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Evaluating the case for a unified model of regulation in the financial services sector in Kenya.

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Evaluating the Case for a Unified Model of Regulation in the Financial Services Sector in Kenya

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DECLARATION

I declare that this work has 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 another person except where due reference is made in the thesis itself.

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ABSTRACT

The Financial services sector plays a crucial role in the economy of any country. To make sure that the financial sector is stable, it is prudent to regulate it. A sound regulatory framework is thus important to safeguard the smooth operation of the financial sector. In Kenya, the current regulatory framework has been marred by a multitude of challenges due to the dynamic changes that have been experienced in the sector such as technological innovations. This has resulted to regulatory gaps and overlaps which have led to regulatory arbitrage. To resolve some of these challenges, reforms in the regulatory framework have been proposed including the introduction of a unified model of regulation. A unified model of financial regulation is one where there is one single regulator for the whole financial services industry. The current regulatory framework in Kenya is set along sectoral lines such that there is a single regulator for every sector in the financial industry and this has been marred by multitude of problems including regulatory overlaps and gaps. In its search for the most optimal model of financial regulation in the financial services sector, Kenya has introduced reforms towards improving the current regulatory framework and to also ensure alignment to international practices. This paper analyses effectiveness of the current regulatory framework in the Kenyan financial market and the rationale for the proposed model of a unified regulator for the Kenyan financial services against the background of the general objectives of financial regulation and the different models of financial services regulation adopted in other jurisdictions to determine the most suitable model of regulation for the financial services sector in Kenya.

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List of Abbreviations

GFC	Global Financial Crisis
FSA (UK)	Financial Services Authority (United Kingdom)
PRA	Prudential Regulatory Authority
FCA	Financial Conduct Authority
FPC	Financial Policy Committee
BOE	Bank of England
CMA	Capital Markets Authority
IRA	Insurance regulatory Authority
RBA	Retirement Benefits Authority
CBK	Central Bank of Kenya
SASRA	Sacco Societies Regulatory Authority
SACCO	Savings and Credit Co-operatives
FINMA	Swiss Financial market Supervisory Authority
SARB	South African Reserve Bank
PA	Prudential Authority
FSCA	Financial Sector Conduct Authority
UK	United Kingdom
USA	United States of America

List of Statutes

Kenya

1. Capital Markets Act (Amendment), 2019
2. Cooperative Societies Act of 1997
3. Financial Services Authority Bill, 2016
4. Insurance Act (Amendment), 2006
5. Retirement Benefit Act
6. Sacco Societies Act, 2009
7. The Central Bank of Kenya Act (CAP 491)
8. The Banking Act, 2012

United Kingdom

1. Financial Services and Markets Act, 2000
2. Financial Services Act, 2012
3. The Banking Act, 2009)

South Africa

1. Financial Sector Regulation Act, 2017

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To my loving parents Jeff and Maggy and to my siblings, Jackie and Steve.

CHAPTER 1

1 BACKGROUND AND INTRODUCTION TO THE STUDY

1.1 Background

The financial services sector plays a crucial role in the economy of a country. The stability of any financial market is pegged on an effective regulatory framework. Such a framework should aim towards fostering economic prosperity, preserving the stability of financial institutions, promoting the safety and soundness of financial institutions, protecting consumers, and cushioning financial institutions from systemic risks.[1]

The Global Financial Crisis (GFC) in 2008-2009 was greatly attributed to the lack of a sound regulatory framework within the financial services sector, which saw the collapse of many financial institutions in the most advanced and influential economies of the world.[2] As a result, most countries prioritized enhancing the stability and resilience of financial systems through augmented regulation[3]. In turn, this saw the modeling of new financial regulatory structures whose primary purpose was to encompass the dynamic developments in the financial sector, such as innovation, and regulate the amount of risk a financial institution could take to cushion against systemic risk.[4]

In Kenya, the GFC had little impact on the financial sector as the Kenyan economy was not directly linked to the global economy, which was the epicenter of the crisis.[5] However, this was the beginning of multiple debates around the most appropriate model of financial regulation that Kenya should adopt. Key amongst these debates was whether the current regulatory framework was appropriate to deal with the emerging trends in the financial services sector in Kenya. Amongst the emerging trends was the cross-selling of products within different sectors. For instance, bancassurance, where many banks were now offering insurance products, and the rise of mobile

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[1] Cranston R, Avgouleas E, Kristen Van Z, *Principles of Banking Law*, Oxford University Press, 2018, 27

[2] Avgouleas E, *'Governance of Global Financial Markets: The Law, the Economics, the Politics'* Cambridge University Press, 2012, 102

[3] Mwega F, Financial Regulation in Kenya: Balancing Inclusive growth with financial stability', (2014) 1 working paper available at https://www.odi.org/sites/odi.org.uk/files/odi-assets/publications-opinion-files/9279.pdf

[4] Schwarcz D, Zaring D, 'Regulation by Threat: Dodd- Frank and The Non-bank Problem', 84 *The University Chicago Law Review*, (2017), 1817

[5] Gakeri J, 'Financial Services Regulatory Modernization in East Africa: The search for a new paradigm for Kenya',1 *International Journal of humanities and social Science*, (2011), 162

banking and online lending services. It was argued that the current regulatory framework was not advanced enough to deal with these dynamic developments in the finance industry, thus the need for a more appropriate regulatory framework.[6]

In the UK, the Coalition government, a coalition of two political parties, the Conservative Party and the Liberal Democrats, blamed the GFC on the regulatory approach that the Financial Services Authority (FSA) (UK) had implemented, which was more principle-based than rule-based. The principle-based approach applied general principles and left individual financial institutions to implement them. As a result, the FSA, which was the single regulator, was abolished in 2010 by enacting the Financial Services Act, 2012. This Act introduced a new regulatory model whose key focus was safeguarding the UK financial market from systemic risk. It was considered that there was a need to have a strong regulator whose primary focus would be prudential regulation of large financial institutions that presented systemic risk hence the creation of PRA, a subsidiary of the Bank of England, which oversaw micro-prudential regulation of the UK's financial system. Furthermore, the Financial Conduct Authority (FCA) was also introduced directly under the oversight of the treasury. It regulated market conduct between financial institutions and their customers and the prudential regulation of the smaller institutions. The other key financial regulator introduced was the Financial Policy Committee - a committee under the Bank of England whose key function is macro-prudential regulation.[7]

In the USA, the Dodd-Frank Act (2010) was enacted, which brought about significant reforms regarding systemic risk supervision in the United States.[8] The Act, whose official name is the Wall Street and Consumer Regulation Act, strengthened oversight over banks.

Post the GFC, the UK moved from a single regulator to what has been labeled as the 'twin peaks model, whereas in Kenya, proposals had already been made to move to the single regulator model similar to what the UK had before the financial crisis. This research shall indicate the various debates Kenya has had on whether to implement similar changes in the Kenyan financial sector.

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[6] Nzomo Mutuku, *Case for Consolidated Financial Sector Regulation in Kenya* (Retirement Benefits Authority 2008) available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1837354 on 11 July 2020

[7] Rawlings P, Georgosouli A, Russo C, 'Regulation of financial services: Aims and methods' *Queen Mary University of London, Centre for Commercial Law Studies* (2014), 26

[8] Avgouleas E, *Governance of Global Financial Markets: The Law, the Economics, the Politics*, Cambridge University Press, 2012, 20

The research investigates whether Kenya should stay the course of a single regulator or adapt another model of regulation similar to what other jurisdictions have adopted post the GFC.

The financial sector in Kenya currently adopts the institutional or functional model of regulation whereby a different authority regulates different institutions within the financial sector according to their function. Each of these institutions has come up independently and at different times in Kenya's history. The financial sector regulatory framework has evolved chronologically.

The Central Bank of Kenya(CBK) was established by an Act of Parliament of March 14, 1966, after the dissolution of the East African Currency Board(EACB). It opened its doors to the public on September 14, 1966. It is now anchored in the Constitution of Kenya, 2010, under Article 231, with the mandate to formulate and implement monetary policy, foster liquidity, solvency, and stability of the banking sector and provide banking services to the government. The regulation of the insurance sector was initially under the commissioner of insurance, an office under the Ministry of Finance. The office of the Commissioner of Insurance had been enacted by the Insurance Act, Cap 487 of 1986. Following the amendment of the Insurance Act in 2006, the Insurance Regulatory Authority was established. The Capital Markets Authority(CMA) was set up in 1989 by statute under the Capital Markets Act Cap 485A. It has the mandate to regulate and develop orderly, fair and efficient capital markets in Kenya to promote market integrity and investor confidence. The RBA is the regulatory body in Kenya for retirement and providence funds established under the Retirement Benefits Act, 1997. Finally, the SASRA is a statutory state corporation established under the Sacco Societies Act (Cap 490B), which came into full operation upon the gazettement of the Sacco Societies Regulations, 2010. The principal mandate of the Authority under the Act has been to license, supervise and regulate Sacco Societies in Kenya.

The functional model of regulation has worked reasonably well over the years. However, it has been subject to a myriad of challenges. First, the functional framework has been characterized by regulatory overlaps. This is where more than one regulator regulates some institutions. For instance, an insurance company that is also a listed company is under the scope of regulation by both IRA and CMA. Second, the functional model has insufficient regulations to cater to the technological innovations in the financial industry. For example, the mobile banking industry is largely unregulated. Third, cross-institutional linkages pose a challenge where an institution has diversified in respect to the services offered. A good example is where a pension scheme is also investing in real estate. This poses the challenge as to how such an institution should be regulated. Last, the operational costs of running all the individual regulators are high. The main reason behind these challenges is the increased synergies between the different sub-sectors within the financial sector, resulting in loosened regulatory barriers between the distinct sub-sectors.[9]

To curb some of these challenges, different stakeholders in the financial industry have advocated for the consolidation of the regulatory agencies within the financial sector into a single unified entity whose primary purpose would be oversight of the financial services sector.[10] This proposal was influenced by the global trend whereby most countries had implemented reforms towards a single regulator in the financial sector post the GFC. The most prominent example was the FSA in the UK. Another good example is Switzerland which moved towards a single regulator, the Swiss Financial market Supervisory Authority (FINMA), responsible for financial regulation, including prudential.[11] To emulate the global trend and best practices of financial regulation, the President of the Republic of Kenya formed a taskforce on parastatal reforms, which was tasked with coming up with appropriate reforms for the financial sector. In its report, the taskforce made recommendations for the consolidation of the financial regulatory agencies into a single unified regulator. The Central Bank would, however, retain its supervisory role over the banking sector. In making this recommendation, the taskforce considered the dynamic developments in the financial sector where different sub-sectors were forming financial conglomeratesand analyzed some of the countries that had successfully applied this model. The Central bank of Kenya has also advocated for the consolidation of the financial regulators. It is a global phenomenon whose key driver is the need for a one-stop shopping centre for financial services that the unified regulator would facilitate.[12]

These recommendations later gave rise to the Financial Services Authority Bill, 2016, which proposed the establishment of the Financial Services Authority (FSA) as a single unified regulator for the financial sector[13]. The FSA would merge and take over functions of the four main financial

[9] Mwega F, Financial Regulation in Kenya: Balancing Inclusive growth with financial stability'29
[10]Republic of Kenya, *Report of the Presidential Taskforce on Parastatal Reforms,* Presented to His Excellency Hon Uhuru Kenyatta CGH President and Commander in Chief of the Defense Forces of the Republic of Kenya (2013), 87
[11] Avgouleas E, *Governance of Global Financial Markets: The Law, the Economics, the Politics*, 10
[12] Mwega F, *Financial Regulation in Kenya: Balancing Inclusive growth with financial stability*'29
[13] Section 9, *Financial Services Authority Bill,* 2016

regulators, namely, Capital Markets Authority (CMA), Insurance Regulatory Authority (IRA), Retirement Benefits Authority (RBA), and the Sacco Societies Regulatory Authority (SASRA). The main function of FSA would be to regulate, prudentially supervise financial institutions, and supervise the conduct of financial institutions[14]. However, the proposal to implement the establishment of FSA was put on hold by the Government, citing, amongst other reasons, vested political and economic interests.[15]

This research will evaluate the case for the proposed unified model of financial regulation and determine whether the proposal to implement the unified model should be adopted.

1.2 Statement of the Problem

This research re-evaluates the effectiveness of the current regulatory framework in the financial services sector in Kenya vis-à-vis the proposed unified model of financial regulation to determine if there is need to improve the current regulatory framework through adoption of alternative models of regulation for example the twin peak model. The financial sector in Kenya currently adopts the functional model of regulation. It is organized around sectoral lines where each sub-sector has its regulator depending on the services it provides or the role it plays. For instance, insurance, securities markets, banking services, pension schemes, and SACCOs are regulated by the IRA, CMA, CBK, RBA, and SASRA, respectively. Worth noting, each of these regulatory agencies emerged independently and at different points in Kenya's history. However, while these regulators may have aligned goals of oversight on the financial sector, including prudential management and consumer protection, regulation of the financial sector is setback by inherent shortcomings of the regulatory framework. This framework has experienced numerous challenges including unregulated market activities to cater for the emergent trends in the financial services sector. These emerging trends have been as a result of innovation and technological advancements including the rise of mobile banking and shadow banking[16]. The current regulatory framework has not provided for adequate regulation to cater for these emerging trends thus exposing consumers to malpractices and exposing the financial system to systemic risk.

[14] Section 10, *Financial Services Authority Bill*, 2016
[15] https://www.theeastafrican.co.ke/tea/business/kenya-retreats-on-plans-to-merge-financial-sector-regulators-1413614 on 1 August 2020
[16] Republic of Kenya, *Report of the Presidential Taskforce on Parastatal Reforms*, 88

However, as much as this system has been successful in regulating the financial sector over the years, reforms have been proposed by stakeholders in the financial sector for the adoption of a unified financial services regulator, to ensure there is an adequate regulatory framework. Some global economies have successfully implemented this, such as Switzerland's Swiss Financial market Supervisory Authority (FINMA). However, as proven by the UK's case with the FSA, a unified regulatory framework also has its shortcomings in effecting regulatory oversight. While it serves to have a single regulatory entity over the entire sector, regulatory control over each subsector and institution is loose, and the systemic risk in the sector is increased. This paper will therefore evaluate the menu of options Kenya has in respect to its financial regulatory model: whether to keep the current functional model of regulation, adopt the proposed unified model of regulation or choose the different path of the twin peak model which has been applied in other jurisdictions e.g. the UK where it was applied for around 10 years and had proven to be successful up until the GFC when the twin peak model was implemented

1.3 Justification of the study

The financial services sector is one of the key sectors in any country's economy. To achieve the growth of any economy, it is imperative to have a stable financial services sector free of systemic risks[17] and an effective legal and regulatory framework[18]. Such a framework should preserve consumers' confidence in financial services and ensure that financial institutions are more resilient.[19]

Over the years, the Kenyan financial sector has evolved, and new developments ranging from technological advancements and new financial products cut across different financial sub-sectors have emerged. To accommodate these developments, it would be sensible to remodel the current regulatory framework to accommodate the dynamic nature of the financial market.

[17] Momanyi D, 'Influence on Financial Regulation in Kenya on financial Inclusion: A Case Study of the Banking Industry in Kenya,' 3

[18] Dr Millhouse DG, From Campbell to Hayne: W[h]ither Australia? Australian Financial Regulation and Supervision at cross-roads, 13:2-3 *Law and Financial Markets Review,* (2019), 82

[19] Avgouleas E, *Governance of Global Financial Markets: The Law, the Economics, the Politics, 6*

The current regulatory framework has proved inadequate in regulating some market trends created by innovation and technological advancements, hence its inability to detect potential risks at the onset. It is, therefore, essential to deliberate on the most suitable model of financial services regulation in the Kenyan financial market, starting with a proposal that is on the table but has not been progressed to a conclusion. The conclusions of this research would be relevant to various stakeholders and policymakers such as the National Treasury, the Parliamentary Committee on Finance and Budget, individual banks, insurance companies, pensions funds, Saccos, and Fintech companies.

1.3 Objectives of the Study

This research will seek to achieve the following:

a) To interrogate the effectiveness of the current regulatory framework in the Kenyan financial sector vis a vis the proposed regulatory model
b) To determine if Kenya should adopt the proposed unified model of regulation in the Kenyan financial sector.
c) To determine the most suitable model of financial regulation in the Kenyan financial sector.

1.4 Hypothesis

The current regulatory framework in the financial services sector in Kenya has effectively regulated the financial sector since its introduction. However, it has not adequately addressed the emerging trends in the financial sector, which expose the financial sector to systemic risk. This dissertation hypothesizes that while the proposed unified model of regulation may not adequately address the challenges existing in the regulatory space in the financial services sector in Kenya, it might be the most suitable model for the architecture of the financial sector in Kenya.

1.5 Research Questions

This research will seek to answer the following questions:

a) How effective is the current regulatory framework in the financial services sector in Kenya?
b) To what extent should the Kenyan financial sector consider the models of regulation applied in other jurisdictions?
c) What is the most suitable model of financial regulation for the Kenyan financial sector?

1.6 Literature Review

In analysing the literature review on financial regulation , this study will first focus on the impact of the global financial crisis on financial regulation in different jurisdictions including the UK, Australia and South Africa. Secondly, this study will look at the historical evaolution of financial regulation in these jurisdictions and lastly the literature review will explore financial regulation in Kenya and its historical developments.

Ross Cranston and Emilios Avgouleas[20] discuss the causes of the GFC 2008 and reforms implemented after that to minimize systemic risk. They argue that one of the key causes of the GFC was failures and loopholes in the financial system, which led to the collapse of many financial institutions. This book outlines the objectives of financial regulation and why it is essential to have a sound regulatory framework in the financial sector.

Alastair Hudson[21]discusses the evolution of financial regulation in the United Kingdom. He further provides for the key causes of the GFC, which led to regulatory reforms. One of the key causes was the mis-selling of domestic mortgages by mortgage companies that started in the US. He argues that the GFC greatly impacted systemically important financial institutions in the USA and UK. The key institutions that were significantly impacted include Lehman Brothers, an investment Bank in the USA, and the Northern Rock Bank in the UK. He further provides the reforms that led to the introduction of the twin peak model in the UK post the crisis. He indicates that the policy reforms that led to the enactment of the Financial Services Act 2012 were laid out in the Treasury White Paper, which focused on regulatory reforms focused on prudential regulations. This study will be critical as it will provide the foundation for the comparative analysis between Kenya and the UK.

Jacob Gakeri[22]discusses the three key types of regulation in the financial services sector and describes the different models applied by different jurisdictions. He argues that countries with a sizeable financial services sector apply either the functional or institutional model, the unified, or the twin peaks models. The unified model adopted by many jurisdictions, including the UK, had

[20] Cranston R, Avgouleas E, Kristen Van Z, *Principles of Banking Law,* 10
[21] Hudson A, *The Law of Finance,* Sweet and Maxwell, UK, 2013, 190-231
[22] Gakeri J, 'Financial Services Regulatory Modernization in East Africa: The search for a new paradigm for Kenya' 162 -167

not successfully responded to the financial crisis. On the other hand, the twin peaks model had been adopted by different countries post the GFC, including the UK and Australia.

In his analysis, he argues that most jurisdictions that have adopted the unified model have been influenced by market developments, such as increased market conglomerates. He further outlines the disadvantages of Kenya's current functional regulatory framework, including regulatory gaps and inconsistent rules. In his conclusion, he argues that Kenya may not be ready to adopt the unified regulation model due to limited connections in the different sub-sectors of the financial market. This may, however, not be accurate as the study was conducted nine years ago and fails to consider the current market developments in the financial services sector.

Phillip Rawlings[23] discusses the history of financial regulation in the United Kingdom and details how each regulatory regime was introduced to effect reforms after a financial crisis to strengthen the stability of financial institutions. After the banking crisis of 1973 to 1975, which saw the collapse of many small banks in the UK, the Bank of England, which was the sole regulator, introduced internal changes within the Bank. This saw the creation of a Supervision Division whose main aim was to improve the collection of data. Later, in 1984 the Johnson Matthey Bank collapsed. An inquiry as to the cause of the collapse indicated that the Bank of England did not act promptly as it should have, considering the collapse of the Bank would have impacted the financial system. As a result of this, the Banking Act 1979 was amended by the Banking Act 1987.

Rawlings further highlights that in the late 1990s, there were questions about the effectiveness of the current regulatory structure and, in particular, the effectiveness of the Bank of England. As a result, the Labor Government decided to make the Bank of England independent and oversee monetary policy, whereas the Bank of England's regulatory function, insurance, and building societies were transferred to a single regulator, the FSA (UK). However, after the financial crisis of 2008, the Coalition government blamed the crisis on the poor regulatory approach adopted by FSA and thus abolished it in 2010. This gave rise to the twin peak regulatory model where two financial regulators were introduced, the FCA responsible for market conduct and the PRA responsible for prudential regulation. The Bank of England retained its supervisory role over

[23] Rawlings P, Georgosouli A, Russo C, 'Regulation of financial services: Aims and methods' 11 -14

banks. This study will be crucial in the comparative analysis between the Kenyan approach to adopting a unified regulator and the approach adopted by other countries.

Andrew Godwin [24] discusses the reforms that led to South Africa adopting the twin peak model of regulation. These reforms resulted in a policy paper titled, 'A safer financial sector to serve South Africa better,'leading to legislative amendments to the regulatory framework. These amendments later introduced the twin peak regulators, the Prudential Authority, established in January 2018, and the Financial Sector Conduct Authority, established in October 2018. He further outlines the advantages and disadvantages of twin peak models in South Africa. Still, he acknowledges that it might have been the most significant reform in the financial regulatory framework in South Africa as it aimed towards financial stability.

Godwin further highlights the factors that led to the establishment of the twin peak model in Australia, citing innovation in product design and the formation of conglomerates in the financial sector. In Australia, the prudential regulator, Australian Prudential Regulation Authority, is independent of the Reserve Bank of Australia, which oversees monetary policy. He contrasts this with the twin peak model in South Africa, where the South African Reserve Bank works closely with the prudential regulator.[25] The twin peak model promotes information sharing and coordination amongst the regulators. This analysis shall facilitate the evaluation of the success of the twin peak models in different jurisdictions.

Kenneth Mwenda[26]notes that many countries have been adopting the unified model of regulation in the financial sector. He highlights the different factors to be considered in designing a sound regulatory framework, including the size and structure of the industry. He further analyses the countries that have adopted the unified model of regulation and highlights the challenges each country has faced in the process. He emphasizes that as much as a unified model of regulation may promote a sound financial sector, in deciding whether to adopt this framework, policymakers need to analyse the challenges facing the financial sector in the respective countries. He argues that the

[24] Godwin A, 'Introduction to special issue-The Twin peaks model of financial regulation and reform in South Africa' 11 *Law and Financial Markets Review,* (2017) 152-153
[25] Godwin A, 'Australia's Trek towards Twin Peaks- Comparison with South Africa,' 11 *Law and Financial Markets Review,* (2017) 183-185
[26] Mwenda K, *Legal Aspects of Financial Services Regulation and the Concept of a Unified Regulator*, World Bank Publications, 2006, 6-49

unified model of financial regulation would only be suitable where segments of the financial industry are connected.

Francis Mwega[27]highlights prudential regulation in Kenya and focuses on the Central Bank of Kenya, which is mandated with supervising the banking sector. He further makes a case for adopting the unified model in Kenya due to the increased synergies in the financial sectors, which have led to the formation of conglomerates. In addition to this, he argues that the institutional model of regulation is subject to regulatory challenges due to the different regulatory regimes applied to different institutions. However, he does not justify whether the unified model of regulation is most suitable for the financial services sector in Kenya.

Nzomo Mutuku[28]highlights the challenges of the institutional regulatory framework adopted in Kenya and justifies the unified model of regulation. He also provides a case for and against the unified model and analyzes the different regulatory models adopted by different countries, including the UK and Australia. In his analysis, he suggests that there is no ideal regulatory model. Various factors, including historical developments and the prevailing market circumstances, determine the type of regulatory model a jurisdiction shall adopt. However, this study may be limiting as it does not indicate the factors that led to the proposal to adopt a unified model of regulation in the financial sector in Kenya, such as the rise in conglomerates and emerging trends such as technological innovations.

The Presidential taskforce on parastatal reforms was mandated to undertake policy review and identify challenges faced by government-owned entities. The report[29] presented by the taskforce recommended the establishment of a single entity that would oversee government-owned agencies in the financial sector. The taskforce proposed a unified regulator that would consolidate the regulatory institutions in the financial services sector into one. The rationale for this proposal was that the unified regulator would increase the efficiency and effectiveness of supervision, therefore promoting information sharing among regulators and minimizing regulatory arbitrage. The taskforce report shall be crucial in this research as it provides the reasons for the proposal to adopt a unified regulator in the financial services in Kenya.

[27] Mwega F, *Financial Regulation in Kenya: Balancing Inclusive growth with financial stability*'28 - 29
[28] Nzomo Mutuku, *Case for Consolidated Financial Sector Regulation in Kenya,* 11-15
[29] Republic of Kenya, *Report of the Presidential Taskforce on Parastatal Reforms,* 87

In conclusion, the literature review indicates that a particular financial regulatory framework cannot be claimed to be the best for all jurisdictions; a 'one size fits all.' Each has its pros and cons, and more importantly, the market structure in various jurisdictions varies. Therefore, various factors, including technological developments, current global trends in regulation, prevailing market circumstances, the architecture of the markets, and the needs of the financial system, should be considered in determining the type of regulatory model a jurisdiction should adopt. Reforms in financial regulation often happen after a crisis as they are reactive. However, a financial regulatory structure should be periodically and critically appraised and reformed so that it anticipates crises and averts them all together.

1.7 Research Methodology

This research shall employ the qualitative method to collect information relevant to the study and to draw conclusions. The qualitative method will assess the sources of information touching on financial regulation which include legislation, government policy documents and reports. This information will be useful in assessing the global trends in financial regulation and the historical developments of financial regulation in Kenya. Document review shall be the most extensively used research method as it will offer crucial information on financial regulation. The research shall also dedicate a chapter for comparative analysis of the models of financial regulation applied in other jurisdictions with a key focus on the UK and South Africa.

1.8 Limitations

This study is limited to in design as it does not take into account quantitative data from fieldwork which would facilitate the collection of accurate data through interviewing key stakeholders in the financial industry who have been close to the debate around reforms in regulatory framework in Kenya.

1.9 Chapter Breakdown

Chapter one: Background and Introduction to the study

This chapter provides a background to the study and formulates the problem statement. This chapter also highlights the key questions that the study aims to answer. It discusses the literature review that guides the study.

Chapter two: The Concept of Financial Regulation

This chapter will introduce the concept of financial regulation and evaluate the different objectives of financial regulation as applied in other jurisdictions like the UK, which has a more mature financial system. These objectives will provide the basis against which Kenya's regulatory framework shall compare.

It notes that, while there are several objectives of financial regulation, this dissertation will evaluate its subject based on prudential regulation and the elimination of systemic risk. It further discusses the different models of regulation of the financial services sector and provides a case for each.

Chapter three: Regulation of Financial Services in Kenya

This chapter provides a brief history of the regulatory framework in Kenya. It also looks at the current regulatory framework and the challenges it is experiencing. It further provides the basis for reform in the current regulatory framework. It analyzes whether the current framework needs to be improved and determines the best-suited model for the sector.

Chapter four: Comparative analysis of the Regulatory Models adopted in other jurisdictions

This chapter provides a comparative analysis of the regulatory models adopted in other jurisdictions. It compares the regulatory framework adopted in the UK and South Africa, vis a vis the one adopted in Kenya. This chapter further looks at the advantages and disadvantages of each regulatory framework and critically analyzes whether the unified model is the best model for Kenya.

Chapter five: Conclusions and recommendations

This chapter summarizes the research findings and provides recommendations as to whether Kenya should implement the unified model of regulation or not.

CHAPTER 2

2 The Concept of Financial Regulation

2.1 Introduction

In the aftermath of the GFC, many jurisdictions reviewed their regulatory frameworks to ensure they were strong enough to withstand any internal and external risks. The GFC was greatly attributed to a poor regulatory framework, fraud in the financial sector, and inadequate corporate governance structures.[30]The regulatory framework in various jurisdictions, including the United Kingdom and the United States, failed to encompass emerging trends in the financial services sector, such as innovation in products offered to customers, technological advancements in the financial markets, and failed to protect consumers adequately. This resulted in systemic risk, which impacted systemically critical financial institutions leading to a ripple effect in the global financial system.

In responding to the crisis, many jurisdictions revised their regulatory approaches to safeguard financial markets from systemic risk, which was the root cause of the global financial crisis. This resulted in the adoption of new regulatory models[31] and a shift in regulatory culture from a light touch approach to a principle-based approach of financial regulation in some jurisdictions. In addition, many regulatory bodies applied more vigor in enforcing regulations and shifted from the belief that financial markets were self-correcting, an assumption in which the consumer was exposed[32].

The regulatory models adopted in various jurisdictions are similar. However, each model is dependent on the architecture of the financial market in which it operates. This means that each regulatory model takes into consideration its domestic conditions. Further, each model aims to achieve particular objectives of financial regulation to promote the stability of the financial market and the economy as a whole and protect the consumer's interest.

[30] Alastair Hudson, *The Law of Finance*, 1312
[31] Schmulow Andew D, 'The Four Methods of Financial System Regulation: An International Comparative Survey' 26(3) *Journal of Banking and Finance Law and Practice* (2015),151
[32] Hudson, *The Law of Finance*, 1346

This chapter provides the theories and objectives of financial regulation as they have developed in more mature legal systems such as the UK, which Kenya is aligned to. These objectives and theories will provide the basis against which the Kenyan legal system will compare, regarding financial regulation. In addition, this chapter will introduce the three key models of financial regulation and interrogate the objectives that each model aims to achieve. The key objectives of financial regulation that this chapter will focus on are: monitoring financial stability, consumer protection, promoting safety and soundness of the financial markets, and regulation of business conduct in financial markets.

2.2 **Definition of Financial Regulation**

Regulation refers to the application of a set of rules by a private entity or a government body to safeguard a particular sector[33]. On the other hand, financial regulation is the application of general policies of regulation on financial institutions to maintain the integrity of financial systems.[34]

Financial regulation applies both legal and financial principles in the regulation of the financial sector. While the law plays a limited role in financial regulation, the significant aspect of financial regulation in practice is finance theory, a hybrid of complex mathematics and economics. Law and regulation operate in distinct areas. However, there is an overlap between financial regulation and the application of substantive law, as much as law plays a subsidiary role in financial regulation.[35] Financial systems are legally constructed and rule-bound and therefore require the law as a supportive device for their existence[36]. The role of the law in financial regulation is to give legal powers to regulatory bodies to act in whichever way they consider appropriate from a list of statutory provisions created to regulate the financial services industry. The law enables the holder of these powers, the regulatory bodies, to choose their ideal cause of action from within a statute[37]. Regulatory bodies are created by enacting statutes, and their powers and mandates are outlined in the statutes. Therefore, the law plays an enabling function in financial regulation. However, the decision as to which cause of action or which regulatory policy is to be followed by a regulatory

[33] Mwenda, *Legal Aspects of Financial Services Regulation and the Concept of a Unified Regulator*, 5
[34] https://theintactone.com/2019/07/06/fms-u1-topic-5-financial-regulation-theory/ on 2 September 2020
[35] Hudson, *The Law of Finance*, 195
[36] Pistor K, A Legal Theory of Finance, 41 *Journal of Comparative Economics* (2013), 318
[37] Hudson, *The Law of Finance*, 196

body is governed by finance theory and political interest such as consumer protection. The interplay between law, finance, and politics is what creates the financial regulatory environment.

Financial regulation may appear more like many positivist systems of general law where the law is considered sovereign as it provides commands to its subordinates that must be obeyed and failure of which there is imposed punishment. There are aspects of financial regulation that resemble this, for example, the criminalization of regulated financial activity carried out without a license. Regulatory bodies have statutory powers conferred upon them to punish the breach of specific regulations with fines and penalties.[38]

Financial regulation applies different regulatory frameworks to enable a financial system to achieve its regulatory objectives. The type of regulatory framework adopted in a given financial sector depends on the regulatory objectives to be achieved.[39] Scholars have also argued that the type of risk control systems evident in a financial sector will ascertain the structure of the regulatory framework to be adopted. Financial regulation postulates the objectives of regulation to determine the optimal regulatory framework for any given financial system. Hence, the type of regulatory framework preferred by a particular country must meet the objective being sought. The underlying principle of financial regulation is that regulation of financial systems is essential to ensure the financial sector's stability.

2.3 Objectives of Financial Regulation

Financial regulation has an economic, ethical, and educational dimension.[40] The economic dimension ensures the stability of the financial services sector, which results in the economic prosperity of a country. The ethical dimension is concerned with promoting the financial system's integrity through proper business conduct by financial institutions and consumer protection. On the other hand, the educational dimension focuses on using regulations to educate consumers on the operations of financial markets and products being offered to protect them.

[38] Hudson, *The Law of Finance*, 56
[39] Mwenda, *Legal Aspects of Financial Services Regulation and the Concept of a Unified Regulator*, 3
[40] Hudson, *The Law of Finance*, 195

The objectives of financial regulation are determined by the statutory powers of bodies tasked with financial regulation. To better understand the objectives of financial regulation, one must consider the responsibility of regulatory bodies as conferred by statute[41]. This differs from jurisdiction to jurisdiction depending on the architecture of the financial sector in that particular jurisdiction. The objectives of financial regulation may be similar for various regulatory bodies operating in the same financial system and thus the need to ensure that there is a balance across the systems applied to achieve these objectives.

In establishing sound and effective regulatory objectives, legislators must consider the specific needs of the financial services ecosystem. It is from these needs that the objectives of financial regulation are borne. Some of the fundamental regulatory needs of any financial services ecosystem include, first, the need to protect the financial system from potential shocks that may threaten the financial system's stability in its entirety. Failure to assess risks surrounding a financial system may result in systemic risk. [42] Systemic risk occurs where the financial position of different institutions is closely linked such that the failure of one institution may result in the collapse of the other. This was considered as one of the leading causes of the GFC. Controlling systemic risk falls under prudential regulation, which entails assessing and controlling risks associated with financial institutions.[43] Prudential regulation involves both macro-prudential regulation and micro-prudential regulation. Micro-prudential regulation deals with assessing risk for individual financial institutions, while macro-prudential regulation deals with assessing and controlling risks associated with the entire financial system in which financial institutions operate. Lastly, there is a need to protect consumers and investors of financial products. This entails regulating how financial institutions conduct their business to ensure that the integrity of the financial services industry is upheld.

In general, this chapter will discuss the key objectives of financial regulation as developed in other developed systems of law, e.g., the UK and thus applicabe on a global level including Kenya.

[41] Rawlings P, Georgosouli A, Russo C, 'Regulation of financial services: Aims and methods' Queen Mary University of London, Centre for Commercial Law Studies, 2014, 24

[42] Systemic risk refers to the breakdown of an entire system rather than failure of specific parts of a system. In the case of the financial system, systemic risk refers to the risk of a cascading failure in the financial sector.

[43] Hudson, *The Law of Finance*, 207-208

These objectives include: monitoring financial stability through avoidance of systemic risk, regulating business conduct in financial markets, consumer protection, and promoting the safety and soundness of financial institutions.

2.3.1 Financial Stability

One of the key objectives of financial regulation is monitoring the stability of the financial services industry. This is achieved by assessing and monitoring risks that threaten the financial services ecosystem as a whole and imposing capital requirements for financial institutions to ensure solvency.

The achievement of this objective is tasked to various regulatory bodies, which differ from jurisdiction to jurisdiction. This objective is embedded in statute to ensure that regulatory bodies formulate regulations that uphold the financial system's stability. Before the GFC, this objective was not embedded in statute as many regulatory bodies worldwide focused on micro-prudential regulation as opposed to macro-prudential regulation. It was believed that in the case of significant risk, financial markets were self-correcting; players in the industry dubbed this as 'too large to fail.'[44] However, the financial crisis was greatly attributed to insufficient prudential regulations, resulting in regulatory bodies' failure to identify prudential risks, including systemic risk.[45]

Before the financial crisis, systemic risk was not given much attention amongst regulatory bodies and thus not considered for inclusion in the statutory framework for financial regulation. Following the financial crisis, many governments enshrined the identification and assessment of systemic risk in various statutory frameworks to monitor financial stability.

In the United Kingdom, the Financial Services Act, 2012, was enacted after the crisis. It created additional regulatory bodies, including the Prudential Regulatory Authority (PRA) and the Financial Conduct Authority (FCA). The PRA was responsible for micro-prudential regulation, and the FCA was responsible for regulating business conduct. In addition to these two regulatory bodies, the Bank of England (BOE) was retained as the key regulator responsible for overseeing

[44] Hudson, *The Law of Finance*, 1345
[45] Adair Turner, "The Turner Review: A Regulatory Response to the Global Banking Crisis", March 2009

the monetary policy and financial stability of the entire financial system in the United Kingdom.[46]The objective of financial stability was first introduced by the Banking Act, 2009, which provided that the BOE had an objective to contribute to the protection and enhancement of the stability of the financial systems in the United Kingdom.[47] To pursue the financial stability objective, the Financial Services Act, 2012, created a new macro-prudential regulatory authority known as the Financial Policy Committee (FPC). The FPC's key function was to implement the bank's strategy concerning its financial stability objective[48]. The FPC would achieve this objective by dealing with systemic risks[49] posing a threat to the UK's financial system.

In the aftermath of the GFC, many sub-Saharan countries adopted expansive monetary and fiscal policies in response to the crisis, similar to those adopted in more developed markets such as the UK and the US. The impact of the GFC did not directly impact the sub-Saharan countries, as they were not directly linked to the global financial market where the impact was felt the most. However, this does not mean that sub-Saharan countries were not impacted, albeit remotely. In Kenya, in response to the GFC, the Central Bank of Kenya included in its mandate the responsibility of promoting financial stability through regulation, supervision, and licensing of financial institutions[50]. This objective was further embedded in statute[51] as it was a key goal of the entire global financial system.

By including financial stability as an objective of financial regulation in statutory framework, many regulatory bodies have started to pay attention to eliminating systemic risk to maintain the financial stability of financial markets. Initially, this was not a key area of focus, but following the learnings from the GFC, maintenance of financial stability has taken center stage in regulatory frameworks.

[46] Section 4(a), *The Central Bank of Kenya Act* (CAP 491)
[47] Section 238, *The Banking Act (2009)* (UK)
[48] Hudson, *The Law of Finance*, 202-203
[49] Section 9C (1) (a) and (2), *Financial Services and Markets Act (2000)*, (UK)
[50] https://www.centralbank.go.ke/ on 15 July 2021
[51] Hudson, *The Law of Finance*, 57

2.3.2 Regulation of conduct of business in financial markets

The purpose of regulating the conduct of business is to ensure that financial markets function well. Conduct of business entails governing the operations of financial institutions in carrying out business with customers. This objective also governs the business conduct of financial intermediaries who act on behalf of their clients in buying and selling financial products and services.

Regulation of business conduct is achieved through various approaches, one through enhancing the integrity of financial markets. The general meaning of integrity as per the English dictionary is moral soundness; however, in financial regulation, integrity refers to the reputation of the financial system, such as it is free from fraud and market abuse. Further, integrity refers to the capability of financial systems to weather external market shocks such as systemic risk and its ability to conduct business in a sound and proper way.[52]

The integrity of a financial system is achieved through transparency in the flow of information to consumers, which may prevent market failure and thus promote financial stability. Regulatory bodies formulate regulations governing the dissemination of information to consumers. These may include the requirement that financial institutions make public their financial statements to ensure consumers have adequate information to base their decisions regarding buying and selling financial products and services. Regulatory bodies responsible for business conduct also impose regulations inhibiting insider dealing to maintain the integrity of financial systems.

The other approach of business conduct regulation is the promotion of effective competition amongst players in the market. The aim of this is to safeguard the interests of both the market and consumers. Before the GFC, regulatory bodies did not impose stringent measures on competition as it was feared this would stifle innovation in the market. However, post the GFC, measures were implemented to de-concentrate the market share in a few financial institutions.

In Kenya, this objective is embedded in the statutes that create the regulatory bodies. Section 3A of the Insurance Act provides that the Insurance Regulatory Authority's objectives include formulating and enforcing standards for the conduct of insurance and reinsurance business in Kenya. Further, Section 3 (1b) of the Banking Act provides that the CBK shall license all financial

[52] Hudson, *The Law of Finance*, 217

institutions undertaking banking business to enable them to carry out operations. Licensing of institutions is one of the tools used by regulatory bodies to regulate the conduct of business.

In the UK, regulation of business conduct is the responsibility of the Financial Conduct Authority (FCA) which replaced the Financial Services Authority through the enactment of the Financial Services Act, 2012. The FCA is regarded as the consumer champion in the financial system in the UK as its strategic objectives include enhancing the confidence in the UK financial system and ensuring financial markets function well[53]. In addition to this role and in line with market conduct regulation, the FCA promotes competition amongst financial institutions, which is aimed towards economic growth.

2.3.3 Consumer Protection

Consumer protection regulation ensures that consumers are treated fairly, thus cushioning them from any losses. Financial regulatory bodies impose minimum standards of business conduct upon financial institutions, including entry requirements and pricing restrictions, to protect consumers. However, this does not always ensure that customers are cushioned from all potential risks that may result in loss, as consumers are responsible for their own decisions. Regulators, therefore, ensure a balance in how financial institutions conduct business not to curtail legitimate business.

The purpose of consumer protection is to provide investors with the necessary tools to make informed decisions regarding investing in financial markets. Regulators do this through mandatory requirements for financial institutions to provide information to consumers. This is also achieved through financial education, where regulatory bodies educate consumers on financial matters.

Worth noting, consumer protection is an objective for every regulatory body regardless of the framework or jurisdiction. In Kenya, Section 11(d) of the Capital Markets Act provides that one of the key objectives of the Capital Markets Authority is the protection of investor interests. The CMA achieves this through various regulations, which require regulated entities to disclose various information regarding their financial performance and governance matters.[54] One of the requirements under the CMA regulations is that all regulated entities are required to publish their financial performance on two newspapers with nationwide circulation.[55] Section 3 of the

[53] Section 1B(2), *Financial Services and Markets Act (2000)*, (UK)
[54] The Capital Markets (Securities) (Public Offers, Listing And Disclosures) Regulations, (2002)
[55] Regulation B.20, *The Capital Markets (Securities) (Public Offers, Listing and Disclosures) Regulations,* (2002)

Retirement Benefits Act gives the key objectives of the RBA in protecting the interest of members and sponsors of retirement benefits schemes and funds. The Sacco Societies Act of 2009 established SASRA to protect the interest of SACCO members and ensure that consumers of SACCO products had confidence in the SACCOs industry. Section 3A(1a) of the Insurance Act provides for the IRA's objectives, including customer protection and consumer education.

In the UK, the FCA is regarded as the consumer champion. The FCA undertakes to ensure consumer protection through financial education to consumers and formulating regulations to ensure financial institutions provide information to their clients.[56]

2.3.4 Promoting safety and soundness of financial institutions

The financial system is prone to a lot of risks due to its complex nature. Financial institutions are characterized by dynamic changes, especially due to innovation in the products and services offered. It is therefore essential to safeguard the soundness of financial institutions to protect them from external risks.

In the context of financial regulation, soundness refers to the management of financial institutions and monitoring of internal controls to promote the safety of the operating environment in which financial institutions operate. Regulatory bodies achieve this objective by imposing stringent measures on financial institutions to ensure they are run to avoid any adverse effects on the financial system's stability.

The financial stability objective of financial regulation overlaps with the objective to promote the safety and soundness of the financial system. To achieve financial stability, there has to be proper and sound running of financial institutions. Therefore, regulatory bodies have to play a coordinated role in executing their responsibilities for the greater good of the financial system.

In Kenya, the different regulators are tasked with promoting the safety and soundness of the financial markets. One of the key objectives of the CMA is to maintain and regulate the market to enable the trading of securities in an orderly and fair manner[57]. This responsibility is in line with the objective of promoting the soundness of the financial markets. In the UK, the Prudential

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[56] Hudson, *The Law of Finance*, 60

[57] Section 11(1C), *Capital Markets Act (Amendment Act)*, (2019)

Regulatory Authority (PRA) is responsible for promoting the soundness of the financial system[58]. The PRA achieves this objective through the formulation of prudential guidelines.

2.3.5 Management of Climate Change Risks

The impact of climate change on financial stability has been a critical topic of discussion in the financial arena globally for the past few years. These discussions have now culminated in implementing regulations requiring financial institutions to disclose climate-related risks relevant to their operations. These regulations have been implemented in Europe and the US.[59] In the UK, the Bank of England included this as an objective of the bank in that the bank shall play a leading role in ensuring the UK's financial system is resilient in respect to any risks from climate change.[60]In Kenya, this objective is yet to be adopted by the regulatory authorities as one of the critical objectives of financial regulation.

The majority of the financial regulation objectives were enshrined into statute after the GFC. The objectives of financial regulation are enshrined in the different regulatory models adopted in different jurisdictions depending on the needs of the specific jurisdiction. The main regulatory models and the objectives they aim to achieve are discussed below.

2.4 Models of Financial Regulation

There are four main models of financial regulation that have been adopted by different countries globally. These include the institutional or traditional model, functional model, integrated or unified model, and the twin peak model.[61] Several factors need to be considered before determining the type of model to be applied in a given jurisdiction. Amongst the factors to be considered is the regulatory objectives to be achieved by a given regulatory framework. This influences the shape the regulatory model will take. Additionally, the architecture of the financial sector and the culture of regulatory bodies influences the decisions as to which model is adopted. In some jurisdictions, political and government influence has also played a key role in determining the regulatory model to be adopted. This was evident in jurisdictions like the UK, where new

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[58] Hudson, *The Law of Finance*, 220

[59] https://www.ecofact.com/blog/climate-change-and-finance-regulations-everything-you-need-to-know/ on 15 September 2021

[60] https://www.bankofengland.co.uk/climate-change on 15 September 2021

[61] Schmulow Andew D, 'The Four Methods of Financial System Regulation: An International Comparative Survey' 152

government regimes introduced different regulatory models for the duration of their terms in power.[62]

Following the GFC, there have been global debates on which regulation model is most suitable for a stable financial market. Inadequate regulatory policies and lack of sufficient powers by regulatory authorities to provide an optimal action plan in case of a crisis were blamed for the GFC[63]. As a result, many countries proposed reforms to their regulatory models to strengthen their financial markets and cushion them from external risks. This has seen a shift in the regulatory models adopted in different countries, searching for the most effective regulatory framework for that specific financial architecture. The UK, for example, shifted from the unified model to the twin peak model, whose main objective is to safeguard financial stability. On the other hand, Kenya proposed reforms to shift from the institutional model to a unified model; however, this was not implemented, as discussed in the subsequent chapter.[64]

There is a significant interlink between the models of financial regulation and the objectives of financial regulation. Different models have different objectives that they seek to achieve to maintain stability in the financial markets, which differ from country to country. This section will discuss in length the models of financial regulation against the objectives they seek to achieve.

2.4.1 Institutional or traditional model

This regulation model focuses on the form of a legal entity under regulation and assigns a particular regulator to that entity.[65] This model is characterized by different regulatory agencies regulating different sectors of the financial markets.[66]It is designed to have a different regulatory agency for each sector, i.e., the insurance sector has its regulator, which is different from that of the banking sector and the pension sector. This model ensures specialization by allowing a particular regulatory

[62] Rawlings P, Georgosouli A, Russo C, 'Regulation of financial services: Aims and methods' 11 -14
[63] Hudson, *The Law of Finance*, 1322-1323
[64] Nzomo Mutuku, *Case for Consolidated Financial Sector Regulation in Kenya* (Retirement Benefits Authority 2008) available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1837354 on 24 July 2021
[65] Schmulow Andew D, 'The Four Methods of Financial System Regulation: An International Comparative Survey' 152
[66] Gakeri J, 'Financial Services Regulatory Modernization in East Africa: The search for a new paradigm for Kenya' 163

authority to focus on one sector only. The institutions determine regulation as opposed to the nature of business being transacted.

Various countries, including China and Mexico, have adopted this model. In Mexico, there are separate regulatory bodies responsible for the different sectors of the financial industry. These include the National Banking and Securities Commission (CNBV), which is responsible for safeguarding financial stability in the financial markets in Mexico. This entity regulates all financial institutions, including bank, non-bank, and stock brokerage institutions. The National Insurance and Bond Companies Commission is responsible for regulating the insurance sector, while the National Commission for Retirement Savings System oversees the regulation and administration of pension funds. There are other regulatory bodies in Mexico responsible for the protection of consumers. The regulatory framework in Mexico is structured so that there is no lead regulator for the financial sector.[67]

The institutional model's key objective is the protection of consumers, thus focusing on different regulators per sector. As a result of many regulatory agencies in the market, there is a lack of synergy amongst the regulators, thus leading to a limited regulatory oversight of the entire financial system. This model has been criticized for being insufficient in dealing with financial conglomerates as it is significantly fragmented. This means that entities that undertake a hybrid of businesses, e.g., banking and insurance, as in the case of bancassurance, are not adequately regulated and thus prone to contradictory regulations. Additionally, this model has been argued to be subject to inconsistent application of rules and subject to duplication of regulations due to overlapping regulations by different regulators.[68]

2.4.2 Functional model

The functional model operates under the underlying principle that similar functions are regulated together[69]. This model is structured so that an institution engaging in multiple types of transactions

[67] Schmulow Andew D, 'The Four Methods of Financial System Regulation: An International Comparative Survey' 155

[68] Schmulow Andew D, 'The Four Methods of Financial System Regulation: An International Comparative Survey' 156

[69] Gakeri J, 'Financial Services Regulatory Modernization in East Africa: The search for a new paradigm for Kenya' 163

will be subject to many regulatory bodies; for example, a company that undertakes insurance, banking, and investment transactions will be under the ambit of multiple regulatory bodies. Therefore, a regulator is responsible for regulating the business conduct of an institution as applicable to each type of product and service being offered.

The functional model is closely related to the institutional model. As opposed to the institutional model, the functional model emphasizes the types of transactions under regulation rather than the financial institutions offering the product or service. Different jurisdictions have adopted this model, including France and Italy, where each financial sector has its supervisor.[70]
Kenya’s regulatory model has attributes of both the institutional and functional model but adopts more of the functional model. The Insurance Regulatory Agency(IRA) has oversight on the insurance subsector; the Capital Markets Authority(CMA), the securities markets; the Retirement Benefits Authority(RBA), pension schemes; the Central Bank of Kenya(CBK), banking services; and the Sacco Societies Regulatory Authority(SASRA), SACCOs. Each subsector has its regulator with oversight on it.

The functional model has been praised for being effective as it promotes specialization in specific sectors, promoting efficient regulation in different sectors. This model has, however, been regarded as being subprime. This is because it is difficult to differentiate which activities fall within the scope of a particular regulator. In return, this may inhibit innovation in the financial markets. The main advantage of this model is that a regulatory body develops consistent rules for a certain sector, thus avoiding regulatory arbitrage. Another disadvantage of this model is that it is costly and time-consuming as financial institutions are subject to numerous regulatory bodies.

Similar to the institutional model, the functional model's objective is to protect consumers and ensure the safety and soundness of financial institutions. This is because a regulatory authority focuses on a specific function in the financial markets, thus ensuring that consumers in that sector are adequately protected and that financial institutions operate soundly.

[70] Schmulow Andew D, ‘The Four Methods of Financial System Regulation: An International Comparative Survey’ 154-155

2.4.3 Unified or Integrated model

The unified model of regulation focuses on a single regulator for the entire financial services sector. This means that all sectors in the financial markets are combined under one supervisory body. In this regulatory model, the supervisory body is responsible for the conduct of business and the financial stability of the markets.[71]

A unified model may either be fully or partially unified. A partially unified model is where a single authority regulates various subsectors of the financial sector. For example, the pensions and insurance sectors are combined under the scope of one regulator, as is the case in Zambia, where securities, banking, and investment sectors are under the control of one regulator. A fully unified regulator is whereby an individual regulator regulates all the activities in the financial services industry.[72]

The fully unified mode was adopted in the UK before the GFC, where the Financial Services Authority (FSA) was the single regulator of the financial markets. The UK is the most significant example of the unified model, and many countries borrowed a lot from this jurisdiction. The financial services markets in the UK are complex, diverse, and sophisticated compared to other jurisdictions, and therefore, many countries benchmarked with the UK on the application of this model. However, as much as the unified model in the UK had been praised by scholars due to its efficiency, the GFC threatened its foundation, and this regulatory model was blamed for poorly managing the crisis. The FSA was at the center of the crisis in the UK, and it was blamed for its failure to identify systemic risk at the onset due to its light-touch approach and insufficient regulation. This led to the UK shifting to the twin peak model where business conduct regulation and prudential regulation are delineated,as discussed in more detail in chapter 4 of this research.

One of the key advantages of the unified model is its ability to provide a unified regulatory approach without giving rise to regulatory arbitrage. The model is also cost-efficient as there is only one regulator.

[71] Schmulow Andew D, 'The Four Methods of Financial System Regulation: An International Comparative Survey' 155

[72] Anyango L, 'Financial Services Regulation in Kenya: A Critical Analysis of the proposed Unified Financial Services Regulator' Unpublished LLM Thesis, University of Nairobi, 2014, 84

Following the GFC, the shortcomings of this model were exposed, especially in the UK, where it had been applauded as an efficient model. Key amongst its shortcomings, as evidenced by the failure of the FSA in the UK, is the issue of having a single point of failure. This is because a single regulator may fail to identify a point of failure in the system, where there are no other regulatory bodies that can undertake the task, as is the case in other models. This model has also been criticized for lacking competition amongst regulatory authorities. Scholars suggest that competition amongst regulators is essential as it ensures performance.[73]

2.4.4 Twin peak model

The twin peak model is whereby prudential and business conduct regulatory functions are separated. This means that there are separate independent regulatory bodies responsible for prudential regulation and business conduct regulation.

The twin peak model became popular post the GFC as the prevention of systemic risk through enhancing financial stability was attributed to it. This model maintains a balance between prudential regulation and business conduct regulation by addressing conflicts that may arise between these two objectives. This model is applied in Australia, Netherlands, UK, and recently, South Africa adopted it, being the first country in Africa to adopt it.

In the UK, the twin peak model was implemented to reform the regulatory architecture following the GFC. This led to the introduction of the PRA, which is responsible for prudential regulation, and the FCA, responsible for regulating business conduct to protect consumers.

The key objective of the twin peak model is to ensure financial stability and to avoid systemic risk. It has been argued that this model is optimal in promoting financial stability as it ensures transparency in the conduct of business and implements a risk control approach to ensure that financial institutions are under prudential regulation, thus avoiding a financial crisis. Additionally,

[73] Schmulow Andew D, 'The Four Methods of Financial System Regulation: An International Comparative Survey' 150-164

this model ensures that consumers of financial products and services are protected and treated fairly as there is a separate body responsible for regulating business conduct.[74]

The advantages of this model include specific allocation of objectives among independent bodies, effective coordination among regulators, sound governance systems, and adequate resources. The effectiveness of this model is not a guarantee that a financial crisis will not occur. However, it has been suggested that the adoption of this model is geared towards an optimal regulatory architecture which may result in the avoidance of financial crisis.[75]

2.5 Conclusion

Financial regulation is at the center stage of economic prosperity for any country. The financial services sector plays a vital role in the stability of an economy, and where proper regulation is implemented, financial crisis and systemic risk are avoided.

Effective financial industry regulation depends on the regulatory framework adopted and a clear definition of the regulatory objectives to be achieved. The objectives discussed in this chapter are universally accepted, although they are implemented differently depending on the regulatory model adopted by different jurisdictions. A good regulatory framework entails objectives aligned towards prudential regulation, which entails assessment of risks that may pose a threat to a financial system, consumer protection which entails disclosure obligations to ensure fair and transparent operations of financial markets as well as proper rules governing business conduct to ensure the soundness of the financial markets.

The regulatory models adopted by different countries rely on the specific circumstances of that country, and thus different countries adopt different models best suitable to their local conditions. However, this does not mean that some models are better than others. Each model has its pros and cons based on the objectives being pursued. Therefore, there is no optimal model in as much as different countries have been reforming their regulatory frameworks by shifting to the twin peak model. Before the GFC, many countries had moved to the unified model as it was the most efficient

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[74] Gakeri J, 'Financial Services Regulatory Modernization in East Africa: The search for a new paradigm for Kenya' 165

[75] Schmulow Andew D, 'The Four Methods of Financial System Regulation: An International Comparative Survey' 172

model at the time. Going by history, it is evident that in case of another crisis in the future, the twin peak model may be considered ineffective, and countries may shift to yet another model which is yet to be created. This is because proposals to shift to different regulatory models arise after a crisis, as evident in the UK.

In Kenya, there have been debates on the most optimal model of regulation. A proposal to shift to the unified model had been supported until it was evident that international practices indicated a shift to the twin peak model instead of a unified model. This led to the abandonment of this reform, as shall be discussed in the subsequent chapter.

CHAPTER 3

3 Financial Services Regulation in Kenya

3.1 Introduction

The financial services sector in Kenya has evolved over the years, and so has its regulatory model. Initially, the government governed the industry through the Ministry of Finance, which had a supervisory role over the entire industry. The regulatory structure was such that there were different departments under the ministry responsible for different financial industry sectors.[76] For example, the regulation of the insurance sector was under the Office of the Commissioner of Insurance, which was a department in the Ministry of Finance. This office came into existence with the enactment of the Insurance Act in 1986. Before this, the regulation of the insurance sector was under the UK legislation as stipulated in the Companies Act, 1960.[77] The banking sector was, however, regulated independently. After independence, the independent government established the Central Bank of Kenya, and its primary role was the control of monetary and financial policy.[78] With the industry's growth, there was a need for advanced regulation, which saw the establishment of independent state bodies responsible for the regulation of each sector.

The independent regulatory bodies report to the Ministry of Finance, which is tasked with policy formulation for the entire financial services industry. However, the regulatory bodies are responsible for formulating regulations to govern their specific sectors while still complying with the broader policies governing the entire industry.

This chapter discusses the current regulatory framework in the financial industry in Kenya. It outlines the key challenges of this framework that lay a basis for regulatory reforms in the country. This chapter further investigates if there is a need to shift from the current regulatory framework to the proposed unified model and whether Kenya is ready to adopt the unified model.

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[76] Nzomo Mutuku, *Case for Consolidated Financial Sector Regulation in Kenya* (Retirement Benefits Authority 2008) available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1837354 on 24 July 2021
[77] https://www.ira.go.ke/index.php/about-us/ira-history on 13 September 2021
[78] Tumwine-Mkubwa, *Essays in African Banking and Practice,* Uganda Law Watch, Kampala, 2009

3.2 Current Regulatory Framework in the Financial Services Industry in Kenya

Kenya employs both the institutional and functional model of financial regulation in its financial industry[79]. This means that the regulatory framework is fragmented, such that there are different regulators for each sector. The Treasury, also known as the Ministry of Finance, oversees the whole industry's regulation by formulating and implementing policies.[80] Each regulatory body reports to the treasury. The regulatory bodies responsible for regulating the financial industry are a creation of statute and derive their mandate from statutory law. The key financial regulatory bodies in Kenya include the Central Bank of Kenya (CBK), which is responsible for regulating the banking sector; the Capital Markets Authority (CMA), which oversees the capital markets; the Insurance Regulatory Authority (IRA), which regulates the insurance sector; the Retirement Benefits Authority (RBA) responsible for pension and retirement benefits, and finally, the Saccos Societies Regulatory Authority (SASRA) responsible for savings and credit co-operative societies.

These regulatory bodies formulate policies and regulations to supervise the sectors they are responsible for with the aim of maintaining financial stability and regulating business conduct for the entire financial services industry in the country. The different regulatory bodies are discussed in detail, their mandate, and the challenges they face in their operations.

3.2.1 Central Bank of Kenya (CBK)

The Central Bank of Kenya was established under Article 231 of the Constitution of Kenya, 2010. Article 231 (2) provides that the Central Bank of Kenya shall formulate monetary policy, promote price stability, issue currency, and other duties as conferred by statute. In achieving and maintaining financial stability, the CBK ensures that the supply of money in the economy is consistent with the growth and price objectives set by the government through the Treasury. The key purpose of monetary policy is to maintain price stability in the economy through the regulation of inflation[81].

Article 231 (3) of the Constitution further provides for the independence of the CBK in that it shall not be under the control of any other person or authority. This had led to multiple debates as to

[79] Gakeri J, 'Financial Services Regulatory Modernization in East Africa: The search for a new paradigm for Kenya' 163

[80] https://www.treasury.go.ke/vision-mission/ on 24 July 2021

[81] https://www.centralbank.go.ke/monetary-policy/ on 14 September 2021

whether the CBK is under the control of the treasury or not. Some scholars have argued that given the CBK is a creation of the Constitution, it is an independent body and thus should not report to the treasury. However, the current regulatory framework is structured so that there is coordination between the Treasury and the CBK in carrying out their mandate. Still, it is not clear which body is superior to the other.[82]

In addition to this, the CBK can formulate and implement foreign exchange policy and license foreign exchange dealers[83]. The CBK does not necessarily set the foreign exchange rate. It is responsible for providing an indicative rate that guides dealers to measure the value of the Kenyan shilling. Licensing of forex bureaus is done by the CBK in line with the foreign exchange policies formulated.

The Banking Act also provides for the power of the CBK to license and issue licenses to banking institutions under Section 3(b).[84]The CBK formulates prudential regulations for banking institutions, i.e., setting minimum capital requirements and governance regulations to promote stability in the banking sector. Further, the CBK develops laws and regulations to govern the banking sector and continuously reviews them to ensure they remain relevant to the emerging trends in the market. The CBK is responsible for assessing risks that may impact the solvency and liquidity of banking institutions in the country to ensure financial stability.[85] The CBK also acts as a banker to other banking institutions, which enables the bank to collect information to ensure transparency in the operations of banking institutions. The objectives of Central Bank as defined in the Central Bank of Kenya Act are in line with the objectives of other central banks globally which include formulation of monetary policy as outlined earlier in Chapter 2

3.2.2 Capital Markets Authority (CMA)

The Capital Markets Authority regulates capital markets. The CMA is created under Section 5 of the Capital Markets Act. Its main objective is to supervise, license, and monitor market intermediaries, including stock exchanges, stockbrokers, dealers, fund managers, collective investment schemes, investment banks, credit rating agencies, investment advisors, investment

[82] Section 4(5), *The Central Bank of Kenya Act*, (2014)
[83] Section 4A, *The Central bank of Kenya Act*, (2014)
[84] Section 3(b), *The Banking Act*, (2012)
[85] https://www.centralbank.go.ke/bank-supervision/ on 14 September 2021

dealers, derivative brokers, futures brokers, and Central depositories amongst others.[86] Under its regulatory function, the CMA licenses and supervises capital market intermediaries, ensures the proper conduct of licensed institutions, regulates the issuance of capital market products, promotes investor education, and protects investors investing in capital markets.

The CMA achieves its objectives through a regulatory framework in which players in the industry are compelled to adhere to, failure of which the CMA imposes regulatory penalties.[87]

3.2.3 Insurance Regulatory Authority (IRA)

The Insurance Regulatory Authority regulates the insurance sector. The regulation of the insurance sector was initially under the Commissioner of Insurance, an office under the Ministry of Finance.[88]The office of the Commissioner of Insurance had been enacted by the Insurance Act, Cap 487 of 1986. Following the amendment of the Insurance Act in 2006, the Insurance Regulatory Authority was established.[89]

The key objective of the IRA is to license, supervise, and regulate the insurance and reinsurance businesses in Kenya as provided under Section 3A(1a) of the Insurance Act[90]. IRA's other objectives include consumer protection and education and promoting an inclusive, competitive, and stable insurance industry. To achieve its objectives, IRA formulates prudential regulations, i.e., setting the minimum capital requirements for insurance companies[91]. These regulations aim towards ensuring that the insurance sector remains competitive and flexible. In its mandate, the IRA acknowledges the importance of regulation in ensuring a properly functioning insurance industry and protecting consumer interests.

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[86] https://www.cma.or.ke/index.php?option=com_content&view=article&id=9&Itemid=146 on 24 July 2021
[87] Section 34A, Capital Markets Act, (2013)
[88] https://www.ira.go.ke/index.php/about-us/ira-history on 24 July 2021
[89] Section 3A, *Insurance Act*, (2006)
[90] Section 3A (1C), *Insurance Act*, (2006)
[91] Guideline 2.0, *IRA Guidelines on Capital Adequacy* (Draft)

3.2.4 Retirement Benefits Authority (RBA)

The Retirement Benefits Authority is established under Section 3 of the Retirement Benefits Act. Its primary responsibility is to regulate and supervise the establishment and administration of retirement benefits schemes.[92]The RBA is responsible for governing both pension schemes and provident funds. A Pension fund is a retirement fund where a lump sum is paid at the point of retirement, and the remainder is paid out in periodical payments. On the other hand, a provident fund is a scheme where a lump sum is paid to employees when they leave employment or to their beneficiaries in case of death.[93]

Its key objectives are to protect the interest of members and sponsors of retirement benefits schemes and funds, promote the development of the retirement benefits sector, and approve trustees' remuneration as provided under section 5 of the Retirement Benefits Act.

In achieving its objectives, the RBA applies a compliance-based supervisory model, whereby resources are allocated to the supervision of pension schemes proportionate to the scheme's size. This means that larger schemes have more dedicated resources in terms of supervision, thus protecting consumers.[94]

The key challenge experienced in the Kenyan pension system is the lack of a consistent regulatory policy as some schemes are governed by different Acts of Parliament, and not all of them are under the scope of RBA. The National Social Security Fund (NSSF) is a pension scheme under the defined contribution basis, governed by the NSSF Act. The NSSF is not under the governance of the RBA, and this has resulted in inefficiency in the governance of the entire retirement benefits sector. However, there have been reforms in the sector aligning the NSSF Act with the Retirement Benefits Act to ensure it is under the scope of the RBA. This has resulted in a more effective regulatory framework in the pensions industry.[95]

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[92] Section 3, *Retirement Benefit Act*

[93] https://www.rba.go.ke/types-of-schemes/ on 14 September 2021

[94] https://www.rba.go.ke/supervision-framework/ on 24 July 2021

[95] Anyango L, 'Financial Services Regulation in Kenya: A Critical Analysis of the proposed Unified Financial Services Regulator' Unpublished LLM Thesis, University of Nairobi, 2014, 49

3.2.5 Saccos Society Regulatory Authority (SASRA)

SASRA was created under the Sacco Societies Act in 2009[96]. Its primary role is to supervise and regulate the SACCO societies in Kenya. SASRA was first established in furtherance to the Government of Kenya's reforms in the financial sector, which aimed to protect the interest of SACCO members and ensure that consumers of SACCO products had confidence in the SACCOs industry.[97]

SASRA regulates SACCOs through its regulatory framework, which entails licensing guidelines and prudential guidelines, which provide the minimum capital requirements for SACCO societies in the deposit-taking business. Before enacting the SACCO Societies Act, there was no specific legal and regulatory framework for SACCOs. All SACCOs were governed by the Cooperative Societies Act of 1997. This resulted in a myriad of weaknesses within the SACCO sector. There were no prudential regulations to curb potential risks, thus exposing the sector to external risks. However, after establishing SASRA, an efficient regulatory framework was borne, which increased accountability and transparency and enhanced governance in the management of SACCOs.[98]

This structure culminates into the functional regulatory model, where a different regulator regulates each sector in the financial industry. The Central Bank and the Treasury are at the top of the hierarchy as they both have oversight over the other regulatory bodies.

3.3 Challenges Facing the Current Regulatory Framework in the Financial Services Industry in Kenya

There have been numerous market developments in the financial industry in Kenya. These developments have impacted every sector in the financial industry. The key developments include the rise in fintech, where technology has been instrumental in developing financial products through innovation. An excellent example of fintech is the popular M-Pesa platform which merged

[96] https://www.sasra.go.ke/index.php?option=com_content&view=article&id=12&Itemid=116#.YTzedJ0zY2w on 24 July 2021

[97] Ngaira L, 'The Impact of SACCO Regulatory Authority Guideline on SACCO operations in Kenya – The Case of Nairobi Deposit Taking SACCOs' Unpublished MBA Thesis, University of Nairobi, October 2011, 12

[98] Rule 9, SACCO Society's (Deposit Taking Sacco Business) Regulations, (2012)

telecommunications with finance. M-Pesa is a mobile money system that enables the transfer of money between users. When Mpesa was introduced in 2007, it was amongst the first mobile-based money transfer platforms of its kind, and thus it was not regulated as it was new in the financial industry. M-Pesa is now used globally as an alternative way of transferring money as opposed to traditional banking. One of the key challenges Mpesa has faced is in respect to the regulatory framework governing it. The key challenge in the regulatory space is that Mpesa is offered by Safaricom, which is regulated by the Communication Authority of Kenya, yet the platform undertakes bank-like activities, including money transfer, payments, and shadow banking through its M-Shwari product that facilitates savings and loan facilities to consumers. The M-Shwari product is a partnership between Safaricom Plc and NCBA Bank, with the mobile product being a front end to a fundamentally banking product. KCB – M-Pesa, a product similar in its architecture to M-Shwari, is a partnership between KCB Limited and Safaricom Plc. Safaricom provides the front-end service and while KCB provides the back-end banking service. Safaricom is not a deposit-taking financial institution, and therefore it is not subject to banking regulations. However, it is a party to partnerships involving banking activities which creates a regulatory complexity. Regulatory oversight on Safaricom Plc has evolved to now include the CBK in mobile money and international money transfer services and the CMA on corporate governance. Shadow banking remains a largely unregulated area, although the back-end banks party to the mobile money products are under the oversight of the CBK. Still, regulators face a challenge in formulating a regulatory framework. It is a new concept that cuts across various sectors and lacks best practices that could be used as a benchmark.[99]

Digital advancements have also impacted all sectors in the financial industry. In the banking sector, mobile banking has been adopted as the new way of doing business. In the insurance industry, different institutions have adopted digital applications for payment of premiums and management of insurance policies. In the capital markets sector, digital platforms have gained momentum in the buying and selling of securities, changing the traditional way of doing business. A good example in the insurance space is the introduction of a Digital Last expense product launched by the UAP Old Mutual Group, a financial Group undertaking investment, banking, and insurance business. This product is bought using a digital platform, and premiums are paid on the same

[99] https://www.wto.org/english/tratop_e/serv_e/wkshop_june13_e/wanjau_e.pdf on 14 September 2021

platform. This has enabled the insurance business to shift from the traditional way of doing business where there has to be one-on-one contact with the client.

In the banking sector, many banks have now adopted mobile banking platforms whereby clients can access their bank accounts and pay bills on digital devices. Equity Group Holdings Limited has made significant strides in this space by introducing Equitel, a mobile phone platform that enables users to carry out financial transactions and conduct other telecommunication functionalities. This initiative was a partnership between Airtel and Equity Bank.

The financial markets sector in Kenya has also seen a rise in cross-border products where different sectors in the financial industry are merging to sell more advanced financial products. An excellent example of this is bancassurance, where banking institutions are now registering agencies whose primary role is selling insurance products in partnership with insurance companies that underwrite the risks for these products. KCB Bank Kenya, for example, has an insurance agency known as KCB Insurance Agency which sells insurance policies ranging from health policies to motor vehicle policies in partnership with different insurance companies which underwrite the risk.[100] Insurance products are also carrying investment components rendering them under the scope of both the IRA and CMA. Such a product is the Imarika Investment Plan offered by Britam Insurance. This product is designed as a medium-term investment product with a life insurance plan.[101]

The rise in shadow banking has been another key development in the financial sector in Kenya. Shadow banking refers to activities similar to bank services that take place outside the traditional banking sector. [102] In Kenya, the uptake of shadow banking increased before 2016 when the government introduced an interest cap to banks. Before the introduction of the interest cap, banks had become notorious for charging high interests, and thus borrowers opted to shift their focus to shadow banking. For instance, in Kenya, Tala is a fintech company that offers short-term loans to

[100] https://insurance.kcbgroup.com/ on 14 September 2021
[101] https://ke.britam.com/invest/personal/grow-your-wealth/imarika-investment-plan on 14 September 2021
[102] Mugasha A, 'Securing Effective regulation of the shadow Banking System' 498

borrowers.[103] Regulation around shadow banking has not been as stringent as that of traditional banking, resulting in an inadequate regulatory framework. This is despite the fact that risks in shadow banking are similar to those in the traditional banking sector. As a result, shadow banking has exposed the economy at large to risks and exposed consumers to predatory interest rates.

Another key market development has been the convergence of services offered across different sectors due to innovation. For instance, SACCOs were only credit facilities initially. However, due to advanced practices, SACCOs are now deposit-taking institutions and are regulated as such.[104]

These developments have exposed gaps in the regulatory framework of financial services in Kenya. The current regulatory framework has proved inadequate in regulating emerging market trends due to its fragmented nature. Some emerging trends are inadequately regulated as there is no clear boundary as to which financial sector some of these products fall. The key challenges facing the current regulatory framework are discussed as follows:

3.3.1 Capacity Constraints

There have been a lot of reforms in the global financial markets, especially after the Global Financial Crisis. These reforms have seen larger financial markets and economies shift their regulatory framework through the adoption of international best practices to promote financial stability.

Due to capacity constraints, the Kenyan financial industry being much smaller in size and less complex in terms of services offered, has faced difficulty in adopting these global approaches. The current regulatory framework has not adequately regulated the financial sector in Kenya. This may be attributed to the lack of adoption of international practices that have worked in other jurisdictions. However, this has not been intentional but mostly attributable to poor strategies by regulatory bodies and lack of support from the political environment, which is crucial for any

[103] https://www.standardmedia.co.ke/business/financial-standard/article/2001300058/the-rise-of-kenyas-new-shylock-economy on 14 August 2021
[104] Nzomo Mutuku, Case for Consolidated Financial Sector Regulation in Kenya, 11

regulatory framework to thrive.[105]As much as there have been enhancements, the current regulatory model has failed to catch up with these advancements from a regulatory perspective.

Lack of technical know-how has also been a key factor curtailing the adoption of an enhanced regulatory framework since the Kenyan demography does not consist of trained skills to deal with complex financial products compared to other jurisdictions.

3.3.2 Regulatory Overlaps

The current regulatory model is characterized by regulatory overlaps where one financial institution is regulated by more than one regulatory body. This is evident in the banking industry, where banking agencies dealing in bancassurance products are regulated by both the IRA and CBK due to the cross-border nature of the products. A good example is the KCB Insurance Agency which IRA and CBK regulate since it is part of a banking institution.[106]. This has caused confusion as to which regulatory agency should take precedence in case of conflict. Regarding governance regulations, the CMA Code of Corporate Governance for Issuers of Securities to the Public, recommends that regulated entities should ensure that a director serving on their board should not hold directorship in more than three listed entities[107]. On the other hand, the CBK prudential guidelines provide that banking institutions should ensure their directors do not hold more than two directorships in institutions licensed under the Banking Act. The issue arises where a director holds directorship in three banks, which are all listed entities. In such an instance, such a director would be compliant under the CMA Code of Governance; however, he would breach the CBK Prudential Regulations. These kinds of regulatory overlaps call for harmonization of regulations in the financial sector to ensure uniformity. There is a need to resolve these overlaps to enable compliance from a regulatory perspective and avoid regulatory arbitrage, where one institution may argue to comply with some regulations while avoiding compliance to others.

[105] Classens S, Current Challenges in Financial Regulation, *World Bank Policy Research Working Paper 4103*, (2006), 29
[106] https://insurance.kcbgroup.com/ on 14 September 2021
[107] Guideline 2.2.6, *CMA Code of Corporate Governance Practices for Issuers of Securities to the Public*, (2015)

3.3.3 Regulatory Gaps

Regulatory gaps have become a common characteristic of the functional model of regulation. This is evident in the Fintech space, where some firms are not regulated since the current regulatory framework did not encompass fintech developments but was reserved for more traditional products.[108] With increasing developments in the financial markets, there is a need for more enhanced regulation to encompass technological developments. The current regulatory model has failed to sufficiently regulate new advancements, i.e., cross-border products. This has also been attributed to inadequate sharing of information amongst regulators.

Regulatory gaps have been common in the fintech sector and shadow banking, where regulators have faced difficulty in implementing regulations in these sectors due to their complex nature. Difficulty in categorizing different advanced products has also been a key challenge to regulators in determining under which sector a particular product falls for purposes of regulation.[109]

3.3.4 Costs

The administration and management of multiple regulatory agencies is costly. In Kenya, the regulatory bodies in charge of the financial industry are funded through public funds as they are incorporated as state corporations. Therefore, the running of these bodies is expensive due to overhead costs and staff costs as they require trained and skilled personnel who attract higher salaries. Most regulatory agencies generate their revenue through levies and licensing charges; however, they still receive additional revenue from the Ministry of Finance to aid in their operations. Consolidating these regulatory bodies into one would reduce operating costs by reducing staff and overhead costs.[110]

3.4 Proposed Reforms to the Current Regulatory Framework

The functional model of financial regulation has been instrumental in regulating the financial services industry over the years. However, due to the challenges discussed above, key stakeholders have proposed reforms to shift from the functional model to a unified model of regulation.[111] These

[108] https://www.businessdailyafrica.com/bd/opinion-analysis/columnists/opportunities-pitfalls-in-fintech-regulatory-push-3376510 on 14 September 2021
[109] Classens S, Current Challenges in Financial Regulation, 31
[110] Nzomo Mutuku, Case for Consolidated Financial Sector Regulation in Kenya, 11
[111] Nzomo Mutuku, Case for Consolidated Financial Sector Regulation in Kenya, 11

reforms are to implement the most efficient regulatory model for the Kenyan financial services industry, considering its architecture. The reforms are also pursuing international best practices as many countries have moved from the functional model to a more efficient model, the twin peaks model. The latter separates prudential regulation from business conduct regulation.

The CMA presented the first proposal to move to a unified regulatory model in Kenya in its Annual Report in 1997[112]. This was before the UK, where the unified model was subsequently implemented, had adopted this model. The CMA observed that it was important for the Kenyan financial services industry to build towards a consolidated regulatory approach for the financial services to address regulatory overlaps.[113]

In 2002, the finance minister then, Honorable Chris Obure, was reported to have alluded to the Government's desire to undertake reforms in the regulatory framework for the financial industry that would see the regulation of all sectors under a single regulator. The justification for the proposed reforms was that they would result in cost efficiency. The reforms would be a step towards embracing international best practices regarding the regulation of the financial industry.[114]

Further, in 2012 the Minister of Finance, Mr. Njeru Githae, in his speech in Parliament during the annual budget presentation, mentioned that the government was working on streamlining the regulatory framework for the financial services industry through the introduction of a single regulator. The CMA, IRA, RBA, and SASRA would be merged to form a single regulator. However, the CBK would continue operating independently and would continue overseeing the regulation of the banking sector.[115]

In 2013, the President of the Republic of Kenya formed a taskforce on parastatal reforms. It was tasked with investigating the management and governance of Kenya's parastatals to determine how they would best contribute to the pursuit of national development, which was a key goal under

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[112] Capital Markets Authority, "Annual Report", 1997, 35
[113] Gakeri J, 'Financial Services Regulatory Modernization in East Africa: The search for a new paradigm for Kenya' 170
[114] Capital Markets Authority, "Annual Report", 2002, 52
[115] https://www.standardmedia.co.ke/opinion/article/2000061004/having-one-financial-services- accessed on 24 July 2021

Vision 2030. In respect to the financial services sector, the taskforce recommended the establishment of a single entity to oversee the supervision of state-owned regulatory bodies in the financial industry. [116]The justification for this recommendation was that the financial industry was characterized by the convergence of products. As a result, the boundaries demarcating products in one sector to those of another sector gradually faded away, thus the need for a single regulator. Additionally, the single regulator would address the need to increase efficiency in supervision while promoting the sharing of information amongst regulators.

The recommendation by the presidential taskforce led to the introduction of the Financial Services Authority Bill, 2016. The bill was designed to merge the financial regulators into one regulator. The Financial Services Authority (FSA) Kenya would be established as a state corporation under the State Corporations Act.[117]

The Financial Services Bill, 2016 mandated the FSA, Kenya, to make prudential rules in consultation with the Cabinet Secretary for Finance.[118] These prudential rules would be aimed at ensuring the safety and soundness of prudentially regulated entities, promoting the financial sector's stability, and protecting consumers of financial services. These objectives are in line with the objectives of financial regulation as outlined in chapter 2.

The FSA Kenya would also oversee the conduct of business in the financial industry. The Authority would have the responsibility of formulating rules regarding the conduct of the business of financial institutions. The conduct rules would promote the integrity of the financial markets in Kenya and ensure that customers are treated fairly.[119]

In its supervisory role, the FSA Kenya would issue financial conduct licenses to institutions undertaking financial business or offering financial products. However, these licenses would not

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[116] Republic of Kenya, *Report of the Presidential Taskforce on Parastatal Reforms*, Presented to His Excellency Hon Uhuru Kenyatta CGH President and Commander in Chief of the Defense Forces of the Republic of Kenya (2013), 87
[117] Section 9, *Financial Services Authority Bill*, (2016)
[118] Section 29, *Financial Services Authority Bill*, (2016)
[119] Section 30, *Financial Services Authority Bill*, (2016)

be required for entities supervised by the Central Bank of Kenya and those licensed as issuers of securities. [120]

To ensure increased collaboration amongst all the regulators in the financial industry, the FSA Kenya would co-operate and coordinate with the Central Bank of Kenya in carrying out its function. This would resolve the lack of coordination amongst key regulators, which is paramount in the current functional model.

The Financial Services Authority bill borrowed a lot from the UK Financial Services Market Act of 2000 that established the Financial Services Authority in the UK. Considering the success the FSA (UK) had experienced before the global financial crisis, the Kenyan government thought it prudent to employ a similar framework in Kenya. The Kenyan financial markets were evolving similarly to those of the UK in the early 2000s.

The Financial Services Authority Bill had been approved for implementation by the Cabinet of Kenya. It was a welcome reform towards eliminating regulatory gaps and increasing consumer protection which were some of the vital objectives stakeholders were aiming to achieve.[121] The bill was, however, later withdrawn before it was tabled before parliament for discussion and assent. The FSA Kenya was therefore not implemented as a single regulator due to political reasons and vested interests. The establishment of the FSA Kenya as a single regulator in the financial industry was seen as a threat to certain positions in the current regulatory bodies[122]. It was also felt that the Chief Executive Officer (CEO) of the FSA Kenya would become too powerful a public figure due to his power to oversee the whole financial industry, which is quite significant in the economy of any country. There was also the issue of the power that the FSA would hold, as was the case in the UK, whereby the head of the FSA (UK) was considered too powerful to be controlled by other senior persons in the UK financial industry.

[120] Section 34, Financial Services Authority Bil, (2016)
[121] https://www.president.go.ke/2017/04/06/cabinet-approves-bill-to-merge-functions-of-financial-regulatory-bodies/ on 24 July 2021
[122] https://www.theeastafrican.co.ke/tea/business/kenya-retreats-on-plans-to-merge-financial-sector-regulators-1413614 on 24 July 2021

3.5 Case for a Unified Model of Regulation in Kenya

The proposal to shift to a unified model of regulation in Kenya may have been the saving grace the financial industry in Kenya needed from a regulatory perspective. The unified model would have increased synergy in the financial industry through proper coordination and sharing of information which is beneficial in the case of a financial crisis. The model would have also resulted in increased responsibility and accountability, resulting in efficiency in supervision.

On the other hand, the unified model may not have been ideal for the Kenyan financial industry as it would have resulted in a monopoly, causing a lot of bureaucracy in decision-making, which could stifle legitimate competition in the industry. It is also argued that the unified model could have resulted in a loss in regulatory diversity by undermining the specialist knowledge and expertise applied in the functional model of regulation where different sectors are regulated separately.[123]

3.5 Conclusion

Regulatory reforms in any jurisdiction are a work in progress and materialize after a long time to achieve the success they were intended to achieve. Therefore, in deciding whether to shift from one regulatory model to another, it is crucial to determine the responsibility of the regulatory body as envisioned by stakeholders. From a political perspective, a shift to a unified model may not be viable as the functional model favors political ambitions, as those aligned to a ruling government are awarded positions in these regulatory bodies. In contrast, the unified model does not support these ambitions. This was evident in the case of Kenya, where the political environment did not welcome the unified model, and that saw it being abandoned.

Further, weaknesses in any regulatory model do not necessarily call for a complete shift in the regulatory model. Sometimes what is required may be improvements to the current regulatory model. In the case of Kenya, in as much as the functional model was marred by a myriad of challenges, instead of recommendations to shift to a new model, stakeholders would have proposed

[123] Gakeri J, 'Financial Services Regulatory Modernization in East Africa: The search for a new paradigm for Kenya' 170

reforms aimed at improving the current framework as it had successfully regulated the financial industry over the years.

The proposal for Kenya to shift to a unified regulatory model may not have been a timely move considering that the reform was being recommended after the global financial crisis, which exposed its inability to manage the financial crisis as was palpable in the UK. Moreover, the factors that had led to other jurisdictions adopting the unified model were not present in the case of Kenya as the financial industry in Kenya was not as complex as that of other jurisdictions, i.e., the UK.

The Financial Services Authority Bill was a welcome reform in the regulatory space as it aimed to resolve some of the challenges that were evident in the functional model. The introduction of the Financial Services Authority would address all the key objectives of a sound regulatory framework. These objectives included promotion of financial stability, consumer protection, and enhancement of a sound financial market. As mentioned in chapter two, these are the universal objectives that any sound regulatory model aims to achieve. This Bill was inclined towards a unified model of regulation with a single regulator due to the key developments that had since taken place in the financial industry in Kenya. This means that the Financial Services Authority would have met the global standards of other financial regulatory bodies, making it a more preferred regulatory body.

However, according to international best practices, the move was behind time as many jurisdictions had since moved to the twin peaks model, which was considered more efficient in withstanding systemic risk and promoting financial stability. Perhaps Kenya should have considered moving in this direction. From the analysis, Kenya needed to address whether the unified model was optimal for its financial industry, given its architectural design.

CHAPTER 4

4. Comparative analysis of the Regulatory Models adopted in other jurisdictions

4.1 Introduction

After the general introduction to this work laid down in chapter one, chapter two introduced the general objectives of financial regulation and the models for financial regulation. Chapter 3 was specific on financial regulation in Kenya and explained that there had been some debate about improving the financial system through the proposed reforms toward introducing a unified model of regulation. This chapter advances my thesis by presenting comparative literature in the UK and South Africa. This is because the UK was among the countries that adopted the unified model of regulation for a long time, and South Africa's regulatory framework has evolved similarly to that of Kenya.

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Many countries adopted new regulatory models after the global financial crisis to strengthen their financial markets and promote financial stability. The impact of the global financial crisis was primarily felt in larger financial markets where the financial systems were more inter-connected because of cross-border activities. The financial crisis started in the banking industry in the financial institutions where risky borrowers could not pay back.[124] These institutions were interconnected in that they borrowed from each other, and therefore when one institution was affected, it caused a ripple effect to the other financial institutions.[125] The first institution to be affected was the Lehman Brothers, an investment bank at the center of institutions dealing in Collateral Debt Obligations (CDOs). CDOs were complex financial products that were being sold amongst investment banks and financial institutions globally. After the collapse of Lehman Brothers, there followed a 'credit crunch' whereby liquidity in the market dried up because financial institutions could not lend to one another, and thus borrowers could not access credit. As a result, governments had to intervene to cushion the economy. [126]

In the USA, some financial institutions were taken into public ownership while others were forced to merge to protect them from collapsing.[127] However, in the case of Lehman Brothers, there was

[124] Hudson, *The Law of Finance*, 1312
[125] Hudson, *The Law of Finance*, 1315
[126] Hudson, *The Law of Finance*, 1313
[127] Hudson, *The Law of Finance*, 1316

no government bailout. At the onset of the crisis, the Federal Reserve Bank in the USA had put a rescue plan towards saving the investment bank. It invited other financial institutions to buy out the Lehman Brothers. Barclays Bank showed intention to buy out the Lehman brothers. However, the UK regulatory authorities refused to sanction it to acquire Lehman brothers due to fear that the acquisition might also affect the stability of Barclays bank.[128] No other buyer emerged.

In the UK, the first institution to be impacted was Northern Rock bank, which started running into financial difficulties after the collapse of Lehman Brothers. In a bid to save it, the government tried to find a buyer, but there were no viable buyers, and thus the Government was forced to nationalize it. The law at the time did not provide for an action plan in respect of regulation in case of a crisis; thus, most regulators' hands were tied, and the government had to intervene.[129]

The crisis exposed weaknesses in the regulatory framework, and it was evident that financial regulators had failed to identify and prevent systemic risk in good time. Another finding was that financial regulation had been structured so that financial regulators lacked the power to deal with a financial crisis. These findings led to the commencement of regulatory framework reforms in the UK and the US to protect financial markets from systemic risk, which was the root cause of the crisis.

The UK reformed its financial regulatory model by shifting from the unified regulatory model to the twin peaks model. This was mainly because the financial crisis in the UK was blamed on the inability of the then single regulator, the Financial Services Authority, to regulate the financial markets. The Financial Services Authority was linked to the Labor government. With the introduction of a new regime, the Coalition government thought that the light-touch approach that the FSA had applied was ineffective in regulating the UK's financial markets.

Closer home, South Africa also reformed its regulatory model, albeit a bit later after the financial crisis in a bid to adopt international regulatory practices. South Africa adopted the twin peaks

[128] Hudson, *The Law of Finance*, 1326
[129] Hudson, *The Law of Finance*, 1317

model in 2017.[130] Before shifting to the twin peaks model, South Africa applied the functional regulatory model whereby multiple regulators were operating in silos.[131]South Africa was amongst the first developing countries to adopt the twin peaks model, and thus this shift was a benchmark for other developing and sub-Saharan countries.

This chapter analyses the different regulatory models adopted in other countries, mainly the UK and South Africa. It also discusses the factors that led to the regulatory reforms in these countries and the challenges of the regulatory frameworks applied. This comparative analysis will provide greater insight into whether the optimal model of financial regulation in Kenya is the proposed unified model.

4.2 Financial Regulation in the United Kingdom (UK)

4.2.1 Evolution of Financial Regulation in the UK

In the early 1800s, the Bank of England (BOE) was the primary regulatory authority in the financial sector in England. The Bank of England was considered the Government's bank and the custodian of the monetary system. At the time, the Bank of England was at the epicenter of the UK's self-regulatory system. Later, in the 1900s, the Banking Act, 1970, placed regulation as an issue of government policy and considered regulation as statutory footing. This enabled the government to intervene in the regulation of the financial industry[132].

The banking crisis of 1973-1975, which saw the collapse of small banks involved in lending in the commercial property sector, resulted in reforms in the Banking Act. This led to the enactment of the Banking Act, 1987. This Act provided that the role of the Bank of England was to supervise institutions authorized by it in the exercise of the powers conferred to it by the Act. This Act also introduced the prudential responsibility of the BOE as it required all deposit-taking firms to have adequate capital, report large loans, have accounting and control systems, and conduct business with integrity. This led to the introduction of a statutory framework for regulating banks, which

[130] Godwin A, 'Introduction to special issue-The Twin peaks model of financial regulation and reform in South Africa, 152
[131] Heerden CV and Niererk GV, 'Twin Peaks in South Africa: a new role for the Central Bank', 11 *Law and Financial Markets Review*, (2017), 154

was different from the informal supervision by the Bank of England that had been applied earlier.[133]

In the early 1980s, the UK's financial sector applied the self-regulatory approach, which was assumed to be the best method of regulation then. In this approach, the Bank of England had acted as a Central Bank but was controlled by self-regulatory organizations incapable of dealing with financial markets. The conservative government had adopted this approach. At the time, there were too many regulatory bodies with overlaps in their responsibilities, and thus there was no single line of regulatory policy. To improve the regulatory framework, reforms were implemented in the financial regulatory structure, which saw the abolishment of the multiple-agency regulatory structure. These reforms led to the enactment of the Financial Services Market Act (2000), which established the Financial Services Authority (UK), a single regulator.[134]

The FSA (UK) was responsible for regulating the entire financial services sector in the UK. The regulatory functions of the BOE were transferred to the FSA, and this formed the unified model of regulation. However, the FSA (UK) still worked closely with the BOE and the Treasury in regulating the financial markets. This formed the tripartite authority, which was responsible for overseeing the entire financial market in the UK. The BOE was responsible for monetary policy and the stability of the financial markets, while the Treasury was responsible for formulating the governing legislation for the financial markets. The interaction between the three entities was governed by a Memorandum of Understanding (MOU) that clearly outlined each entity's role and how the entities would interact, ensuring coordination.

The key objectives of the FSA (UK) were to enhance market confidence, promote public awareness and consumer protection.[135] In achieving these objectives, the FSA (UK) applied a principle-based approach. It set outcomes, but the measures and procedures on achieving these outcomes were left for determination by the financial institutions. However, in 2007 the FSA(UK)

[133] Rawlings P, Georgosouli A, Russo C, 'Regulation of financial services: Aims and methods' *Queen Mary University of London, Centre for Commercial Law Studies* (2014), 11-17

[134] Hudson, *The Law of Finance*, 196-197

[135] Section 4, *Financial Services and Markets Act (FSMA)*, (2000)

moved to a rule-based approach of regulation whereby it provided a set of rules that the regulated institutions were required to comply to.[136]

After the global financial crisis, the UK government blamed the FSA for failing to manage and foresee the crisis. The FSA was blamed for its light-touch approach in regulation through applying the principle-based approach. It was deemed that this approach assumed that institutions were self-correcting in case of any risks. In his report, Adair Turner attributed the failure of the FSA in managing the crisis to its belief that the good health of a financial institution was the role of its management through its governance structures such as the Board. He further alluded that the key challenge with the FSA was that it had an insufficient regulatory will to enforce its regulations. The FSA was accused of having focused too much on consumer protection and conduct of business regulation that it failed to address the more significant risk, which was systemic risk.[137] The BOE and the Treasury avoided blame in the face of the crisis, yet they were also responsible for regulating the financial markets.

Following the global financial crisis, many legislative reforms were introduced to address the flaws in the regulatory framework, which was considered insufficient in regulating the financial services sector. The policy reforms were laid out in the Treasury White Paper "*A New Approach to Financial Regulation: the Blueprint for Reform,*" published in 2011. These policy reforms introduced the Financial Services Act 2012, which established the twin peaks model of regulation. The reforms were geared more towards streamlining prudential regulations for the financial services markets in the UK.[138]

The White Paper outlined the key challenges in the UK financial system as lack of systemic oversight and lack of effective tools for financial regulation. The paper argued that the previous regulatory regime led by the FSA (UK) had paid more attention to micro-prudential regulation, which focused on individual firms and failed to focus on external risks posing a threat to the system. Further, the banking laws at that time had failed to vest adequate powers on regulators to

[136] Rawlings P, Georgosouli A, Russo C, 'Regulation of financial services: Aims and methods' 18
[137] Adair Turner, "The Turner Review: A Regulatory Response to the Global Banking Crisis", 86-88
[138] Hudson, *The Law of Finance,* 227

deal with bank failures as had been experienced during the crisis. The regulators in the UK did not have statutory powers to act and compel financial institutions to act while dealing with the crisis. Therefore, they relied on political and government influence while dealing with collapsing banks. The government had to step in to resolve the crisis through nationalization and recapitalization of financial institutions using public funds.[139]

As part of the reforms proposed in the White Paper, the new UK government dismantled the FSA (UK), which was closely linked to the previous Labor Government regime. The reforms implemented after the crisis centered power on the two public bodies for regulatory oversight on the entire financial services system: Her Majesty the Treasury and the BOE. The FSA was replaced by several regulatory bodies which operated as subsidiaries to the BOE. These included the Prudential Regulatory Authority (PRA) and Financial Policy Committee (FPC). On the other hand, the Financial Conduct Authority (FCA) was established, and it was under the supervision of the Treasury. This new structure culminated in the twin peaks model of regulation whereby prudential regulation was separated from the conduct of business regulation[140].

4.2.2 Twin Peak Model of Regulation in the UK

The new structure of financial regulation was introduced in 2013 with the enactment of two new statutes, the Financial Services Act, 2012, which amended the Financial Services and Markets Act, 2000, and the Banking Act, 2009, which replaced the Banking (Special Provisions) Act, 2008. The latter had been enacted amid the crisis in 2008 to compel the sale of collapsing banks. However, the Banking Act (2009) gave similar powers to the regulatory authorities to deal with collapsing banks in the case of a crisis. Before the crisis, this power had been vested in statute.[141]

The Financial Services Act established two key regulatory bodies, the PRA and the FCA, forming the twin peaks regulatory model. The FPC was also established under the BOE, which was already in existence. The FCA now regulates business conduct between financial institutions and their customers and is accountable to the Treasury. Prudential regulation was brought under the Bank

[139] Hudson, *The Law of Finance*, 228 -229
[140] Hudson, *The Law of Finance*, 209
[141] Hudson, *The Law of Finance*, 195

of England through its subsidiaries. The PRA oversees micro-prudential regulation, and the FPC, an ad hoc committee under the BOE, oversees macro-prudential regulation of the financial system. The main regulatory bodies which are part of the structure include Her majesty the treasury and the BOE, which control financial regulation and activity in the UK.

4.2.2.1 The Bank of England (BOE)

The Bank of England carries the role of the Central Bank in England. Its key role is monetary policy and the control of money supply in co-operation with the Treasury. Among its other key roles is the regulation of financial activity through the regulation of deposit-taking banking institutions and the formulation and achievement of monetary policy for the entire financial system. In this paper, attention shall be paid to the regulatory role of the BOE.

In its regulatory role, the BOE acts as the lender of last resort to the banking system. It oversees monetary stability by setting interest rates, oversees financial stability through macro-prudential regulation of the entire financial system, and regulates systematically essential infrastructure, i.e., clearing houses and payment systems. Its other key responsibilities that are not directly linked to regulation of the financial market include printing banknotes and acting as the banker to the government.[142]

The key objectives of the Bank of England in respect to financial regulation are maintaining financial stability and overseeing the regulation of solvency and the condition of individual financial institutions. This paper will focus on the BOE's financial stability objective. The BOE achieves this objective through the Financial Stability Committee, created by S.238 of the Banking Act, 2009. The role of this committee is to implement the bank's strategy in the financial stability objective. The Bank works with other regulatory authorities to achieve this objective, including the Treasury.

The PRA, a subsidiary under BOE, oversees micro-prudential regulation through regulation of internal conditions of financial institutions to maintain their solvency and protect them from shock in case of a crisis. The function of the PRA is discussed in detail later in this chapter.

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[142] Hudson, *The Law of Finance,* 200 - 203

The structure of the Bank of England contains several committees and subsidiary entities that oversee different functions. The Bank of England is governed by a Court of Directors headed by a Governor of the Bank. The Financial Services Act, 2012 created the role of the Deputy Governors who head the two principal subsidiaries: the PRA and the FPC. The Governor of the BOE is considered an influential figure due to the role he carries. The BOE's performance against its statutory objectives is overseen by the Oversight Committee, a committee of the Court of Directors. Therefore, its performance is not open to public scrutiny and lacks democracy of oversight. This has led to a lot of contention, especially after the global financial crisis. Scholars argue that this interferes with democracy. Before the crisis, financial regulators did not have any accountability to the public, which led to mismanagement.[143]

4.2.2.2 Prudential Regulatory Authority (PRA)

The PRA was created under the Financial Services Act, 2012[144] , and its main function is to oversee the micro-prudential regulation. Its general objective is to promote the safety and soundness of PRA-authorized persons. In this context, soundness refers to the management and the internal controls applied by a regulated entity in managing its operations. Its other objective is to facilitate effective competition in the financial markets.

The PRA advances its objectives by ensuring that PRA authorized institutions avoid any adverse circumstances that may affect their solvency, hence the stability of the UK financial system. The PRA applies the stress-testing method in achieving its objectives, which entails assessing the ability of individual financial institutions to cope with adverse future market conditions. The PRA, a subsidiary of the BOE, reports to the BOE and the Treasury, as the Treasury has a role in creating regulations that specify the PRA's activities.[145]

[143] Hudson, *The Law of Finance*, 200 - 203
[144] Section 1, *Financial Services Act*, (UK) (2012)
[145] Hudson, *The Law of Finance,* 200 - 203

4.2.2.3 Financial Policy Committee (FPC)

The FPC is a powerful committee under the BOE. It was established as an ad-hoc committee in 2011. Its role is to analyze any threats to financial stability. The FPC contributes to the Bank's financial stability objective by dealing with systemic risks. In general, the FPC is responsible for macro-prudential regulation.[146]

In achieving the financial stability objective, the FPC identifies and assesses systemic risks and provides directions and recommendations to deal with the same. It has a duty to give direction to the PRA and the FCA regarding macro-prudential measures to avert risks. Since the FPC is responsible for macro-prudential regulation, the PRA and the FCA lack independence to some extent when it comes to macro-prudential regulation. This was not always the case. After the global financial crisis, there was the need to protect the financial system from systemic risk, which was the cause of the crisis. Therefore, the assumption in the regulatory ecosystem in the UK is that systemic risks are more significant than risks specific to individual financial institutions. The role of the FPC is to give directives to the other regulators.

4.2.2.4 Financial Conduct Authority (FCA)

The Financial Conduct Authority replaced the FSA. The FCA's function is to regulate the conduct of business and authorization of financial institutions. The FCA is considered the consumer champion in the UK's regulatory setting. It regulates business conduct by ensuring that financial institutions treat their customers fairly to eliminate market abuse.

The strategic objective of the FCA is to ensure that relevant financial markets function well, hence enhancing confidence in the financial system. Its strategic objective is qualified by its operational objectives, which entail consumer protection, promoting integrity, and ensuring fair competition. The FCA reports to the Treasury. However, it is subject to regulatory oversight by the BOE in matters of macro-prudential risk.

However, it has been opined that one of the key shortcomings of the FCA in achieving its objectives is that its regulations are too generic and are not specific to different market sectors and

[146] Hudson, *The Law of Finance,* 212-214

products. This is similar to the shortcomings of the FSA, whereby the FSA did not formulate regulations specific for all the sectors under its regulatory scope.

There is a potential risk of regulatory overlap with multiple regulators. In the case of the UK's twin peaks model, there is a requirement for enhanced cooperation amongst the regulators. In dealing with these overlaps and enhancing cooperation, the financial regulators use a Memorandum of Understanding (MOU), which provides a formal agreement between regulatory bodies as to how they intend to use their regulatory powers in the case of overlapping regulations. As per the provisions of the MOU, the regulators are also required to obtain information from one another.

The treasury has the power to specify which matters should be under the scope of PRA and which should be under the scope of FCA as it has a supervisory role over the regulation of the entire financial services market. Additionally, the regulatory bodies are also required to co-operate with the BOE to pursue the financial stability objective, which is crucial for financial regulation in the UK.

The twin peaks model in the UK separates prudential regulation from the conduct of business regulation. The PRA oversees prudential regulation, while the FCA oversees the conduct of business. This model also comprises the main regulatory bodies: the BOE and the Treasury, which formulate policies for the financial markets in the UK and have supervisory roles over the PRA and the FCA. Since its conception, the twin peaks model has effectively regulated the financial market in the UK without any major crisis.

4.3 Financial Regulation in South Africa

4.3.1 Evolution of Financial Regulation in South Africa

In the early 1980s, South Africa applied the institutional model of financial regulation whereby the banking sector, insurance sector, and capital markets were regulated separately. This model of regulation was characterized by a lack of coordination and cooperation amongst the regulators.[147]

[147] D Rajendaran, 'Approaches to financial Regulation and the case of South Africa', *IFMR Finance Foundation*, (2012), 1

As a result of the challenges that faced the institutional model of regulation, in 1987, the De Kock Commission chaired by Dr. Gerhardus Kock, who later became the Governor of the South African Reserve Bank, recommended for deregulation and a shift in the regulatory framework towards a functional model of regulation. This was implemented in the 1990s after the political isolation regime in the country ended.[148]

In 1993, the Melamet Commission of South Africa, under the leadership of Judge David Melamet, recommended a move to a unified model of financial regulation in line with global practices. Many developed countries were applying the unified model. The move was not fully realized. The regulatory framework remained functional with the Financial Services Board (FSB), responsible for regulating the non-bank financial sector, and the South African Reserve Bank (SARB), responsible for regulating the banking sector. The National Credit Regulator was responsible for promoting fairness in accessing consumer credit, consumer protection, and enhancement of sound competition in the credit industry.[149]

In 2008, the International Monetary Fund (IMF) and the World Bank conducted a financial sector assessment program for the financial services system in South Africa. The key findings from the assessment indicated that while the functional regulatory model was effective, it required reforms to fortify both prudential and market conduct regulation.[150] The adoption of the twin peaks model was proposed. At this time, the impact of the financial crisis had already been felt globally, and many countries were undertaking regulatory reforms to cushion their economies. The recommendation by the IMF was in line with the global practice whereby developed financial markets were shifting to a model that separated prudential regulation from market conduct.

Against this backdrop, the South African Treasury issued the National Treasury Policy Document in February 2011 titled *A Safer Financial Sector to Serve South Africa Better*. The report addressed the shortcomings of the industry as per the issues raised by the IMF report. The reforms towards

[148] S Andrew, 'Financial Regulatory Governance in South Africa: The Move Towards Twin Peaks' *African Journal of International and Comparative Law*, (2017), 11
[149] S Andrew, 'Financial Regulatory Governance in South Africa: The Move Towards Twin Peaks' 12
[150] D Rajendaran, 'Approaches to financial Regulation and the case of South Africa' 3

implementing the twin peaks model were bolstered by three key pillars; prudential regulation, market conduct, and coordination.[151]

South Africa had been contemplating implementing the unified model of regulation that the Melamet Commission had proposed. However, following the recommendation by the IMF, the South African Treasury resolved to adopt the twin peaks model of regulation. In its report, the treasury acknowledged the challenges the functional model of regulation was facing and recognized the need to adopt the twin peaks model as an optimal means of prioritizing transparency while still promoting consumer protection.[152]

In 2015, the National Treasury tabled the legislation implementing the twin peaks model before Parliament, known as the Financial Sector Regulation Act (FSRA). It was later enacted into law in 2017.[153] This Act provided the substantive law for implementing the twin peaks model, which established the Prudential Authority (PA) and the Financial Sector Conduct Authority (FSCA).

4.3.2 Twin Peak Model of Regulation in South Africa

The adoption of the twin peaks model in South Africa was a significant step in the international financial market, as it was the first developing country to adopt this model. South Africa borrowed heavily from the UK in its implementation of the model. Like the UK, the PA and FSCA regulate the financial sector alongside the South African Reserve Bank (SARB), which is responsible for the supervision of the banking sector, and the South African Central Bank, the equivalent to the BOE in the UK. Further, the South African regulatory system includes two other regulatory bodies, the National Credit Regulator responsible for market conduct regulation of credit approvers and the Financial Intelligence Center, responsible for combating money laundering and financial terrorism.[154]

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[151] D Rajendaran, 'Approaches to financial Regulation and the case of South Africa' 3
[152] S Andrew, 'Financial Regulatory Governance in South Africa: The Move Towards Twin Peaks' 17
[153] Godwin A, 'Introduction to special issue-The Twin peaks model of financial regulation and reform in South Africa, 152
[154] Godwin A, 'Introduction to special issue-The Twin peaks model of financial regulation and reform in South Africa, 152

The implementation of the twin peaks model in South Africa was done in two phases. Phase 1 included the establishment of the two regulatory bodies. Phase 2 involved outlining what aspects of the financial system the two regulators would regulate. The implementation of the new Act establishing the new regulatory bodies was concluded in 2018, resulting in the two regulatory bodies being fully functional. The twin peaks model in South Africa is less than three years old since its implementation and thus has not been subject to scholarly criticism compared to the UK model, which is more mature. This paper outlines the functions of each regulatory body in the South African twin peaks model, namely the Prudential Authority (PA) and the Financial Sector Conduct Authority (FSCA).

4.3.2.1 Prudential Authority

The Financial Sector Regulation Act, 2017, established the Prudential Authority within the administration of SARB. This Act enhanced the role of SARB by adding the mandate to maintain and enhance financial stability to its core mandate, which is the formulation of monetary policy. The Act further provided that the key responsibility for the PA would be to oversee the regulation of financial institutions, including commercial, mutual and co-operative banks, insurers, financial conglomerates, and various market infrastructure. [155] The FSRA provided a requirement for the creation of a Prudential Committee under the PA, which would be responsible for guiding the regulatory body in terms of its regulatory and supervisory role to achieve its objectives

Functions of the PA include licensing of financial entities and micro-prudential and macro-prudential regulation, which entails assessing risks that pose a threat to a financial institution and the entire financial system. [156]

4.3.2.1 Financial Sector Conduct Authority (FSCA)

The FSR Act established the Financial Sector Conduct Authority (FSCA) as a market conduct regulator of financial institutions. The key objectives of the FSCA are to enhance the integrity of financial markets and consumer protection by ensuring fair treatment of customers in the financial industry. The FSCA is also responsible for maintaining the financial stability of the South African

[155] https://www.resbank.co.za/en/home/what-we-do/Prudentialregulation on 4 August 2021
[156] https://www.resbank.co.za/en/home/what-we-do/Prudentialregulation on 4 August 2021

financial market in co-operation with the SARB. In achieving its objectives, the FSCA is required to have regard for internationally accepted standards.
The FSCA is the equivalent of the FCA in the UK, which is also responsible for regulating business conduct. [157]As stated earlier, the twin peaks model in South Africa drew inspiration from the UK's regulatory framework.

4.4 Conclusion
The comparative analysis of the regulatory frameworks in the UK and South Africa indicates the key reasons why a country decides to move from one model of regulation to another. The unified regulatory model, which had worked for several years in the UK, failed to manage the crisis. This failure was attributed to insufficient regulations on the UK financial system, lack of independence due to external influence, the application of a light touch approach in regulation, and failure to separate prudential regulation from business conduct regulation.

In South Africa, the government did not implement the unified model despite multiple recommendations to shift to this model. This was mainly due to the need to adopt international best practices especially following the global financial crisis that saw the collapse of big financial institutions in developed markets. It is evident that South Africa took the learnings of the UK from the financial crisis and delayed the implementation of the unified model.

The financial system in Kenya has developed and progressed a lot over the past few years. The twin peak models applied in South Africa and the UK The proposed unified model may be efficient in regulating the financial system. However, considering that the market is currently segmented into various sub-sectors, it may not be ideal for Kenya. The unified model may fail to anticipate risks in certain sectors, resulting in adverse effects for the Kenyan economy, as was the case in the UK. The Kenyan economy is also relatively small compared to developed countries and may not withstand a crisis that entails the collapse of many financial institutions.

The current regulatory model in Kenya has two main regulatory bodies that oversee the formulation of financial policies similar to the UK. The twin peaks model has successfully

[157] https://www.fsca.co.za/Pages/About-Us.aspx on 4 August 2021

regulated the UK financial markets since its conception without a crisis. The UK and South African financial markets are bigger and more complicated in structure than the Kenyan market. Kenya may, therefore, not be ready to adopt the twin peaks model. However, given that technological developments in the past few years have characterized the financial industry in Kenya, there may be a need to separate prudential regulation and conduct of business regulation. This differentiation will ensure increased oversight over the entire financial sector. The most suited model for this structure might be the twin peaks model. In implementing this model, Kenya should consider establishing two regulatory bodies to oversee prudential regulation and business conduct separately. There is also a need for Kenya to pursue international best practices in reforming its regulatory structure.

CHAPTER 5

5. Conclusions and Recommendations

5.1 Introduction

As has been illustrated in the preceding chapters of this study, financial regulation plays a vital role in the economy of any country. As a result, the financial regulatory environment is a crucial area of focus for any government. In ensuring adequate functioning of the financial industry, governments and legislative bodies formulate laws and regulations to control the activities being undertaken and ensure that the industry is stable.

In implementing laws and regulations, different jurisdictions consider a lot of factors, including the public policies, objectives of the legal and regulatory framework, size and structure of the industry, and various skills available in that country's demography. [158] These factors enable legislators to draft proper laws and regulations suitable for that specific industry. The legal and regulatory framework further provides for the model of financial regulation most suitable to a particular financial jurisdiction. The structure of the financial regulatory model is a key metric for the success or failure of the financial industry in any given country. Where a country develops a regulatory model that is unsuitable for its financial industry's architecture, it is bound to fail. This has been evident in many jurisdictions, especially after the global financial crisis. Countries that didn't have a robust regulatory model suitable for their financial industry's architecture were significantly impacted by the crisis.

The type of regulatory model adopted by any country has to achieve some of the universally accepted objectives of financial regulation. These include enhancing financial stability, consumer protection, promoting the safety and soundness of financial institutions, and regulation of the conduct of business.[159] Different models of financial regulation aim to achieve different objectives. Therefore, there is a need to formulate policies within the regulatory framework that align with these objectives.

[158] Mwenda K, *Legal Aspects of Financial Services Regulation and the Concept of a Unified Regulator*, 6
[159] Hudson, *The Law of Finance,* 55-62

In Kenya, financial regulation has evolved due to the emerging trends in the industry. As a result, legislators and key stakeholders in the industry have been searching for the best model of financial regulation suited to the structure of the financial industry in Kenya. Several reforms have been proposed, the most recent one being the introduction of the unified model of regulation. While the functional model of financial regulation has been efficient, there is a need to consider international trends and practices in the market and implement a structure that is in line with these trends.

This chapter will summarize this study, including the key findings and recommendations for the financial regulatory framework in Kenya using the international practices as a benchmark.

5.2 Findings

Chapter one introduced the background to this study and provided the relevant literature review that this research has relied on. It outlined the key causes of the global financial crisis that resulted in regulatory reforms in financial regulation in many jurisdictions in Europe and America. It also highlighted the impact of the global financial crisis on the regulatory models adopted at the time. The UK, for instance, was one of the countries at the center stage of the crisis as it is home to a financial center, London. At the time of the crisis, the UK applied the unified model of regulation. This model was argued to be inefficient in managing the crisis hence the call for reforms. Simultaneously, Kenya was having discussions about shifting from the functional model to the unified model. Therefore, there was a need to deliberate on the optimal model for Kenya, which is the primary area of focus in this paper.

In Chapter 2, the concept of financial regulation is introduced. It is noted that financial regulation relies on both the law and finance. The notions of these two distinct fields are applied in regulating financial markets. Financial regulation is formulated in such a way that it targets to achieve specific objectives. These objectives are universal and are applied in all jurisdictions. However, different jurisdictions prioritize different objectives depending on the needs of the financial industry. This chapter discusses the objectives of financial regulation as developed in the UK, which is one of the most mature financial markets in the world. Kenya has borrowed these objectives in its regulatory framework, embedding most of them in statutes. This chapter further outlines the three financial regulatory models applied globally and each model's objectives. The unified model, in particular, aims to achieve the safety and soundness of the financial industry by ensuring that a single regulator has visibility across each sector. After the global financial crisis, the key objective for many regulatory frameworks shifted to financial stability and avoidance of systemic risk.

The twin peaks model, introduced in the UK after the crisis, focused on financial regulation with the key objective to avoid systemic risk. It was designed so that prudential regulation and regulation of business conduct were vested on different entities. This was mainly due to the argument that the Financial Services Authority failed to detect systemic risk in the UK due to its light-touch approach. Therefore, financial stability through the identification and management of systemic risk was given priority.[160] In countries where the twin peaks model has been applied, macro-prudential and micro-prudential regulations are given priority. This is evident in the UK, where a specific entity ensures that the other regulators enhance financial stability.[161]

Since its inception, the twin peaks model has efficiently managed external threats that would result in systemic risk, as is evident in the UK. It has been argued that the twin peaks model is the most optimal model of financial regulation. However, although it is evident that in the UK, where it was implemented after the global crisis, the financial market has been stable, and there has been no threat of systemic risk, it cannot be argued to be the best with certainty.

The existing regulatory framework in Kenya is analyzed in chapter 3, highlighting its strengths and weaknesses. The financial industry in Kenya applies both the institutional and functional models of regulation. Multiple regulatory bodies oversee the regulation of different sectors in the financial industry. The functional model has been prone to regulatory overlaps and gaps due to the multiple regulatory bodies responsible for different sectors.[162] Another shortcoming of this model is its inability to regulate emerging trends and innovation within the industry efficiently. As a result, some sectors, such as online lending services, are inadequately regulated, resulting in regulatory arbitrage.

[160] Mwega F, Financial Regulation in Kenya: Balancing Inclusive growth with financial stability' 1
[161] Hudson, *The Law of Finance,* 200 - 203
[162] Nzomo Mutuku, *Case for Consolidated Financial Sector Regulation in Kenya,* 3-7

In order to deal with some of these challenges, reforms towards adopting a unified model of regulation were introduced. The unified model has been argued to be most suitable for countries with a growing emergence of financial conglomerates. Kenya fits this description since its financial industry has evolved over the years and is now characterized by cross-sector activities and cross-selling of products across the different financial sectors.[163]

The proposals to implement a unified model of regulation, although welcome, may not be ideal for the architecture of the financial industry in Kenya. This is because the financial industry is smaller than that of other jurisdictions whereby the unified model has been applied[164]. A single regulator is ideal for bigger financial markets to allow for coordination and prevent other regulatory bodies from working in silos. Additionally, given the learnings of other jurisdictions regarding the unified model, current trends in financial regulation should be considered whereby prudential regulation and regulation of the conduct of business are separated. However, the unified model may help resolve some of the current issues that the current regulatory model is facing, such as regulatory overlaps.

Chapter 4 is a comparative analysis of Kenya, the UK, and South Africa. The study examined the evolution of financial regulation in these jurisdictions and the regulatory models currently applied. The findings of the comparative analysis indicate that following the global financial crisis, both the UK and South Africa adopted the twin peaks model, whose key objective is to ensure the stability of the financial industry. The UK was amongst the first countries to adopt the twin peaks model after the crisis. On the other hand, the shift by South Africa is relatively recent and has borrowed a lot from the UK. In the UK, the twin peaks model is such that the conduct of business and prudential regulation are separate and overseen by different regulators. These regulators then report to the BOE and the Treasury, which are responsible for formulating policies for the financial industry.[165] In South Africa, the model is similar to the UK, with two regulatory bodies overseeing prudential regulation and business conduct regulation separately. Similarly, the Treasury in South

[163] Mwenda K, *Legal Aspects of Financial Services Regulation and the Concept of a Unified Regulator*, 39-40
[164] Gakeri J, 'Financial Services Regulatory Modernization in East Africa: The search for a new paradigm for Kenya' 169
[165] Hudson, *The Law of Finance,* 195

Africa and the South African Reserve Bank (SARB) oversee the regulation of the financial industry in South Africa through the formulation of policies.[166]

The comparative study reveals that the twin peaks model is a more efficient model of financial regulation due to its focus on both macro and micro-prudential regulation. The differentiation of these two regulatory functions allows efficient oversight over the financial markets, making it easy to detect systemic risks quickly. In adopting the twin peaks model, various factors must be considered, including the key objectives that stakeholders aim to achieve.

This study makes the following recommendations regarding the proposal to implement a unified model of regulation in Kenya.

5.3 Recommendations

There is a need to reform the regulatory framework in the financial industry in Kenya. This is due to the myriad of challenges facing the current regulatory framework in Kenya. However, this does not mean that Kenya needs to adopt a new model. Considering the cost implication and the time required to implement a new model, Kenya may continue applying the functional regulatory model subject to a few amendments. One of the challenges that require addressing is regulatory overlap. The regulations governing each financial industry sector should be harmonized to ensure that there are neither conflicting regulations nor overlaps. Mandatory policies that compel collaborative efforts amongst all key players in the financial regulatory industry, including the treasury, should be formulated.

The regulatory framework of the financial sector should be periodically, critically appraised. Not only should current global trends in financial regulation be considered in reforming or shifting to a regulatory framework, but also, importantly, the size and architecture of the financial sector. Functional efficiency and effectiveness should be central in appraising the regulatory framework. The Financial Services Authority Bill proposed the introduction of a single regulator for the entire financial services sector. Given the learnings from other jurisdictions, and the global trends in

[166] S Andrew, 'Financial Regulatory Governance in South Africa: The Move Towards Twin Peaks' 17

financial regulation, Kenya should consider adopting a model whereby there is a clear distinction between prudential regulation and regulation of business conduct. The functional model of regulation applied in Kenya has borrowed mainly from the twin peaks model. The CBK and the Treasury are considered superior to the other regulatory bodies as they oversee the entire industry through formulation of policies, including monetary policies. Kenya should retain this structure and develop a separate structure of regulatory bodies that are solely responsible for prudential regulation. This will ensure that external risks are managed and systemic risk minimized. The current regulatory model should be modified to suit the needs of the financial industry's architecture and ensure that the objective of financial stability is given priority.

Finally, independence between the regulatory bodies in the financial industry should be promoted. One of the key reasons the FSA (Kenya) was not implemented was due to external influences. The independence of regulatory bodies would promote the integrity of the financial industry and should be embedded in statute.

5.4 Conclusion

To achieve an efficient financial industry, Kenya needs to reform its regulatory framework. This should be in line with the emerging trends and universally accepted objectives of financial regulation. This study, therefore, calls for reforms in the current regulatory framework

This dissertation observed that reforms in the regulatory framework of any jurisdiction take time. In the case of the UK, regulatory reforms were introduced after a crisis with the hope of strengthening and cushioning financial markets from external threats. In Kenya, the financial industry has not experienced a significant crisis over the years. However, this does not mean that Kenya should wait for such an occurrence to implement reforms in its regulatory framework. These reforms should be aimed towards achieving financial stability in the financial industry, as have been evident in other countries.

Furthermore, after a comparative study of South Africa and the UK, we observed that financial stability is best achieved with a clear distinction between prudential regulation and business regulation conduct. The twin peaks model vests prudential regulation on different bodies. In the UK, prudential regulation is overseen by the PRA and FPC, both under the BOE. In South Africa, prudential regulation is overseen by the PA, which is within the administration of SARB. This ensures that risks within the ecosystem of a financial institution and external risks are assessed and managed promptly, promoting the financial sector's stability. Additionally, this model promotes the integrity of financial markets since regulation of business conduct is overseen by one entity, giving it visibility of how financial institutions are conducting business. The comparative study also indicates it is prudent to have the Treasury and the Central Banks (BOE and SARB) as the main regulatory bodies in any given financial sector due to their role in formulating financial policies. Regulatory bodies should therefore report to these two bodies.

In conclusion, Kenya needs to reform its current regulatory framework by separating prudential regulation and regulation of business conduct. In this way, financial stability shall be enhanced in the sector. Additionally, the current key challenges facing the current framework, including regulatory gaps and regulatory overlaps, will be resolved by ensuring that there are two different regulatory bodies responsible for prudential regulation and business conduct. Therefore, this study calls for reforms to the current regulatory framework which is highly fragmented, through the amendment of all the statutes governing the financial sector to provide for the separation of prudential and business conduct regulation. This will enhance regulatory oversight, promote financial stability, and ensure Kenya’s financial regulatory framework is in line with international best practices of financial regulation.

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Appendices

Appendix A – Ethical Clearance Report

Strathmore UNIVERSITY

18th November 2021

Ms Ndichu Lilian,
wanjiku.ndichu@strathmore.edu

Dear Ms Ndichu,

RE: Re-Evaluating the Case for a Unified Model of Regulation in the Financial Services Sector in Kenya

This is to inform you that SU-IERC has reviewed and **approved** your above **SU-master's** research proposal. Your application reference number is **SU-IERC1222/21**. The approval period is **18th November 2021 to 17th November 2022.**

This approval is subject to compliance with the following requirements:

i. Only approved documents including (informed consents, study instruments, MTA) will be used
ii. All changes including (amendments, deviations, and violations) are submitted for review and approval by SU-IERC.
iii. Death and life-threatening problems and serious adverse events or unexpected adverse events whether related or unrelated to the study must be reported to SU-IERC within 48 hours of notification
iv. Any changes, anticipated or otherwise that may increase the risks or affected safety or welfare of study participants and others or affect the integrity of the research must be reported to SU-IERC within 48 hours
v. Clearance for export of biological specimens must be obtained from relevant institutions.
vi. Submission of a request for renewal of approval at least 60 days prior to expiry of the approval period. Attach a comprehensive progress report to support the renewal.
vii. Submission of an executive summary report within 90 days upon completion of the study to SU-IERC.

Prior to commencing your study, you will be expected to obtain a research license from National Commission for Science, Technology, and Innovation (NACOSTI) https://research-portal.nacosti.go.ke/ and obtain other clearances needed.

Yours sincerely,

for: Prof Fred Were,
Chairperson; SU-IERC

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(SU-IERC)
18 Nov 2021
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Appendix B – Plagiarism Report

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Document Information

Analyzed document	Evaluating the Case for a Unified Model of Regulation in the Financial Services Sector in Kenya.docx (D118932728)
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Submitted by	
Submitter email	Wanjiku.Ndichu@strathmore.edu
Similarity	7%
Analysis address	library.strath@analysis.urkund.com

Sources included in the report

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