 491 of the Laws of Kenya.

⁶⁰ *Banking Act*, cap 488 of the Laws of Kenya.

regulator to cut across all the financial sectors. In conclusion and based on a comparative study between the UK and South Africa, Ndalo made a recommendation for establishment of a Financial Service Council and that the BA, Capital Markets Act (chapter 485A of the laws of Kenya 2012), Sacco Societies Act (Act No. 14 of 2008 and revised in 2012), Retirement Benefits Act (Act No. 3 of 1997 revised in 2017) and the National Social Security Fund Act (2013) be amended to recognize the new regulator. He further proposed introduction of four independent regulators from the Banking, Insurance, Sacco and Capital Markets sectors sign a Memorandum of Understanding under the guidance of the Financial Service Council for purposes of co-operation so as to address the conflicts of interests that had been present for example when a bank governed under Central Bank of Kenya (CBK) also sells insurance products (governed under Insurance Regulatory Authority (IRA) then which regulator would the Bank be answerable to in terms of enforcement CBK or IRA?

Ndalo's study did not take into account provisions of the director's duties in terms of the provisions of the CA that are aligned to corporate governance principles. His proposal to enhance better bank performance would be through consolidation of the existing regulations which does not factor the role played by directors in implementation of the success of financial institutions as banks are required to adopt the structure of a company and the CA provisions apply. This study attempts to address this gap.

Gathaiya R⁶¹ conducted a study to analyze the issues that affected the collapse of Chase Bank Limited, Imperial Bank Limited and Dubai Bank Limited. His article avers that corporate governance plays a vital role in the success and prosperity of the banking business as he noted that the collapse of these banks was attributed to: weak corporate governance practices, lack of internal control mechanisms, weaknesses in regulatory and supervisory systems, insider lending, poor risk management and conflict of interests in the conduct of affairs of the board.

Gathaiya proposed the need for the government to conduct reforms on the management and enforcement activities by the main banking regulator (CBK). He also suggested the need for the government to refine the existing banking laws to close up the legislative gaps that were being exploited by directors and managers thereby leading to bank failures in terms of the corporate governance policies.

⁶¹ Gathaiya-Robert N, 'Analysis of Issues Affecting Collapsed Banks in Kenya from Year 2015 to 2016, *International Journal of Management & Business Studies*, (2017).

Gathaiya further recommended that the bank shareholders, directors and employees ought to be subjected to normal credit assessment prior to being given loans as it was noted that insider loans comprised majority of the non-performing loans in the three institutions that underwent systemic failure. The study did not however give recommendations of the kinds of laws that could be introduced to seal the existing loopholes that had led to systemic failures in these institutions. This study looked into ways of broadening the provisions of Section 143 (1) (c) of the CA to address how directors can foster stakeholders' (depositors in this case) interests in promoting the success of banking institutions.

2.5. To whom are directors duties owed: broadening the common law perspective

Under common law, directors owe their primary duty to the shareholder to whom they are accountable. There is no duty owed to stakeholders and in the event that this duty is breached, case law has stated that it is only the company that can sue. In the event that shareholders opt to sue, they cannot do so in their personal capacity but would only do so on behalf of the company through what is called a derivative suit,⁶² other stakeholders have not been given this opportunity. Given the fact that banks use depositor's monies to conduct their business affairs, it is evident that the depositor's role is crucial as without depositors, bank operations would be rendered inoperable. It is my argument that depositors as bank customers play a critical role and therefore need legal recognition by having a voice in the affairs of a bank's operations.

Under Common law, the board of directors is accountable to the shareholders as the owners and/or members of the Company. H Goo in his article⁶³ proposes for the need of introducing law reforms to have the term 'members' be amended to include both shareholders and stakeholders as opposed to the court's interpretation that the same means shareholders only where the law states that "directors are to act for the benefit of its members"⁶⁴

He further proposes for the need to have stakeholders represented by a board member. Although this may prove expensive and prolong decision making process, the author argues that this should not outweigh the benefits of an all-inclusive board in line with the new proposals of having

⁶² *Foss V. Harbottle* [1843] 2 Hare 461.

⁶³ Say H Goo, 'An Economic Efficiency Approach to Reforming Corporate Governance: The Case of Multiple Stakeholder Boards Law and Economics in East Asia' (2017) 4 Asian Journal of Law and Society 387.

⁶⁴ *Re Smith and Fawcett Ltd* (1942) ch304, Court of Appeal of England and Wales, Boyle & Birds (1995) pg. 452 definition of company to mean interests of the company as a commercial entity to be judged by reference to the interests of the present and future shareholders alone.

diversified boards. My study takes this proposal forward and advocates for this amendment within the Kenyan context and proposes the need for adoption of this school of thought so that the existing legislation can be aligned accordingly.

In the United States of America (the US) for instance, the business movement sought to have firms consider the interests of all corporation stakeholders rather than solely focus on the financial interests of the shareholders.⁶⁵ This was meant to address the perception that the financial downturn was caused by excessive focus on creation and/or implementation of shareholder wealth at the expense of other stakeholders. However, it was noted that in as much as there was social enterprise legal reforms and proposed board inclusiveness, basic power structure in terms of corporate governance did not portray this. J. Haskell noted that much as corporate law in the United States gave directors freedom to take into account stakeholder interests, it did very little to ensure that in practice these interests were attended to by the director. He therefore proposed measures of protecting stakeholder interests one of which was to mandate boards of directors to consider stakeholder interests and directors need not worry that they would be sued by shareholders for not focusing on their interests as they would use the business judgement rule as a defense. This would encourage the company to be socially focused on long-term success of the company as opposed to short term profit maximization which serves the interest of the shareholders only. By focusing on the long-term success of the company, this demonstrates greater consideration of stakeholder interests. He also proposed adoption of the two-tier board whereby stakeholders could form a stakeholder advisory board to serve primarily as an advisor to the traditional board. This would promote inclusivity. His concern was however that these boards may sometimes end up doing more harm than good due to potential conflicts of interest as the question that would arise is to whom the managers' report to-the traditional board of directors or the stakeholder advisory boards? In conclusion Haskell advocated for inclusion of a mandatory stakeholder advisory board in companies that are empowered with the necessary corporate governance rights/tools to aid in opening up of communication lines between directors and stakeholders. This study looked into means of introducing provision of a stakeholders' representative to sit in the respective boards within the banking sector in Kenya so as to address the need of having stakeholder inclusivity in our banks corporate board structure.

J. Haskell in his study noted that there were proposals to have a board ombudsperson selected by independent directors whose role would be to evaluate the information required by boards of

⁶⁵ Murray-Haskell J, 'Adopting Stakeholder Advisory Boards' (2017) 54 *American Business Law Journal* 61.

directors to perform their monitoring duties. He however opined that such an office would create a dissonance between directors and managers. In Kenya we have the Commission of Administration of Justice office created pursuant to Article 59 (4) of the Constitution of Kenya and governed by the provisions of the Commission of Administrative Justice Act.⁶⁶ The key mandate of this Commission is investigative in terms of any conduct and/or omission of government officials that is seen as being unfair, amounts to abuse of power/office or injustice. This office does not have any mandate to deal with banking malpractices.

2.6. Conclusion

From the literature reviewed above, it is evident that some studies have been conducted on corporate governance principles within the banking sector and the need to have an effective board to ensure the success of the bank. However, there is little literature that is in place to show the need for depositor's protection in terms of having the directors being accountable to them (in their capacity as a stakeholders) as directors carry out their duties in line with the provisions of the CA.⁶⁷ This is attributed to the fact that focus has been on regulations in terms of assessing corporate governance in the banking sector and little has been written on board implementation of corporate governance policies and/or protection of third parties in the banking industry. Further, there is no research that has been carried out to ensure that depositors' money is protected in the event of systemic failures of banks. This research therefore addresses how best directors can promote the success of the company taking into account the depositor's interest and how best the regulator can ensure adequate deposit protection in the unlikely event of bank failures so that depositors can have the comfort that their investments are safe.

⁶⁶ *Commission of Administrative Justice Act*, Act No. 23 of 2011.

⁶⁷ Section 143 (1) (c), *Companies Act*, 2015.

3. CHAPTER THREE: LEGAL AND REGULATORY FRAMEWORK

3.1. Introduction

This chapter examines legal and regulatory framework governing banking institutions. Specifically, the chapter focusses on provisions covering directors' duty to promote the success of the company within the banking sector. This is important in understanding how this duty protects depositors' interests within the banking sector.

The chapter also interrogates applicable statutory provisions for bank operation and compensation of depositors' funds in the event of systemic failures in the banks. The chapter analyses applicable provisions of the Constitution of Kenya (2010), the Banking Act (chapter 488 of the Laws of Kenya), the Companies Act (Act No. 17 of 2015) and the Central Bank of Kenya Act and the Central Bank of Kenya Prudential Guidelines.

3.2. The Constitution of Kenya

The Constitution of Kenya was promulgated into law in the year 2010 as the supreme law of the Republic of Kenya. Chapter 4 of the Constitution deals with the Bill of Rights- the fundamental rights and freedoms applicable and binding to all individuals in the Republic of Kenya; specifically for purposes of this study, Article 46 addresses consumer protection rights.

Article 46 of the Constitution of Kenya provides that consumers have the right to receive the right kind of information that is necessary for them to gain the full benefit from the goods or services they are using.⁶⁸ From the banking perspective, since the depositor is using bank services when they open a bank account and deposit their money with the banking institution, the depositors must be adequately provided with all the necessary information pertaining to the benefits and potential risks associated with the bank account should a systemic failure occur.

Notably, when a depositor is opening a bank account, information about what would happen in the unlikely event that the bank undergoes a systemic failure is not provided. The depositor is not advised on matters pertaining deposit insurance/how much they would be compensated/ what are the timelines within which the compensation will be effected. Officials from the deposit insurance fund do not educate depositors (when opening bank accounts) of the potential risks they could face should a systemic failure arise. There is therefore need to have this information disclosed to depositors before an account is opened and a consent form signed to confirm that at the point of

⁶⁸ Article 46 (1) (b), *the Constitution of Kenya, (2010)*.

opening the bank account the depositor has been well informed of this critical information and opens the bank account being fully aware of the potential risks associated therein should a systemic failure occur. With the right kind of information, a depositor would be able to assess the potential risk and if possible spread the risk by opening various bank accounts across different banks.

It is pertinent to note that the Article 46 (d) of the Constitution guarantees consumer the right to compensation for loss or injury arising from defects in goods or services.⁶⁹ Banks provide services to their depositors as consumers; by implication, should the depositor in his/her/its capacity as a consumer suffer some loss of the deposits held in their bank as a result of negligence/defective services offered by the bank officials, they should then be compensated. However, the Constitution does not set the timelines within which a consumer would be allowed to receive the compensation. In banks, a depositor is left at the helm of the Kenya Deposit Insurance Corporation, which institution was not involved when the depositor opened the bank account. Once the bank is placed under statutory management/receivership then the depositor is required to wait for press directives from the Kenya Deposit Insurance Corporation on when and if at all they will recover their money having total disregard to the depositors needs to access his/her/its funds as and when the need for the same arises.

3.3. The Banking Act

The law regulating banking business in Kenya is governed by the provisions of the Banking Act (BA). In Kenya, banking business is a restricted as one can only operate banking business if they hold a valid license granted by the Central Bank of Kenya, being the main banking regulator.⁷⁰ A payment fee must be submitted for one to be granted the license, which license is renewable and granted with conditions endorsed therein.⁷¹

Section 16 of the BA restricts deposit taking activities and an institution can only take deposits from its customers if it holds a valid license to carry out banking business. Given this restriction, one is left questioning the efficacy of the licensing process given that in a bank failure the licensed institution would not be able to give the depositor access to his/her/its funds as and when the depositor requires the same.

⁶⁹ Article 46 (1) (d) of *the Constitution of Kenya*, (2010).

⁷⁰ Section 3 (1), *Banking Act* (cap 488) of the Laws of Kenya.

⁷¹ Section 5, *Banking Act* (cap 488) of the Laws of Kenya.

Section 9A of the BA provides that for one to serve as a director in a banking institution, the person must be certified by the Central Bank as fit and proper to manage the institution. However, the BA does not prescribe the test for establishing a fit and proper director. Given the spate of bank failures the question that begs to be answered is how this test aligns with the director's duty to foster the company's business relationship with its customer-the depositor. This is so given that the directors are appointed by the shareholders and often act in the interest of the shareholders in as much as they may pass the "fit and proper test".

In line with corporate governance principle of transparency and accountability, the BA requires banking institutions to exhibit their financial accounts annually⁷² so as to show their performance and financial standing. While this information appears to be useful to the regulator, depositors may lack the technical knowledge to understand the statements and the regulator does not issue any commentary on the said financial statements in a palatable form for the depositors to digest. In addition, the BA does not provide a channel for depositors, even for those with technical expertise, to question the financials.

Part VIII of the BA establishes the Deposit Protection Fund Board⁷³ which is a body corporate mandated to hold and manage the Deposit Protection Fund and impose contributions to be made by banking institutions towards the Fund.⁷⁴ The law provides that the size of the Fund should be sufficient to protect the interest of the depositors;⁷⁵ there is therefore need to re-analyze this provision given that depositors are not guaranteed to receive a full refund of the moneys held in their bank accounts if the same exceed the set out threshold for refund.

The board composition of the Fund as per the provisions of the BA comprises of the Governor of the CBK, the Permanent Secretary to the Treasury and two (2) members appointed by the Minister to represent the interests of the institutions.⁷⁶ It is important to note that there is no person to represent the interest of the depositors in this board yet the Board is meant to manage distribution of funds to depositors. Thus, the depositor's voice is silent in this board yet the depositor is a stakeholder in the banking business.

⁷² Section 22, *Banking Act* (cap 488) of the Laws of Kenya.

⁷³ Section 36 (1), *Banking Act* (cap 488) of the Laws of Kenya.

⁷⁴ Section 36 (3), *Banking Act* (cap 488) of the Laws of Kenya.

⁷⁵ Section 37 (1), *Banking Act* (cap 488) of the Laws of Kenya.

⁷⁶ Section 36 (4), *Banking Act*, (cap 488) of the Laws of Kenya.

The board of the Fund is also empowered to determine its own procedure.⁷⁷ This gives the board autonomous power to run its affairs as it pleases without being accountable.

The BA makes a provision for the protection of the depositors' money.⁷⁸ This money, referred to as the protected deposit, is the aggregate credit balance of any accounts (jointly if they are many) maintained by a customer in the bank, less any liability the customer has and this is to be determined by the Minister.⁷⁹ This is the amount of monies that a depositor will be refunded in the event of a bank going insolvent.

A customer is empowered to lodge a claim with the board once a bank becomes insolvent so that the board can pay the customer his/her/its protected deposit out of the Fund. While this provision sounds promising, when you read it together with the provisions of the KDIC (discussed in section 3.4 below), one realizes that a customer is only entitled to payment of part of protected deposit not the entire amount that he/she/it has in the bank account(s).⁸⁰ Also the BA does not provide for what happens when a customer has more money in the bank account than what falls under the protected deposit.

3.4. The Companies Act

Given that banking institutions are mandated to carry out their business in the form of a company,⁸¹ they adopt the company structure with directors mandated to run the affairs of the company to promote the interests of both shareholders and customers (for purposes of this study depositors are customers of the bank).

A director has been defined to mean: any person occupying the position of a director (in relation to a body corporate); and any person in accordance with whose instructions the directors of a body corporate are accustomed to act (this does not include advice taken in professional capacity).⁸²

Among other provisions, the CA provides duties of directors and one such duty is elaborated in section 143 (1) which mandates the directors of companies to promote the success of the companies

⁷⁷ Section 36 (5) *Banking Act*, (cap 488) of the Laws of Kenya.

⁷⁸ Section 37, *Banking Act*, cap 488) of the Laws of Kenya

⁷⁹ Section 39 (1) *Banking Act*, (cap 488) of the Laws of Kenya.

⁸⁰ Section 39 (2) *Banking Act*, (cap 488) of the Laws of Kenya.

⁸¹ Section 2 (1), *Banking Act* (cap 488) of the Laws of Kenya.

⁸² Section 3 (1), *Companies Act* (2015).

they govern. While exercising this duty, directors are required to, among other things, consider long-term consequences of their decisions and also foster relationships with the customers of the company.⁸³ The CA does not give the specifics of how/what directors need to do to give effect to this duty. Thus, the onus is upon the directors to determine the specific details of how they will achieve this objective. As I indicated in chapter one, the relationship of the depositor with the bank is one of a debtor-creditor; the bank is authorized to utilize the depositor's money to make a profit and accordingly the bank is obligated to grant the depositor immediate access of his/her money as and when the depositor demands for the same.

When the bank's board of directors make decisions, they should take into account how those decisions will affect the depositors, whose money is utilized to run bank businesses. Given the frequency of bank failures that Kenya has witnessed which have been partly attributed to failure of directors to effectuate their duties, the CA needs to be more elaborate/specific on how directors can promote the success of the company whilst fostering relationships with customers.

Section 143 (1) of the CA states that 'a director of a company shall act in the way in which the director considers, in good faith, would promote the success of the company for the benefit of its members as a whole, and in so doing the director shall have regard to:⁸⁴

- a. the long term consequences of any decision of the directors;
- b. the interests of the employees of the company;
- c. the need to foster the company's business relationships with suppliers, customers and others;
- d. the impact of the operations of the company on the community and the environment;
- e. The desirability of the company to maintain a reputation for high standards of business conduct; and
- f. the need to act fairly as between the directors'

The objective of the above provision is important as the idea is to have the director implement his/her duties for the interests of both the shareholders and the stakeholders. The CA requires the director to exercise good faith whilst exercising this duty. There is however no measure of how this is to be done, no standard code of practice/definition of the term 'exercise good faith'. It is important for the CA to have provisions that are easily measurable and set out in details what it means to exercise good faith.

⁸³ Section 143 (1) (c), *Companies Act* (2015).

⁸⁴ Section 143 (1) (a-f), *Companies Act* (2015)

It is important to note that the BA through the Prudential Guidelines (PG) has set out separate categories of directors for banks such as Non-Executive Independent Directors, Executive Directors and equipped them with different roles. This is discussed in section 3.6 below. If one is to be guided by the provisions of the section 143 (1) (c) of the CA, how then will the directors of banks promote the success of the banking institutions by fostering the business relationship of the bank and the depositors through this classification of directors? Section 143 (1) (c) of the CA has not given us the necessary measuring tools on how to assess performance of directors duty to foster the company's business relationships with its depositors. In the banking sector, there is need to break down these duties in a manner that is first and foremost understandable by the directors and achievable.

3.5. The Kenya Deposit Insurance Act (KDIA)

KDIA was incorporated in the year 2012 for purposes of establishing a deposit insurance system that is applicable to deposit taking institutions as provided for in the BA. It also establishes the Kenya Deposit Insurance Corporation (KDIC),⁸⁵ which is a body corporate established to provide a deposit insurance scheme for customers of its member's i.e. for depositors.⁸⁶ Its board composition comprises of:

- a. a non-executive chairperson appointed by the president;
- b. the Permanent Secretary in the Ministry of Finance;
- c. The Governor of the CBK or his representative;
- d. Five (5) members not being public officers appointed by the Minister by virtue of their knowledge and experience in banking, finance, insurance, commerce, law, accountancy and economics (three of whom must be from institutions); and
- e. The chief executive officer who shall be an ex-officio member.

From the above board composition, there is no representation of depositors; by implication, the voice of the depositor is missing from the decisions of the board.

Of concern is that the board is mandated to regulate its own procedures hence a depositor is left to rely on the board procedures⁸⁷ as pertains remitting payments of deposits should a bank fail. This

⁸⁵ Section 4, *The Kenya Deposit Insurance Act*, (2012).

⁸⁶ Section 5 (1), *The Kenya Deposit Insurance Act*, (2012).

⁸⁷ Section 8 (1), *The Kenya Deposit Insurance Act*, (2012).

includes timelines within which the payments are to be done. The board needs some form of accountability and it is for this reason that the board needs proper regulation on how to carry out its duties. The KDIA does not provide for this.

The KDIA has established the Deposit Insurance Fund and vested the administration of the compensation to KDIC.⁸⁸ The Fund consists of the following among others:

- a. monies, which at the commencement of the KDIA, were in the Deposit Protection Fund as established under the BA;
- b. monies contributed to the Fund by institutions as provided in the KDIA⁸⁹ and any interest or penalties levied in respect of such contributions;
- c. monies borrowed from the Central Bank of Kenya as provided under section 21 of the KDIA;
- d. monies that may accrue to the Fund as provided by Parliament;
- e. monies transferred from the funds of the Corporation from the Minister of Finance;
- f. income that may accrue to the Fund from the investments made in pursuance of the KDIA;
- g. monies received as subventions, grants or donations to the Fund; and
- h. all other monies or assets which may in any manner become lawfully payable to, received by or vested in the Corporation relating to any matter incidental to its powers, duties and functions under this Act.⁹⁰

The Fund is used to, among others, meet payments in respect of insured deposits. The extent of the insured deposit cover is defined as the amount being the aggregate credit balance of any accounts maintained by the customer to an institution, less any liability of the customer to the institution.⁹¹ While this provision sounds great, the maximum amount payable under the term insured deposit is Kenya Shillings Five Hundred Thousand (Kshs. 500,000/=) effective from 1st July 2020.⁹² Further for a depositor who may have several banking accounts/monies placed in fixed deposits these accounts will be consolidated as one.⁹³ There is no explanation given on how the compensation amount is arrived at and/or why consolidation of two or more accounts of one depositor is done.

⁸⁸ Section 20 (1) and (2), *The Kenya Deposit Insurance Act* (2012).

⁸⁹ Section 27, *The Kenya Deposit Insurance Act* (2012) provides mechanisms for contribution of monies by banking institutions.

⁹⁰ Section 20 (1) (a-h), *The Kenya Deposit Insurance Act* (2012).

⁹¹ Section 32, *The Kenya Deposit Insurance Act* (2012).

⁹² Remarks given by the then acting Cabinet Secretary for National Treasury Amb. Ukur Yatani during the launch of the enhanced Deposit Coverage Limit by Kenya Deposit Insurance Corporation on 1st October 2019.

⁹³ Section 28 (2), *The Kenya Deposit Insurance Act* (2012).

It is also noteworthy that the under Section 20 (5) KDIA alludes to the fact that the Deposit Protection Fund can have insufficient monies. This points to the possibility of the fund not always being able to meet its objective and permits the KDIC to then transfer funds that it holds from other sources (as provided in Section 16 of the KDIA) other than the above to help it meet its objectives.⁹⁴ As a Deposit Protection Fund meant to compensate depositors, one then wonders how the corporation is supposed to run and meet its objectives if it is permitted to borrow money and whether the Fund is liquid enough to meet its set out objectives or should its efficiency then be reviewed further.

Section 39 of the KDIA empowers KDIC to conduct special examination of institutions ‘when it deems it necessary’. Examination of institutions should be done regularly and within a well-regulated framework that banking institutions are well aware; not when KDIC deems it necessary as this appears to be subjective and/or more of a reactionary measure as usually there would be a red flag that has been spotted necessitating the need for the special examination. Further, the examination should be done harmoniously with the CBK’S officials so that there is no overlap in duties; given that the CBK is the main regulator. If examinations are done regularly, this would ensure that an institution is run efficiently and is well governed. Additionally, KDIC should adopt a progressive mode of operation by making one of its key objectives to have its staff members sit within financial institutions and review account opening procedures, advice depositors of the risks they are likely to encounter when a bank fails and how long it would take for them to be compensated.

3.6. The Central Bank of Kenya Act

Section 3 (1) of the Central Bank of Kenya Act establishes the Central Bank of Kenya (CBK) as the bank regulator in Kenya. Its principal objective is to formulate and implement monetary policy so as to achieve price stability.⁹⁵ Part of the CBK’s function is to promote financial stability of financial institutions by ensuring that the financial system is liquid and stable.⁹⁶ The Kenyan banking sector operates under one principal regulator i.e., the CBK that is in charge of both the prudential regulation as well as market conduct of the financial institutions. The Central Bank of Kenya Act also establishes the currency to be used in the Republic of Kenya.⁹⁷

⁹⁴ Section 20 (5), *The Kenya Deposit Insurance Act*, 2012.

⁹⁵ Section 4 (1), *Central Bank of Kenya Act* (cap 491).

⁹⁶ Section 4 (2), *Central Bank of Kenya Act* (cap 491).

⁹⁷ Section 19, *Central Bank of Kenya Act* (cap 491).

In as much as the CBK is a body corporate with perpetual succession, has a common seal, can sue and be sued in its own name⁹⁸, the provisions of the Banking Act and the Companies Act do not apply to the CBK.⁹⁹

The structure of the CBK consists of a Board of Directors that is comprised of a chairperson, a governor, the Permanent Secretary to the Treasury or his representative and eight (8) non-executive directors.¹⁰⁰ The Central Bank of Kenya Act does not give definitions of who a director is nor does it define the term non-executive directors as comprised in its board. Given the fact that the provisions of the Banking Act and the Companies Act do not apply to CBK as discussed above, it is not clear how categorization of non-executive directors is arrived at.

The Chairperson and the directors are appointed by the president subject to approval of parliament.¹⁰¹ The Act does not mention how such directors are vetted as the requirement for eligibility as provided under Section 11 (7) is that one must be a Kenyan Citizen and one must be knowledgeable in monetary, financial, banking and other disciplines relevant to the functions of the Bank.

The role of CBK board among others is to:¹⁰²

- i. determine the policy of the Bank, other than the formulation of monetary policy;
- ii. determine the objectives of the Bank, including oversight for its financial management and strategy;
- iii. keep under constant review the performance of the Bank in carrying out its functions;
- iv. keep under constant review the performance of the Governor in discharging the responsibility of that office;
- v. keep under constant review the performance of the Governor in ensuring that the Bank achieves its objectives;
- vi. determining whether the policy statements it has made are consistent with the its primary function and policy objectives ; and
- vii. keep under constant review the use of its resources.

⁹⁸ Section 3 (2), *Central Bank of Kenya Act* (cap 491).

⁹⁹ Section 3 (5), *Central Bank of Kenya Act* (cap 491).

¹⁰⁰ Section 11 (1), *Central Bank of Kenya Act* (cap 491).

¹⁰¹ Section 11 (2), *Central Bank of Kenya Act* (cap 491).

¹⁰² Section 10, *Central Bank of Kenya Act*, (cap 491).

The Central Bank of Kenya Act does not mention CBK's role in terms of approving appointed bank directors as provided under the BA/PG discussed above. This is a crucial role of the regulator that needs to be provided under its duties with clear mandates set out and how the approval process of appointed bank directors is done.

3.7. The Prudential Guidelines

Pursuant to the provisions of Section 33 (4) of the BA, the Central Bank of Kenya is empowered to issue directions to banking institutions to ensure they function efficiently and adhere to the issued guidelines; so as to maintain a stable and efficient banking institutions. It is against this background that the Prudential Guidelines (PG) were issued.

Prudential Guideline (PG) number 02 deals with management of the board of directors of financial institutions aimed at aligning the board practices with corporate governance ideals; ¹⁰³and of importance to this study is alignment of the board of directors' duties as they manage the banking institutions to protect the interests of the bank and its shareholders while taking into account the interests of stakeholders and protection of the interests of depositors.¹⁰⁴

The prudential guideline 02 has laid out elaborate procedures of how the board of directors are required to run the bank, formulate various committees to ensure the institutions are underpinned on the key ethical values of fairness, accountability, responsibility and accountability; the aim being to protect the interests and expectations of all stakeholders.¹⁰⁵

Categorization of directors has been set up for purposes of independence and accountability as these directors carry out their roles in the banking sector. We have the Executive director (ED) involved in the daily operations of the bank; this ED is a full time salaried employee of the bank.¹⁰⁶ We also have the Non-Executive Directors who serve on the board but are not full time salaried employees of the bank and neither are they involved in the day-to day running of the bank.¹⁰⁷ This category of directors are employed by the bank but not involved in the management of the bank operations. The PG guidelines also provide for the Independent Non-Executive director¹⁰⁸ who should not be

¹⁰³ CBK/PG/02.

¹⁰⁴ Clause 1.4.1 (c-d) *CBK/PG/02 Prudential Guidelines* (2013).

¹⁰⁵ Clause 3.1.3 *CBK/PG/02, Prudential Guidelines* (2013).

¹⁰⁶ Clause 1.4.4 *CBK/PG/02, Prudential Guidelines* (2013).

¹⁰⁷ Clause 1.4.5, *CBK/PG/02, Prudential Guidelines* (2013).

¹⁰⁸ Clause 1.4.6, *CBK/PG/02, Prudential Guidelines* (2013).

associated with the bank whatsoever i.e. has not been an employee of the bank for the preceding five years, does not have any form of family ties with the shareholders/holds positions likely to bring a conflict of interest with his/her functions as a director of the bank. This class of directors are expected to bring autonomy as they serve on the board as well as harness their technical expertise be it legal, accounting/auditing, business management in effectuation of their duties.

The idea of categorizing and separating directors' roles is sound. However, one wonders how efficient the separation of classes of directors/ separation of their duties is in terms of promoting the success of the company and is there any regard had to depositors; given that bank failures that have occurred despite their being this guideline and the fact that directors are ultimately appointed by shareholders, shows there is no direct duty owed to depositors.

Prudential Guideline (PG) 13 addresses enforcement provisions of banking laws and how the CBK enforces implementation of the said laws.¹⁰⁹ Where CBK has identified an area of concern, banking institutions through their respective board of directors must pass appropriate resolutions as a sign of their commitment to take appropriate action when it comes to correction of any identified area of weakness the institution may have.¹¹⁰ CBK will then issue a commitment letter to the relevant banking institution with specific corrective action items that the bank must undertake and thereafter a memorandum of understanding agreement will be executed outlining the recommended corrective action point to be undertaken.¹¹¹

Clause 2.5 of PG 13 provides as part of the corrective action that the CBK can take as it enforces corrective action with regard to the board is either suspension or removal of directors from office, and/or reconstitution of the board of directors; this clause does not seem to address measures that can be implemented if depositors are not able to have immediate access their funds.

Clause 2.7 of PG13 addresses instances where directors may be removed from office and penalties sanctioned against them. These sanctions however are only applicable where the actions of the directors are with regard to issuance of loans, credit facilities and advances done fraudulently. There is no mention of sanctions to be enforced personally against directors and officers where depositors' loose funds for reasons that may not fall within those mentioned in this clause.

¹⁰⁹ CBK/PG/13.

¹¹⁰ Clause 2.1, CBK/PG/13, *Prudential Guidelines* (2013).

¹¹¹ Clause 2.3, CBK/PG13, *Prudential Guidelines* (2013).

The provisions of clause 2.9 of PG 13 provide that if it appears to KDIC that the affairs of a Bank are being conducted in a manner detrimental to KDIC's interests and that of the depositors, then the Board may increase the specific bank's contributions to KDIC or terminate the protection of its deposits. One then wonders why it takes long for depositors to recover their money if these remedial actions are taken to protect their interests. Presumably, in as much as we have various penalties levied, these penalties do not guarantee a depositor immediate access of their funds.

The provisions of PG 22 provide that all consumers (depositors in this case) must be treated equitably, honestly and fairly in all stages of their relationship with the bank.¹¹² Bank directors are required to emulate corporate governance principles in their dealings with their customers i.e. the depositor; specifically principles of fairness, reliability, transparency, equity and responsiveness.¹¹³

The provisions of clause 3.2.8 of PG 22 provide that a banking institution should provide a customer with periodic statements of the depositors loan account. A lot of emphasis is given on the need for customers with loan accounts to be given information, there is no provision for information regarding the potential risks related to a depositors account should a systemic failure occur, bank performance and what depositors should be on the lookout for when financials accounts are published. These are critical items that depositors need to be informed on from time to time hence it would be prudent to have a clause in this guideline addressing these items of concern.

3.8. The Code of Corporate Governance Practices for issuers of securities to the public 2015

Pursuant to the provisions of Section 11 (3) (1) of the Capital Markets Act (CMA Act) (chapter 485A) of the Laws of Kenya, the Capital Markets Authority (CMA) published the Code of Corporate Governance Practices (the Code) which is applicable to both listed and unlisted public companies in Kenya.¹¹⁴ This study looked into the provisions laid out in the Code to underscore the tenets of these guidelines in line with adoption of good corporate governance practices when a board is running a company.

The CMA has taken a positive step is setting up these standards of corporate governance practices that go beyond the provisions set out in the Kenyan CA for purposes of clarity and better guidance.

¹¹² Clause 3.1, CBK/PG22, *Prudential Guidelines* (2013).

¹¹³ Clause 3.1 (ii), CBK/PG22, *Prudential Guidelines* (2013).

¹¹⁴ https://www.cma.or.ke/index.php?option=com_phocadownload&view=category&download=43:code-of-corporate-governance-practices-for-issuers-of-securities-to-the-public-2015-code&id=43:guidelines&Itemid=195 on 30th June 2021.

The board of directors of an issuer company is required to formulate internal policies as well as strategies that will help the company grow whilst protecting the interests of its shareholders and stakeholders.

The Code came into force on 4th March 2016 and applicable companies were given a grace period of one year from this date to ensure full compliance with the terms therein. Chapter 1 of the Code is the introductory section which sets out the objectives of the Code; it has adopted an ‘apply or explain’ principle wherein applicable companies are better guided through explanations on how to apply the provisions set out in the Code.

Clause 1.1.2 of the Code is the interpretation section which gives definitions of the various classes of directors which is quite insightful to a board in terms of knowing how to effect board appointments. The definitions given are as follows:

- i. An executive director is a board member who works for the company as a manager;
- ii. An independent director is a board member who does not have any material or financial interest/relationship with the company. An independent director is paid sitting allowances for every meeting attended; and
- iii. Non-executive director: is a board member who is not an employee of the company and neither does he/she does not form part of the management of the company. An independent director who serves for more than nine consecutive years qualifies to become a non-executive director.

Under the Code, companies are encouraged to factor the needs of its stakeholders as shall be discussed below. Clause 1.1.2 defines stakeholders as any party that holds an interest in the company and typically this includes employees, investors, customers, suppliers, trade associations, the government and the community.

Clause 1.1.4 outlines the purpose of the code which is to provide minimum standards that are expected from the shareholders, directors, chief executive officers and the management of either a public listed company or a public non-listed company that issues securities to the public. The aim of this objective is to ensure that there is clarity in terms of duties and expectations from the said shareholders, directors, chief executive officers and the management of the public listed company or a public non-listed company.

The code gives guidelines and each guideline is broken-down into three sub-sections namely the principle that the code is giving, followed by recommendations which set the standards that the company is required to adopt and concludes with guidelines which are insights shared on how the company should proceed to ensure implementation and attainment of the principle.

Clause 1.1.6 requires the board of directors of each respective company to formulate its own code stipulating the Company's policies and procedures and the chief executive officers, the management team as well as the entire board must be aware of the set out policies.

Clause 2.1.2 gives recommendations to the company to ensure that there is a nomination committee which oversees board appointments as well as review of performance of existing directors.

Clause 2.3 provides that every company must be led by an effective board that offers strategic guidance and leadership. The board is accountable to the shareholders. The board functions and under clause 2.3.6, for the board to promote sustainability of the company, it is encouraged to ensure it formulates strategies that promote sustainability by giving attention to environmental, social and governance (ESG) aspects of the company business. This objective is in line with the new stakeholder theory principle discussed in chapter 1 clause 1.7.3 that advocates for ESG policies.

Clause 2.6 requires the board to have tools that will help it discharge its duties and these are:

- i. There must be a board charter (a document that outlines the roles and responsibilities of each director, stipulates the roles between the board and the management and outlines the various board committees that are required to effectively run the company). The board charter should be used from time to time as a reference point for guidance on the roles of the directors, it should also be used for induction for new board members. The code requires for the charter to be published on the respective company website.
- ii. The board is required to formulate its code of ethics and standards and ensure the same is known by all relevant parties who fully comply to it;
- iii. The board must have an annual board work plan that focuses on strategic planning of the company and sets out review mechanisms that will look at risk assessment of the company, review the rate of implementation of the set out strategies;
- iv. A board evaluation tool kit that will be prepared by independent corporate governance specialists who will work closely with the board to ensure the evaluation policies set out comply with the current trends of corporate governance and can be implemented.

In a bid to ensure that the company is continually improving its processes, the board members are required to have an induction program (when they join the board) and the learning process does not stop there. Board members are required to constantly attend training sessions to sharpen and/or build their skills to enable them better serve the company.

Clause 2.11 provides for a commendable practice; the company is required take an annual governance audit to confirm if the company is operating under sound governance practices. The recommendation is that this audit be conducted by an independent professional institution that is accredited such as the Institute of Certified Public Secretaries of Kenya (ICPSK). During the audit, an assessment is done on the following areas:

- a. Leadership and strategic management;
- b. Board independence and governance;
- c. Board systems and procedures;
- d. Consistent shareholder and stakeholders value enhancement;
- e. Transparency and disclosure;
- f. Board compliance with laws and regulations;
- g. Board communication with stakeholders; and
- h. Corporate social responsibility.

Chapter 2 of the Code addresses the shareholder rights. The board as stated earlier is accountable to the shareholder hence it is crucial for the board to consider shareholder interests as well as investor protection at all times and this can be done through the following examples:

- i. The board must ensure as a matter of best practice that it gives the shareholders information pertaining to the company's performance and share annual reports;
- ii. The board must ensure that the necessary statutory notices for meetings is given, which notice must provide all details pertaining to the location, time and place the meeting is to held; and
- iii. The board must have open communication system with its shareholders, during meetings they should permit the shareholders to ask questions, give clarification where a matter is not clear.

By ensuring that shareholders are comfortable and confident in the board and the company operations, shareholders are able to invest more in the company which results in the Company's growth.

Chapter 4 of the Code addresses stakeholder relations. In line with both the stakeholder and the new stakeholder theories discussed earlier in chapter 1, it is believed that enhancement of stakeholder relations create a positive impact in the company for the long-term growth. Disclosure and transparency is encouraged as an effective communication channel established by the board encourages stakeholder confidence in the company.

Clause 4.0 of the Code provides that a stakeholder is anyone who can affect or be affected by a company's decisions and reputation hence the board must take into account all its stakeholders interests before making any decision.¹¹⁵

3.9. Conclusion

In conclusion, from the above analysis on the legal and regulatory framework this study, I have found that there is no provision of a direct duty owed to depositors (in their capacity as stakeholders) in both the CA and the BA. The provisions of the CA outline the requirement for directors to promote the success of the company while fostering the company's relationship with its customers but does not offer guidance on how to do this. Looking at the bank board composition, there is no representative of depositors. Similarly, the Deposit Protection Fund Board lacks representation from the depositors yet it works for protection of their interests, there is need to have a depositor's representative in the board to represent their interests. Further, this study noted that depositors lack crucial information pertaining to risks associated with the bank accounts they open should a systemic failure occur. It is prudent for a depositor to be well advised on the cap amount he/she/it would be compensated is such an event so as to make an informed decision. Given that the BA has robust laws on licensing and deposit taking activities that regulate bank operations such as the licensing requirement for deposit taking institutions, it is important to measure efficacy of the licensing regulations given that depositors are the ones prejudiced should the bank be placed under statutory management. There is therefore need for a subsidiary legislation that will specifically outline directors' duties and harmonize provisions of the BA and the CA on the classification of directors and the applicable duties for each category to be aligned in promotion of the success of the bank whilst having regard on the need to foster the relationship between the bank and the depositor and provide tools on how this duty should be carried out.

The provisions set out under the Code of Corporate Governance Practices for Issuers of Securities to the Public 2015 is a positive step in terms of having subsidiary legislation that has been put in

¹¹⁵ Clause 4.1.4, *Code of Corporate Governance Practises for Issuers of Securities to the Public*, (2015).

place to assist directors understand what is required of them and how best to implement their duties. The challenge with this code is that for starters, it only applies to public listed and unlisted companies, for purposes of this study some banking institutions may be required to comply but others that don't fall under its purview will not be required to comply. Furthermore, each company is required to independently formulate its own policies and strategies hence once again this becomes subjective given that there will be no standard code that is applicable across board. Given the fact that this is a Code, there is no mention of penalties for failure to comply with the guidelines provided therein.



4. CHAPTER FOUR: COMPARATIVE STUDIES IN THE UNITED KINGDOM AND THE REPUBLIC OF SOUTH AFRICA

4.1. Introduction

This chapter conducted a comparative study by looking at the best practises within the United Kingdom and the Republic of South Africa; with the aim of learning how the legislative and/or regulatory frameworks of directors' duties are enshrined and if there is something we can borrow from these countries. This chapter also analysed the mechanisms applied to ensure efficacy of the deposit insurance schemes when need for the same arises.

4.2. United Kingdom

The United Kingdom is a common wealth country and given that Kenya borrows heavily from legislation from this country, and to some extent copies their statutes verbatim, I looked at company and banking legislation in line with directors' duties from this jurisdiction to see to what extent the same advocate for protection of depositors' interests as directors carry out their duties within the banking sector.

4.2.1. Directors' duties under the Companies Act 2006

The legislative framework for company law in the United Kingdom is set out under the provisions of the Companies Act 2006 (CA 2006). A director has been defined to include any person occupying the position of director, by whatever name called.¹¹⁶ This definition is ambiguous and does not give a true reflection of who a director is. A shadow director has been defined to mean a person in accordance with whose directions the existing directors are accustomed to act.¹¹⁷ There are no definition of an independent director, executive director, and non-independent executive director under the provisions of the CA 2006.

The provisions of directors' duties are enshrined between Section 171 to Section 177 of the CA 2006. This study was however restricted to the directors' duty to promote the success of the company which is covered under Section 172 (1) of the CA 2006 that provides that 'a director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to:¹¹⁸

- a. the likely consequences of any decision in the long-term;

¹¹⁶ Section 250, *Companies Act*, (2006) (United Kingdom)

¹¹⁷ Section 251, *Companies Act*, (2006) (United Kingdom)

¹¹⁸ Section 172 (1) (a) - (f), *Companies Act*, (2006) (United Kingdom)

- b. the interests of the company's employees;
- c. the need to foster the company's business relationships with suppliers, customers and others;
- d. the impact of the company's operations on the community and the environment;
- e. the desirability of the company maintaining a reputation for high standards of business conduct; and
- f. the need to act fairly as between members of the company.’

The duty requires directors to act in good faith whilst factoring the interests of the customers¹¹⁹ appears to be a subjective duty as when put to test a director would be required to demonstrate how he/she had regard to the interests of customers whilst promoting the interest of the company-this could be proved through for example board minutes that would show the basis of a decision that was made hence directors are ideally encouraged to take and keep proper board minutes.¹²⁰

Directors owe a general duty to the company hence if they breach this duty, it is the company that should take action against the directors and the applicable remedies range from compensation, accountability and penalties for breach of their duties. In the case of *The Queen on the Application of People and Planet v. HM Treasury*¹²¹ campaigners from World Development Movement People, Platform and People & Planet instituted a case against the UK Treasury, for not taking adequate environmental and human rights considerations when they invested with the Royal Bank of Scotland (RBS) which in return used the monies invested in companies and projects that undermine UK’s commitment to halt climate change. In declining the request to hold a judicial review order over Treasury’s actions,¹²² the provisions of section 172 (1) of the CA 2006 was reviewed and court found that the Treasury officials correctly identified the proper ways in which the social and environmental considerations were taken into account. The court held that HM Treasury would not have been expected to go beyond or try and exercise further duties as this would have created a potential conflict with the duties of the board of RBS under Section 172 (1) of the CA 2006 as well as create an avenue for litigation being brought by minority shareholders.¹²³

¹¹⁹ Section 172 (1) (c), *Companies Act* (2006) (United Kingdom)

¹²⁰ -<<https://www.fortunelaw.com/what-need-know-about-directors-duties/>> on 17 May 2021.

¹²¹ *The Queen on the Application of People and Planet v. HM Treasury* [2009] EWHC 3020 Admin, The United Kingdom Queens Bench Division Administrative Court Queens Bench Division Administrative Court.

¹²² -<https://climate-laws.org/geographies/united-kingdom/litigation_cases/r-people-planet-v-hm-treasury-queen-s-bench-division-administrative-court-2009>- on 19 May 2021.

¹²³ Tsagas, G, ‘Section 172 of the Companies Act 2006: Desperate times call for soft law measures. In N. Boeger, & C. Villiers (Eds.), *Shaping the Corporate Landscape: Towards Corporate Reform and Enterprise Diversity* (pp. 131-150)’, *Hart Publishing*, (2018).

Due to challenges faced in implementation of the provisions of section 172 of the CA 2006, the UK government in the year 2017 published a set of guidelines for company directors pursuant to the Corporate Governance Reform: *The Government response to the Green Paper Consultation* as a method on addressing the utility of the provisions of Section 172 of the CA 2006.¹²⁴ A green paper is a document that is prepared by the UK government wherein parliamentarians as well as the members of the public are required to give to parliament their feedback on existing legislation/policies.¹²⁵ The Green Paper was the UK government's response to addressing the gaps that arose in effecting of Section 172 of the CA 2006. It was felt that the legislation did not balance all stakeholders' interests when it comes to the company structure: it was meant to give a voice to players within the company structure.¹²⁶ The UK government proposed to make provision for a subsidiary legislation that requires both private and public companies to give or show how their companies comply with the provisions of Section 172 of the CA 2006 specifically how they factor stakeholder's interests. In a bid to ensure stakeholders interests are factored the government proposed to have the Financial Reporting Council (FRC) to undertake revision of the UK Corporate Governance Code with an emphasis on strengthening the stakeholder voice at the board level.¹²⁷

4.2.2. Banking legislation

4.2.2.1. Financial Services & Markets Act 2000

The legislative framework for United Kingdom's (UK) banking laws is set out under the Financial Services & Markets Act 2000 (FSMA 2000).

Regulated activities are defined under Schedule 2 of FSMA 2000 to include: deposit taking, offering investment advice, dealing in investments, establishing collective investment schemes, using computer-based systems for giving investment instructions, safekeeping and administration of assets among others

Banking business in the UK is heavily regulated as section 19 of the FSMA 2000 prohibits any person/institution from conducting financial services business without having the relevant licenses; it is therefore mandatory for an institution that intends to operate either of the above referenced

¹²⁴ -<<https://www.wlrk.com/docs/corporate-governance-reform-government-response.pdf>> on 10 June 2021.

¹²⁵ <<https://www.parliament.uk/site-information/glossary/green-papers>> on 6 September 2021.

¹²⁶ Introduction given by UK Prime Minister Rt. Hon Theresa May MP on Corporate Governance Reform: *The Government response to the Green Paper Consultation*.

¹²⁷ https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/640470/corporate-governance-reform-government-response.pdf on 30 June 2021.

regulated activities, to ensure it obtains the necessary licenses and approvals as required by the regulator.

Deposit taking is a regulated activity for which one must apply to the Prudential Regulation Authority (through the Bank of England) to be allowed to undertake this activity.¹²⁸ Section 23 of the FSMA 2000 imposes criminal liability on a person who undertakes a regulated activity without having a valid license. Upon conviction, the person is liable to imprisonment for a term not exceeding two (2) years, or a fine or both.¹²⁹

The Financial Conduct Authority (FCA) is an independent body created pursuant to the provisions of the FSMA 2000. Its regulatory objectives as provided for under the FSMA 2000 are: to enhance market confidence, to ensure financial stability of financial institutions, consumer protection, creation of public awareness and prevention of financial crimes¹³⁰ for purposes of overseeing conduct regulation of financial institutions in the UK. Its objectives is to ensure proper functioning of financial markets by enhancing consumer protection, financial market integrity and creating healthy competition amongst financial institutions for the interests of consumers.¹³¹ The funding of this institution is obtained from the fees they charge the financial institutions that they regulate.¹³² The FCA is accountable to the Treasury.

The Prudential Regulatory Authority (PRA) was created pursuant to the provisions of section 2A of the FSMA. PRA is a part of the Bank of England, having been created following the disbanding of the Financial Services Authority (FSA).¹³³ The PRA obtained its powers and responsibilities on 1 April 2013 following the disbanding of the FSA through the Financial Services Act (2012). Its role is to supervise and/or set out prudential regulation all banks, building societies, credit unions, insurers as well as investment firms in the UK; its key objective being to promote the safety and soundness of the firms it regulates.

4.2.2.2. Financial Services and Markets Act (Regulated Activities) Order 2001

This statute provides for regulation of deposit taking by banking institutions. It defines deposit as money paid on terms under which it will be repaid with or without interest or premium, with or

¹²⁸ Part 4A, Financial Services & Markets Act, (2000) (United Kingdom)

¹²⁹ Section 23 (1) (b), *Financial Services & Markets Act 2000*, (United Kingdom)

¹³⁰ Section 1A, *Financial Services & Markets Act* (2000) (United Kingdom)

¹³¹ -<<https://www.fca.org.uk/about/the-fca>> on 22 May 2021.

¹³² -<<https://www.fscs.org.uk/about-us/funding/>> on 22 May 2021.

¹³³ -<<https://www.pfca.org.uk/financial-claims/organisations/prudential-regulatory-authority.html>> on 22 May 2021.

without demand and payable at such agreed time.¹³⁴ For monies obtained to qualify as deposits, they must be lent to others and/or the institution that received the monies must use it to finance its activities.¹³⁵ The statute has defined what would qualify as a deposit perhaps to draw distinct lines based on various types of financial services that may be collecting monies so as to give sufficient guidelines on what would qualify to be called a deposit and what is the regulated deposit taking activity. Section 5 (1) provides for what qualifies as a deposit taking activity which is either money received by way of deposit and let to others or any other activity of the person accepting the deposit is financed wholly, or to a material extent, out of the capital of or interest received by way of deposit.¹³⁶

The global financial crisis of 2008 occurred due to deregulation of financial institutions wherein banks took excessive risks that ended up causing them to go into financial distress and as a result, consumers suffered financial loss.¹³⁷ After the global financial crisis of 2008,¹³⁸ the then regulator Financial Services Authority (FSA) was able to assess what caused failure on its part and/or what contributed to the financial crisis; as a result of this assessment, the banking legislation framework in the UK was remodelled leading to separation of legislative powers between the Financial Conduct Authority (FCA) and the Prudential Regulation Authority (PRA). The FCA and the PRA took over the roles of the FSA.¹³⁹ There is a clear separation of roles and powers between these two regulators to enhance efficiency and not overwhelm one regulator to conduct too many activities and end up reducing its efficiency. The regulatory and supervisory role for banks in the UK is therefore now undertaken by these two regulators- Bank of England (as the PRA) and the FCA. The PRA oversees financial safety of banking institutions whilst the FCA focuses on customer banker relationships. These two institutions work hand in hand with Bank of England which supervises financial market infrastructure.

4.2.2.3. PRA Rule Book and FCA Handbook

Financial institutions are also required to abide by both the PRA Rule Book and the FCA Handbook. The PRA and the FCA, being independent regulators, have their own set of rules and approaches for purposes of guidance as created by the respective institutions; cross-reference of the two

¹³⁴ Article 5 (2) (a), *Financial Services & Markets (Regulated Activities) Order* (2001) (United Kingdom)

¹³⁵ Article 5 (1) (b), *Financial Services & Markets (Regulated Activities) Order* (2001) (United Kingdom)

¹³⁶ Section 5 (1) (a) (b), *The Financial Services and Markets Act 2000 (Regulated Activities) Order* (2001) (United Kingdom)

¹³⁷ -<<https://www.investopedia.com/terms/f/financial-crisis.asp>> on 20 May 2021.

¹³⁸ The global financial crisis (GFC) refers to the period of extreme stress in global financial markets and banking systems between mid-2007 and early 2009.

¹³⁹ -<<https://www.fscs.org.uk/how-we-work/customer-info/financial-protection/>> on 20 May 2021.

handbooks would be done where deemed necessary, such as cases where one is dealing with dual regulated firms.¹⁴⁰

The PRA rule book is made by the PRA for the regulated institutions that fall under its ambit and it contains rules and regulations that such firms must comply with.¹⁴¹ Pursuant to the provisions of the FSMA, the PRA is empowered to make the rules that the regulated entities are required to comply with.¹⁴² The structure of the PRA rule book is such that there are sector specific rules are created namely:¹⁴³

- i. the Banking and Investment Rules (which deals with rules for capital requirement regulations firms [such as banks, building societies, investment firms] and non-capital requirement firms (such as credit unions and PRA designated investment firms);
- ii. Insurance Rules divided into rules for solvency and non-solvency firms; and
- iii. Other Sector Rules (which covers rules for entities not authorised by the PRA).

The FCA handbook was created pursuant to the provisions of the FSMA 2000. Section 138G of Section 138G of the FSMA 2000 empowers FCA to create a handbook setting out its legislative instruments.¹⁴⁴ The rules contained therein must be complied with by all regulated firms.¹⁴⁵ The handbook has set out various legal instruments that its regulated entities must comply with such as Conduct of Business Sourcebook Instrument 2001, Supervision Manual Instrument 2001, Supervision Manual (Financial Crime Report) (Amendment No. 2), Instrument 2021, Financial Services Compensation Scheme (Management Expenses Levy Limit 2021/22) amongst many other instruments.

4.2.3. Financial Services Compensation Scheme

Bank deposit insurance schemes main aim is to protect depositors from the risk of loss of their monies due to lack of information. The UK government does not insure/give compensation rather this is covered under the Financial Services Compensation Scheme (FSCS), whose role is to provide compensation for consumers of financial services when the financial institutions are unable to meet their obligations to pay them their money as and when the consumers demand for their monies.¹⁴⁶

¹⁴⁰ -<<https://www.prarulebook.co.uk/home/Help>> on 19 May 2021.

¹⁴¹ -<<https://www.prarulebook.co.uk/home/Help>> on 19 May 2021.

¹⁴² Section 138G Financial Services & Markets Act 2000.

¹⁴³ -<<https://www.prarulebook.co.uk/>> on 19 May 2021.

¹⁴⁴ -<https://www.fca.org.uk/publication/handbook/readers-guide_0.pdf> on 19 May 2021.

¹⁴⁵ -<<https://www.fca.org.uk/about/handbook>> on 20 May 2021.

¹⁴⁶ -<<https://www.fca.org.uk/publications/policy-statements/ps16-10-financial-services-compensation-scheme-%E2%80%93-management-expenses>> on 22 May 2021.

The FSCS was established by the UK parliament as an independent body and it is funded from the annual levies paid by the PRA and FCA regulated firms.¹⁴⁷ The PRA and FCA determine rules within which the FSCS operates. Each financial institution pays a set out levy to FSCS based on its nature of activity and size so as to enable the FSCS honour its compensation claims.

The FSCS only covers claims from financial institutions approved by the FSMA. For one to be able to make a claim for compensation one must meet the following conditions:¹⁴⁸

- i. The financial firm that the customer was dealing with must be unable to pay the money requested for;
- ii. The firm the customer transacted with must have been authorised by either the FCA and PRA to carry out its activities at the contracting time;
- iii. The customer must be able to show that he/she has suffered financial loss as a result of the non-payment; and
- iv. You are a private individual/an eligible business entity.

Once FSCS pays a claim to a customer, it takes up the customer's legal rights over the funds with the failed financial institution and then follows up the said institution for a possible recovery of the said sums through insolvency procedures; the intention being to help recover composition costs as well as try and realise more for customers who have lost more funds than what is compensated.¹⁴⁹

The FSCS protects up to eighty-five thousand pounds (£85,000) and runs across all accounts an individual hold.¹⁵⁰ If a bank shares a license with another bank, for purposes of compensation, the accounts will be treated as one and the compensation is limited to eighty-five thousand pounds (£85,000) per person, per banking license issued.¹⁵¹ This is unlike the Kenyan provision wherein if an individual or an institution holds more than one account the same are consolidated and compensation given as if one held one account only. If an account is held in joint names the total compensation cover will be one hundred and seventy thousand pounds (£170,000) which is also commendable compared to our local deposit insurance compensation provisions discussed earlier.

¹⁴⁷ -<<https://www.fscs.org.uk/about-us/funding/>> on 22 May 2021.

¹⁴⁸ -<<https://www.fscs.org.uk/how-we-work/claims-process/eligibility-rules/>> on 22 May 2021.

¹⁴⁹ -<<https://www.fscs.org.uk/about-us/funding/recoveries/>> on 22 May 2021.

¹⁵⁰ -<<https://www.fscs.org.uk/>> on 22 May 2021.

¹⁵¹ <<https://www.fscs.org.uk/how-we-work/customer-info/banking-licences/>> on 22 May 2021.

In terms of the timeline for paying, the FSCS has set a timeline of seven (7) days (from the date that the banking institution fails) within which to pay the compensation but provides that other complex payments could take a longer period.¹⁵²

In a bid of creating awareness and transparency process to protect customers, the FSCS has created a bank and savings protection checker (applicable to customers who make cash deposits) wherein one can check how much of their monies are protected should a bank failure occur.¹⁵³ This is important in terms of one being aware of the level of risk they are exposed to and they can make an independent assessment of how and where to keep their deposits for example by ensuring one opens several accounts and not have more than £85,000 in one account thereby spreading the risk.

It is important to note that in the UK, as a matter of practice, banks display on their website's information about the FSCS and what amounts one would be compensated if the bank is unable to meet its obligations hence creating a platform of awareness for depositors.

I now turn to South Africa.

4.3. South Africa

South Africa is a common wealth country and I looked at the legislative and regulatory architecture of South African banking and company laws for comparison purposes seeing that South Africa as leading African country has been reputed to have well established banking regulatory framework aimed at ensuring soundness of the banking institutions.¹⁵⁴ This has been tested given that even during the international GFC, banking institutions in South Africa were able to remain sound and did not struggle with capital adequacy requirements.¹⁵⁵ Further reasons given for South Africa's stable banking system is due to the fact that at the time of the GFC, its domestic banks had not heavily invested in high risk activities.¹⁵⁶

4.3.1. Banking Legislation

The South African Reserve Bank (SARB) is the Central Bank of South Africa whose primary role is to protect the value of the currency of the country to ensure that there is sustainable economic

¹⁵² <<https://www.fscs.org.uk/what-we-cover/banks-building-societies/>> on 6th September 2021.

¹⁵³ <<https://www.fscs.org.uk/check-your-money-is-protected/>> on 22 May 2021.

¹⁵⁴ <<https://thelawreviews.co.uk/title/the-banking-regulation-review/south-africa>> on 23 May 2021.

¹⁵⁵ <<https://thelawreviews.co.uk/title/the-banking-regulation-review/south-africa>> on 23 May 2021.

¹⁵⁶ <<https://www.werksmans.com/wp-content/uploads/2013/04/safinal.pdf>> on 23 May 2021.

growth in the country.¹⁵⁷ Banking business is regulated and for one to conduct such business they must apply for a license from the Prudential Authority.¹⁵⁸

4.3.1.1. The Banks Act 94 of 1990

The Banks Act 94 of 1990 (including the Banks Amendment Act, 2000) provides for regulation and supervision of business that is carried out by public companies that take deposits from members of the public by stipulating capital adequacy requirements and minimum capital reserve funds that the banks should have to operate banking business.¹⁵⁹

Under section 1 (1) of the Banks Act 94 of 1990 (including the Banks Amendment Act, 2000) bank business is defined as acceptance of deposits from the general public (including persons in the employ of the person so accepting deposits) as a regular feature of the business in question; or the soliciting of or advertising for deposits and/or the utilization of money, or of the interest or other income earned on such money, accepted by way of deposit for the granting by any person, acting as lender in his/her/its own name or through the medium of a trust or a nominee, of loans to other persons; for investment by any person, acting as investor in his own name or through the medium of a trust or a nominee; or for the financing, wholly or to any material extent, by any person

4.3.1.2. The Financial Sector Regulation Act No. 9 of 2017

The Financial Sector Regulation Act No. 9 of 2017 (FSRA) was signed into law on 21st August 2017 and came into operation on 29th March 2018. The FSRA introduced the twin peak model of financial regulation creating two regulators within the banking industry namely the Prudential Authority (PA)¹⁶⁰ and the Financial Sector Conduct Authority (FSCA).¹⁶¹

The SARB is tasked with the role of protection and enhancement of financial stability. In the event a systemic failure occurs, SARB's role is that of restoring the banks financial stability.¹⁶² Section 256 of FSRA provides for creation of a financial sector information register. This register contains accurate information pertaining to the countries financial sector laws, regulatory legal instruments and material on implementation of the applicable regulations.¹⁶³ The financial sector information

¹⁵⁷ Section 3 (1), *South African Reserve Bank Act* No. 90 of 1989 (South Africa).

¹⁵⁸ Section 12 (4), *South African Reserve Bank Act* No. 90 of 1989 (South Africa).

¹⁵⁹ Sections 2 and 5, *Banks Act* 94 of 1990 (including the Banks Amendment Act, 2000) (South Africa).

¹⁶⁰ Section 2, *Financial Sector Regulation Act*, No. 9 of 2017 (South Africa).

¹⁶¹ Section 4, *Financial Sector Regulation Act*, No. 9 of 2017 (South Africa).

¹⁶² Section 11 (1), *Financial Sector Regulation Act*, No. 9 of 2017 (South Africa).

¹⁶³ Section 257, *Financial Sector Regulation Act*, No. 9 of 2017 (South Africa).

register must be kept electronically and in a user friendly manner such that members of the public can easily browse and search for information.¹⁶⁴

The Prudential Authority (PA) is established as a juristic person and is a national public entity. It operates within the administration of the South African Reserve Bank (Reserve Bank).¹⁶⁵ It is therefore inferred that the PA is not autonomous and must work under the ambit of the Reserve Bank. Its objectives among others is to promote and enhance safety and soundness of financial institutions,¹⁶⁶ and protect financial customers against risk that those financial institutions may fail to meet their obligations.¹⁶⁷ It is encouraging to note that there is an active role for protection of financial customers specifically assigned to the PA in terms of the losses they would suffer should the financial institutions fail to meet their bargain.

For the PA to meet its objectives, it is required to regulate and supervise financial institutions and co-operate with the Reserve Bank, conduct and publish research that is relevant to its set our mandate.¹⁶⁸ This provision intimates the need for the regulatory body to co-operate with the Reserve bank in enforcing regulations so as to avoid a clash of roles. The FSRA however does not delve into details of how the PA is to go about protecting the financial customers from potential risks associated with systemic risk/failure of the financial institution.

The Financial Sector Conduct Authority (FSCA) is established as a juristic person and operates as a national public entity.¹⁶⁹ The FSCA's objectives among others is to:

- i. enhance and support the efficiency and integrity of financial markets;
- ii. protect financial customers by providing financial customers as well as potential financial customers with financial education programs to promote financial literacy and assist financial customers and potential customers make sound financial decisions.¹⁷⁰

FSCA's objective of creation of financial literacy programs for financial customers and potential customers to enable them make proper decisions backed with the right kind of information is laudable. The provisions section 58 (1) (i) of the FSRA make it a requirement for the FSCA to monitor the extent to which the financial system delivers fair outcomes for financial customers as

¹⁶⁴ Section 259 (1) and (2), *Financial Sector Regulation Act*, No. 9 of 2017 (South Africa).

¹⁶⁵ Section 32 (1), *Financial Sector Regulation Act* No. 9 of 2017 (South Africa).

¹⁶⁶ Section 33 (a), *Financial Sector Regulation Act* No. 9 of 2017(South Africa).

¹⁶⁷ Section 33 (c), *Financial Sector Regulation Act* No. 9 of 2017(South Africa).

¹⁶⁸ Section 34, *Financial Sector Regulation Act* No. 9 of 2017(South Africa).

¹⁶⁹ Section 56 (1), *Financial Sector Regulation Act* No.9 of 2017(South Africa).

¹⁷⁰ Section 57, *Financial Sector Regulation Act* No. 9 of 2017(South Africa).

well as to implement strategies and programs for financial education. This provision must be complied with by the FSCA to ensure it meets its objective of protection of financial customers and shows the commitment of the regulator to assess if the customers interests are being looked out for on a continuous basis. This is a commendable objective to be emulated.

The FSRA has also been instrumental in creation of an *Ombud* council which is a public entity whose objective is to assist in ensuring financial customers have access to affordable alternative dispute resolution mechanisms to air their grievances against financial institutions products/services.¹⁷¹ This provision shows the regulators interests in protection of the customers' interest by allowing financial customers to have an easily accessible and affordable means through which they can channel any issues they have with a financial institution for determination.

It is important to note that the provisions of FRSA incorporates definitions of the Companies Act, the Constitution and the Consumer Protection Act¹⁷² meaning that provisions of these statutes are intertwined and must go hand in hand for proper functionality of the financial regulation/sector.

4.3.2. Deposit Insurance Scheme

The Republic of South Africa does not have a deposit insurance scheme and the government would previously pay depositors on a case-to-case basis in the event of a bank failure, ultimately shifting this obligation to taxpayers. In a bid to shift this obligation from taxpayers, the SARB is currently looking to ways of coming up with an independent deposit insurance scheme;¹⁷³ it has been felt that deposit insurance would be inadequate in preventing bank runs unless there is 100% coverage though this may not be realistic.¹⁷⁴ The SARB's Financial Stability Department therefore came up with a discussion paper on designing a deposit insurance scheme to address this potential gap.¹⁷⁵ Some of the key tenets proposed are as follows:

- i. The Deposit Insurance scheme be established as an independent body corporate but to work under the SARB;
- ii. All registered banks must be members of the deposit insurance scheme;

¹⁷¹ Section 175-176, *Financial Sector Regulation Act No. 9 of 2017*(South Africa).

¹⁷² Section 1 (a), *Financial Sector Regulation Act, No. 9 of 2017*(South Africa).

¹⁷³ -<<https://www.moodysanalytics.com/regulatory-news/sep-01-20-sarb-consults-on-deposit-insurance-funding-model-for-south-africa>> on 23 May 2021.

¹⁷⁴ -<<http://www.treasury.gov.za/twinpeaks/Designing%20a%20deposit%20insurance%20scheme%20for%20South%20Africa.pdf>> on 23 May 2021.

¹⁷⁵ South Africa Reserve Bank-Financial Stability Department-Designing a deposit Insurance scheme for South Africa-a discussion paper.

- iii. Qualifying deposits to be covered up to a maximum sum of one hundred thousand rands (R100,000) per depositor per bank;
- iv. In terms of deposit coverage some of the applicable provisions would be as follows:¹⁷⁶
 - a. Foreign nationals' deposits and foreign currency deposits held at domestic branches of South African banks will be covered;
 - b. There will be no coverage for deposits at foreign branches and subsidiaries of South African banks abroad;
 - c. Accrued interest will be included in the deposits covered, but the netting of account fees will not be allowed;
 - d. Deposits will be covered on a gross basis;
 - e. Pooled accounts will be treated as a single account, except for pooled accounts where professional practitioners hold deposits on behalf of clients. For these pooled accounts, a 'look-through approach' shall be followed to determine the deposit balance of the underlying depositors. Consultation with the banking industry will take still take place to consider the feasibility of covering the individual beneficiaries of pooled accounts that meet the criteria of qualifying deposits;
 - f. Joint accounts will be split equally between the account holders or according to the specific ratios contractually laid down with the bank, provided that banks record these ratios when joint accounts are opened.

It is noteworthy to point out a commendable consideration put in the thought process of how payments should be done for pooled accounts specifically where a practitioner is operating a client's account that has monies for various clients'. The proposals for creation of the deposit insurance scheme are however yet to be implemented into law.

4.3.3. Directors duties under the Companies Act 2008 (Act No. 71 of 2008)

The Companies Act 2008 (Act No. 71 of 2008) of the Republic of South Africa was signed into law on 8th April 2009 and became operative as law from 1st May 2011. This legislation comes into play given the fact that the above banking legislations infer to its provisions as the structure to be adopted by a banking institution should be that of a company that has a board of directors as the governing institution running its affairs.

¹⁷⁶ Clause 8 (a)-(g) South Africa Reserve Bank-Financial Stability Department-Designing a deposit Insurance scheme for South Africa-a discussion paper.

A director is defined to mean a member of the board of a company or an alternate director of a company including any person who occupies the position of the director or alternate director.¹⁷⁷ A company is required to run its affairs under the direction of its board of directors who derive their authority from the provisions of the Companies Act 2008 (Act No. 71 of 2008) or from the company's memorandum of incorporation.¹⁷⁸ Directors are required to act in good faith, for a proper purpose and in the best interests (in a manner they reasonably believe to be so) of the company.¹⁷⁹ This is a subjective provision as the words “*in a manner they reasonably believe to be*” is not measurable. Section 76 of the Companies Act 2008 (Act No. 71 of 2008) sets out standards of director's conduct as they carry out their duties wherein the director is expected to act in good faith and in the interest of the Company and these are:¹⁸⁰

- i. The director must demonstrate that he/she used a degree of care, skill and diligence that is reasonable expected of a person in that position; and
- ii. The director must carry out his/her duties in the same way a director in such a position would do if he had the general knowledge, skill and experience similar to his.

From the provisions of the Companies Act 2008 (Act No. 71 of 2008), there is no requirement for directors to factor the company relations with its customers under this statute.

Section 77 of the Companies Act 2008 (Act No. 71 of 2008) provides for liability to the directors in the event that their actions result in the company undergoing losses. There is however no liability mentioned for losses that the company's customers may have incurred as a result of breach of directors duties. It is important to have directors personally liable for their actions or omissions that result in losses as this makes them cautious in terms of how they conduct the affairs of the company. A holistic approach may however need to be envisaged more so when the company is a financial institution that has customers who incur losses.

The Companies Act No. 71 of 2008 (Act No. 71 of 2008) does not provide for definition of an independent director, executive director, and non-independent executive director and neither does it address their roles and responsibilities in a Company.

¹⁷⁷ Section 1, *Companies Act No. 17 of 2008* (South Africa).

¹⁷⁸ Section 66, *Companies Act No. 17 of 2008* (South Africa).

¹⁷⁹ Section 76, *Companies Act No. 17 of 2008* (South Africa).

¹⁸⁰ Section 76 (3) (a) (b) and (c), *Companies Act No. 17 of 2008* (South Africa).

4.4. Conclusion

From the analysis of the company and banking legislation of the two countries the key provisions/practises that can be borrowed and contextualised in Kenya are as follows:

- i. The challenge of having directors balance the interests of the shareholders and the customers as they effectuate their duties is not unique to Kenya alone. The UK went ahead and published subsidiary legislation to address this problem.
- ii. The UK and SA have two banking regulators one that deals with prudential regulation whilst the second regulator is charged with financial conduct and market regulations (customer relations); Kenya on the other hand has one regulator handling both prudential and financial conduct regulation.
- iii. To promote the interests of depositors it is key for the regulator to have as part of its mandate the need to educate depositors of the risks they could encounter in the event of a bank systemic failure, and in the event, there is a dispute, the regulators should provide affordable mechanisms within which depositors can have their voices heard. In the UK, the Financial Services Compensation Scheme (FSCS) has actively taken this role. In South Africa, the FSCA has as part of its objective creation of financial literacy to financial customers so as to protect the customers' interest.
- iv. The deposit insurance scheme should be transparent in terms of how much depositors would be compensated and look at having a bank and savings protection checker like the one used by the Financial Services Compensation Scheme in the UK wherein one can access the online platform to check how much of their monies are protected should a bank failure occur.

5. CHAPTER FIVE: ANALYSIS OF THE RESEARCH FINDINGS AND RECOMMENDATIONS

5.1. Introduction

This chapter presents a summary of the findings of my study, and concludes by giving recommendations on the way forward on how Kenya's company law and banking laws can be harmonized with a view to have directors act in good faith so as to protect depositors interest.

5.2. Findings on the directors duty to promote the success of the Company whilst fostering company relations with its customers as provided under the respective Companies Acts

Generally in the three jurisdictions, the directors' are required to act in good faith so as to promote the success of the company. In the UK and in Kenya, the directors are required to factor the company's relations with its customers as they exercise the duty to act in good faith. In the UK, it was felt that there was need to promote the social, environmental and governance objectives following the series of corporate failures that occurred when this legislation was introduced (the provisions of section 172 of the Companies Act 2006).¹⁸¹

In all the three jurisdictions, the respective Companies Act do not provide for categorisation of directors i.e. there is no definition of independent directors, executive directors, and non-independent directors. Their roles are also not provided in the respective Companies Act. One is required to refer to other legislations/regulations to get the definitions and the gist of their roles and responsibilities.

The "how" directors should act has not been specified in either of these statutes, and the challenge often felt is that no standard test/threshold that has been set for directors to measure how they are to 'act in good faith'.¹⁸² As earlier highlighted in clause 4.1.1 above, in a response to address the challenge of enforcement of Section 172 (1) of the CA of 2006 by directors, the UK government proceeded to create necessary guidelines to clarify and guide directors accordingly through the Corporate Governance Reform: *The Government response to the Green Paper Consultation*.¹⁸³

¹⁸¹ -<<https://www.law.ox.ac.uk/business-law-blog/blog/2017/09/section-172-uk-companies-act-2006-desperate-times-call-soft-law#:~:text=Section%20172%20of%20the%20UK's,section%20which%20refer%20to%20the>> on 10 May 2021.

¹⁸² -<<https://sites.google.com/site/349924e64e68f035/issue-4/a-critical-examination-of-the-impact-of-section-172-of-the-companies-act-2006>> on 31 May 2021.

¹⁸³ -<<https://www.wlrk.com/docs/corporate-governance-reform-government-response.pdf>> on 10 June 2021.

There is therefore need more so for Kenyan legislation to specify how directors should act in good faith to promote the success of the company while having regard to the need for the company to foster its business relationships with its customers.

5.3. Findings on banking legislation

As discussed in the previous chapter, the UK banking sector is regulated by the Prudential Regulation Authority (PRA) (whose role is prudential regulation and supervision of banks by setting out standards of operation and supervising the banks to ensure compliance) and the Financial Conduct Authority (FCA) (responsible for how banks treat their customers as well as overseeing market behaviour in the financial institutions). Through clear separation of roles and responsibilities between the two regulators, it is hoped that this will enhance better performance of the regulators as discussed in chapter 4 and thereby promote accountability as there is clarity on each of the regulator's mandate.

In South Africa, there is a twin peak system of financial regulation with two regulators as indicated in chapter 4 i.e. the Prudential Authority and the Financial Sector Conduct Authority each with its own distinct functions; the aim being to provide clarity for each of the regulator's function and objectives so as to enhance accountability as roles and duties are clearly outlined.

Kenya on the other hand has one regulator-the Central Bank of Kenya that manages both the prudential and conduct aspect of financial institutions.

5.4. Findings on the Deposit Insurance Fund

As earlier discussed, in the UK, the deposit insurance is run and managed by the Financial Services Compensation Scheme (FSCS). The key highlight of this compensation scheme being the fact that account holders are treated individually (in the case of joint ownership of a bank account) and each account holder will be paid the insured deposit of £85,000/=.

Consumer awareness is a key objective of FSCS. There is a protection checker wherein one can access the FSCS online platform to check how much of his/her money falls under the protected compensation amount that he/she would be entitled to should a bank failure occur. This is a commendable incentive in creating awareness to depositors as it informs them of the potential risk they face (in terms of accessing their deposits) should a systemic failure occur. As a matter of practice, banks that are members of FSCS indicate information about FSCS on their website i.e. what is FSCS, who qualifies to lay a claim (in the event the bank undergoes a systemic failure), how much would be paid and how to apply when seeking compensation etc. in their website.

Currently, the Republic of South Africa does not have a deposit insurance fund/scheme. However, pursuant to the Financial Sector Laws Amendment Bill¹⁸⁴ proposals have been made to introduce a Corporation for Deposit Insurance to administer the Deposit Insurance Fund to enable it cover depositors should a systemic bank failure occur.¹⁸⁵ The provisions pertaining to how joint accounts compensation should be done as discussed in chapter 4 are commendable as monies will be paid to each account holder.

Kenya has a deposit insurance scheme managed by the Kenya Deposit Insurance Corporation (KDIC). However, findings revealed that Kenyan banks do not discuss information pertaining to the provisions of the deposit insurance with depositors' and a bank customer would only interact with KDIC when his/her/its bank undergoes a systemic failure. By sharing information which could be done through publications, webinars and the like, KDIC would be creating an awareness to the public of its role, what risks are associated with the banks in the event of systemic failures and how much money a depositor would be paid as compensation. This information goes a long way in making depositors make informed choices of how much money they have in their bank account.

Additionally, in Kenya, for purposes of compensation of insured deposits by the KDIC, if one has more than one bank account with a bank that has been placed under statutory management, the bank accounts are consolidated and treated as one account. The fact that SARB's Financial Stability Department proposes for a special repayment mechanism for account holders who have pooled resources (specifically practitioners who operate clients' accounts with monies from various clients held in one account) needs to be reconsidered by the KDIC as in our current regime this is not factored when effecting payments of insured deposits.

5.5. Recommendations

The below recommendations are based on the comparison that my research has made with the legislative and regulatory architecture in the United Kingdom and in the Republic of South Africa with regard to their company and banking laws:

¹⁸⁴ The Bill was introduced to the National Assembly of the Republic of South Africa on 17th August 2020 and through the Finance Committee has undergone public participation on 18th May 2021 and is currently under consideration by the National Assembly of the Republic of South Africa- <https://pmg.org.za/bill/960/>.

¹⁸⁵ -<<https://www.werksmans.com/legal-updates-and-opinions/the-deposit-insurance-funding-model-and-the-implications-for-banks/>> on 23 May 2021.

1. There is need to create a link between the provisions of the Banking Act, the Companies Act and the Constitution as this would clearly show how certain aspects of banking law are intertwined with the provisions of the Companies Act and the Constitution.
2. As highlighted in chapter 4, the banking legislations of the UK and the Republic of South Africa take specific cognizance in the definitions and interpretations sections of the Constitution and the Companies Act. Our Banking Act should cite this and give the ‘how to’ when it comes to reliance of the duties of the directors with a view of enhancing consumer protection as provided in the Constitution. This can come in the form of guidelines.
3. Section 143 (1) (c) of the Companies Act 2015 needs to be expounded further by creating an additional sub-section that sets out the standard test of what directors acting in good faith for the interest of the company entails. As discussed in Chapter 1 under section 1.7.3, the New Stakeholder’s theory advocates for identification of processes that are easily understood by directors and that they can easily enforce. The additional sub-section should also assist the regulator by providing a guiding tool of how it should ensure that directors are able to implement this duty.
4. Further, there is also need for guidelines to be set on how directors should balance the interest of stakeholders and those of the shareholders. We can borrow a leaf from the UK government by creating guidelines such as those that were recommended by the Corporate Governance reform:¹⁸⁶ The Government Response to the Green Paper Consultation which in our case would include:
 - i. A subsidiary legislation that compels companies to pass resolutions and explain how they factored customers interests in their decision making process;
 - ii. Through the Institute of Certified Public Secretaries Kenya (ICPSK) (in consultation with relevant industry stakeholders for instance in the Banking Sector) develop a code of practice that guides on interpretation of Section 143(1) (c) is to be exercised/enforced. This will be borrowing from the spirit of the Code of Corporate Governance Practices for Issuers of Securities to the Public Listed Company discussed in Chapter 3 above. The proposal is to have ICPSK come up with a standard code that bank board of directors can use as a guideline with the necessary tools for explanation of the principles,

¹⁸⁶ -<<https://www.wlrk.com/docs/corporate-governance-reform-government-response.pdf>> on 10 June 2021.

guidelines on how to attain the same and recommendations of how to conduct assessments if the standards set are being met.

5. In terms of bank board composition, it is time to consider having a representative from the consumer protection authority to represent the depositors' interest that is a representative appointed by the Consumer Federation of Kenya (Cofek). This in the short term may look like an expensive approach however the long term goal (which is to protect depositors interests and reduce bank systemic failure whose effect is much more costly not only to the bank but to the depositors and the economy generally. This proposal is aligned to the New Stakeholder theory discussed earlier that advocates for the need of the board to look at structures that tend to mitigate the potential long-term risks that arise when banks undergo systemic failures.
6. As we saw in chapter 4, the board of the Kenya Deposit Insurance Corporation does not have a representative of the depositors. To this end, the board composition of the Kenya Deposit Insurance Corporation should be reviewed so as to include a representative from the depositors' as a member of the board. This would ensure depositors voice is well represented in the Board given that it is mandated to safeguard depositors' interests.
7. Further, to promote the interests of depositors it is key for the Central Bank of Kenya as the banking regulator to include as part of its mandate the need to educate depositors of the risks they could encounter in the event of a bank systemic failure, and in the event, there is a dispute, the regulators should provide affordable mechanisms within which depositors can have their voices heard and issues determined; and
8. The Kenya Deposit Insurance Corporation should work closely with banks that are its members to ensure that information pertaining to the deposit insurance scheme is clearly spelt out in the respective bank websites and the bank account opening forms. The Kenya Deposit Insurance Corporation should ensure that depositors' are educated on the following areas: what is deposit insurance, when the need for the same arises, how much one would be entitled to be paid in the event a bank undergoes a systemic failure and how long does the process of compensation takes.

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7.2. Appendix B: Ethics Clearance Report



25th October 2021

Mrs Olaya Caroline
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Dear Mrs Olaya,

RE: Protection of Donors' Interest Within the Banking Sector in Kenya: An Analysis of Donors' Duty to Protect the Success of the Company and the Suitability of the Compensation Fund When the Bank Fails

This is to inform you that SU-IEEC has reviewed and approved your above RE: **olaya's** research proposal. Your application reference number is SU-IEEC/1176/21. The approval period is 28th October 2021 to 24th October 2022.

This approval is subject to compliance with the following requirements:

1. Only approved documents including informed consent, study information, MTA) will be used.
2. All changes including amendments, deviations, and violations) are submitted for review and approved by SU-IEEC.
3. Data and life-threatening problems and serious adverse events or unexpected adverse events whether related or unrelated to the study must be reported to SU-IEEC within 48 hours of notification.
4. Any changes, anticipated or otherwise that may increase the risks or affect the safety or welfare of study participants and others or affect the integrity of the research must be reported to SU-IEEC within 48 hours.
5. Clearance for export of biological specimens must be obtained from relevant authorities.
6. 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 request.
7. Submission of an interim summary report within 90 days upon completion of the study to SU-IEEC.

Prior to commencing your study, you will be expected to obtain a research license from National Commission for Science, Technology, and Innovation (NACOSTI) <http://www.nacosti.or.ke> and also obtain other clearances as may be required.

Yours sincerely,



Prof Paul Wani,
Chairperson, SU-IEEC



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