FINANCIAL REGULATORY STRUCTURE
REFORM IN KENYA: THE PERCEPTION OF
FINANCIAL INTERMEDIARIES IN KENYA
REGARDING THE CASE FOR A SINGLE
FINANCIAL REGULATOR

PRESENTED BY

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DECLARATION

This management project is my original work and has not been presented for a degree in any other university.

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This management project has been submitted for examination with my approval as university supervisor.

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DEDICATION

To my wife Wendy and my children, Mathenge, Kanyua and Wangu for their encouragement, inspiration and understanding.
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I would like to thank God very much for bringing me this far in spite of the many challenges along the way. I know that it is by His strength that I have come to see the end of this programme.

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ABSTRACT

The survey for the study reported here was carried out between 15th April and 15th June, 2007. The study sought to investigate whether there was a perceived need to restructure the regulatory framework of Kenya’s financial markets and the perception of financial market intermediaries regarding a single regulator model for Kenya’s financial markets.

The population of interest in the study comprised all the institutions licensed in the banking, insurance, investments and pensions sectors. The information was collected using a drop-and-pick later questionnaire to be completed by the managing director or company secretary or other officer involved in regulatory affairs in 82 institutions sampled from 730 institutions licensed in Kenya.

It was found that there is a perceived need to restructure the regulatory framework of Kenya’s financial markets and the most important factors in deciding whether or not to change the regulatory structure are historical development, level of skills, size of the financial market, state of development of the financial markets, level of concentration in the financial services industry, adequacy of current regulatory structures, potential economies of scale to be obtained, linkages between financial institutions and institutional structure of the financial services industry. It was also clear from the majority of respondents that Kenya should adopt a single regulator model for its financial markets as it has some merits such as Economies of scale and scope, ease/efficiency of decision making, shared resources, cost reduction for regulated institutions, enhancing accountability by clarifying the roles of the regulatory agency, more effective response to market innovation and development due to better monitoring of issues affecting the entire financial system and unified approach to regulation thereby reducing regulatory arbitrage.

While there was no relationship found between the type of institution and the perceived need for reform of the financial regulatory structure, a relation was found between the type of institution and the support for a single regulator model. An investigation into the cause of this scenario would be necessary.
It was evident from the study that there is still a great need for research to be carried out in the broad area of financial regulation and financial regulatory structure in Kenya as there is limited available information in this area.
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CHAPTER ONE: INTRODUCTION

1.1 Background of the Study

1.1.1 Overview of the Financial Markets: Financial Intermediaries and Regulation

The financial market is the facilitator for the flow of funds from the providers of funds (mainly households) to the users of funds (mainly firms and companies). Very rarely do funds flow directly from the providers to the users. In nearly all cases there is an intermediary through whom the process is achieved (Cornett & Saunders, 1999). This intermediary is called a financial institution. There are different types of financial intermediaries which differ in their special functions. Such financial intermediaries include banks, finance companies and mutual funds, life insurance companies, pension funds and securities exchanges. Each of these types of institutions essentially provides the service of financial intermediation, though the specific aspects of the type of service each type of institution offers differs. Institutions which perform financial intermediation services are considered special because of certain features arising from the nature of their business. Some of the areas giving rise to the special nature of financial institutions in the provision of services are the following (Cornett & Saunders, 1999):

**Information costs:** The aggregation of funds in a financial institution provides greater incentive to collect a firm’s information and monitor its actions. The relatively large size of the financial institution allows this collection of information to be accomplished at a lower average cost (so-called economies of scale).

**Liquidity and price risk:** Financial institutions provide financial claims to household savers with superior liquidity attributes and with lower price risk.

**Transaction cost services:** Similar to economies of scale in information production costs, a financial institution’s size can result in economies of scale in transaction costs.
Maturity intermediation: Financial institutions can better bear the risk of mismatching the maturities of their assets and liabilities.

Money supply transmission: Depository institutions are the conduit through which monetary policy actions impact the rest of the financial system and the economy in general.

Credit allocation: Financial institutions are often viewed as the major, and sometimes only, source of financing for a particular sector of the economy, such as farming and residential real estate.

Intergenerational wealth transfers: Financial institutions, especially life insurance companies and pension funds, provide savers the ability to transfer wealth from one generation to the next.

Payment services: The efficiency with which depository institutions provide payment services directly benefits the economy.

Denomination intermediation: Financial institutions, such as mutual funds, allow small investors to overcome constraints to buying assets imposed by large minimum denomination size.

Because of the foregoing features of the business and the special role financial institutions play in the financial system, financial institutions are singled out for special regulatory attention. Regulation is performed mainly by government agencies created for that purpose. Regulation of financial institutions takes various facets:

Safety and soundness regulation: Layers of regulation have been imposed on financial institutions to protect depositors and borrowers from the risk of failure. This is also known as Prudential Regulation and it covers such issues as capital adequacy, asset quality, management, earnings, liabilities and reporting requirements.

Monetary Policy regulation: Regulators control and implement monetary policy by requiring minimum levels of cash reserves to be held against depository institution deposits.
Credit Allocation regulation: Regulations support the financial institution’s lending to socially important sectors, such as housing and farming, or disadvantaged groups such as blacks and women.

Consumer Protection regulation: Regulations are imposed to prevent the financial institution’s ability to discriminate unfairly in lending.

Investor Protection regulation: Laws protect investors who directly purchase securities and/or directly purchase securities by investing in mutual funds and pension funds.

Entry and chartering regulation: Entry and activity regulations limit the number of financial institutions in any given financial services sector, thus impacting the charter values of financial institutions operating in that sector.

Price regulation: Regulations are imposed on maximum interest rates for lending and minimum interest rates for deposits.

The aim of these types of regulation is to enhance the net social welfare benefits of financial intermediaries’ services.

In considering regulation of financial intermediaries, one of the aspects of the subject is the structure of regulation. The structure of regulation differs from country to country but the nature of the business and rationale for its regulation remains the same. In the recent past there has been a lot of debate on the structural aspect of regulation, that is what form the regulatory agencies should take. The main debate has been on whether to have a single or multiple regulators for the financial markets. Different countries have taken different approaches to the issue. Thus some countries have adopted the single regulator model while others have adopted the multiple regulator model. Among the countries that have adopted the single regulator model are the United Kingdom, Japan, Korea and Sweden. Among the arguments for a single regulator are that it improves coordination, integration of markets, reduces transaction costs due to economies of scale, leads to better knowledge management and information sharing and mitigates systemic risks.
Many other countries have adopted the model where there is a separate agency for each of the main sectors, that is banking, insurance, securities and pension sectors, for example India and Kenya. Yet other countries have adopted a variety of combinations such as combined securities and insurance regulators (Chile and South Africa); combined banking and securities regulators (Germany and France); and combined banking and insurance regulators (Australia and Canada). In the USA there are multiple regulators, even for banks who are accountable to the Federal Reserve, Federal Deposit Insurance Corporation (FDIC) and State Authorities. The regulatory framework in the USA has been described as a “hotchpotch of different regulators for different bits of the financial services industry, mainly for reasons of history rather than deliberate strategy” (The Economist, May 5, 2001).

The international status in regard to the regulatory structure has been reviewed by the International Monetary Fund. A recent study by the IMF notes that in approximately half of the countries examined, the revealed preference is for a regulatory structure based on specialized agencies (IMF, December 2000).

1.1.2 Structure of Regulation in Kenya

Kenya’s Financial Markets have historically been segmented along sectoral lines. Thus there has been a Banking Sector, an Insurance Sector and more recently, the Capital markets and the Retirement Benefits Sector. Other financial market sectors which however play a relatively minor role in the formal sector are building societies and micro-finance institutions. Kenya’s financial markets fall within what are generally described as Emerging Markets. These are markets, which are still in the developmental stage but enjoying high rates of growth. These markets are contrasted with the financial markets in the developed countries like the USA, Western Europe and Japan, which are highly sophisticated but growing more slowly.

The regulatory structure of the Kenyan financial markets flows from the aforesaid sectoral division. Thus each sector has its own specialized regulator and legislation
governing it. The banking sector is regulated by the Central Bank and the governing legislation is the Banking Act, Cap 488 of the Laws of Kenya. The insurance sector is regulated by the Commissioner of Insurance and the governing legislation is the Insurance Act Cap 487. The securities sector is regulated by the Capital Markets Authority and the governing legislation is the Capital Markets Act, Cap 485A. The pensions sector is regulated by the Retirement Benefits Authority and the governing legislation is the Retirement Benefits Act, Act No. 3 of 1997.

A brief description of the regulatory structure is as hereunder. A more detailed description of the provisions of the each of the statutes governing the respective sectors is set out in Appendix 3.

1) The Banking Sector

The Central Bank of Kenya is the principal regulator in the banking sector. It is the Central Bank which is mandated to regulate and supervise banks and financial institutions and mortgage finance companies and generally ensure that they comply with the provisions of the Banking Act.

It should be noted however that the Ministry of Finance also plays a principal role in the regulation of the banking sector. In fact many of the functions exercised by the Central Bank over the banking sector are merely to facilitate the exercise of ultimate responsibility by the Ministry of Finance. An example of this is in the licensing of banks where responsibility for issuing banking licenses lies with the Ministry of Finance with the Central Bank only vetting applications and forwarding them to the Minister with its recommendations.
The Banking Act empowers the Central Bank to issue guidelines to banks and other financial institutions on specific matters. The Act also gives the Central Bank discretionary powers in the aforesaid issues provided in the Act.

The Central Bank of Kenya itself is established under the Central Bank of Kenya Act. Section 4 of this Act provides for the principal object of the Central Bank. The principal object of the bank shall be to formulate and implement monetary policy directed to achieving and maintaining stability in the general level of prices. Further, the Bank shall foster the liquidity, solvency and proper functioning of a stable market based financial system.

Section 3 (1) provides that the bank shall exercise any type of central banking function unless specifically excluded under this Act and shall enjoy all the prerogatives of a central bank”. Indeed the Act, in section 4A, goes on to state the other objects of the bank which include formulating and implementing foreign exchange policy, holding and managing its foreign exchange reserves, licensing and supervising authorized dealers, promoting the smooth operation of payments, clearing and settlements schemes, acting as banker and adviser to, and as fiscal agent of the Government and issuing currency notes and coins.

2) Insurance Sector

The main regulator of the insurance sector is the Commissioner of Insurance. The Commissioner of Insurance is an office created by Section 3 (1) of the Insurance Act Cap 487 of the Laws of Kenya. The Commissioner of Insurance is appointed by the Minister of Finance. The Commissioner of Insurance is not an independent institution. Rather this is an Office within the Ministry of Finance.

The duties of the Commissioner are stated in Section 5 of the Act and include the formulation and enforcement of standards in the conduct of the business of insurance with which a member of the insurance industry must comply, directing insurers and reinsurers on the standardization of contracts of compulsory insurance,
directing an insurer or a reinsurer, where he is satisfied that the wording of a particular contract of insurance issued by the insurer or reinsurer is obscure or contains ambiguous term or terms and conditions which are unfair or oppressive to the policy holders, to clarify, simplify, amend or delete the wording, terms or conditions as the case may be, in respect of future contracts, the approval of tariffs and rates of insurance in respect of any class or classes of insurance and such other duties as the Minister may assign to him.

The Insurance Act and the regulations made there under are very comprehensive and go to minute details of the operations of members of the insurance industry. Not only are the institutions regulated, but prescriptions are given for the product as well. This is in contrast with the Banking Act, which only regulates the players, not the product offered.

1) The Capital Markets
The principal regulatory authority of the capital markets is the Capital Markets Authority. The Capital Markets Authority is established under section 5 of the Capital Markets Act. The Authority is a body corporate with perpetual succession and common seal.

The objectives of the authority are stated in section 11 of the Act as being the development of all aspects of the capital markets with particular emphasis on the removal of impediments to, and the creation of incentives for longer-term investments in productive activities, to facilitate the existence of a nation wide system of stock market and brokerage services so as to enable participation of the general public in the stock market, the creation, maintenance and regulation, of a market in which securities can be issued and traded in an orderly, fair and efficient manner, through the implementation of a system in which the market participants are self regulatory to the maximum practicable extent, the protection of investor interests, the operation of a compensation fund to protect investors from financial loss arising from the failure of a licensed broker or dealer to meet his contractual
obligations, the development of a framework to facilitate the use of electronic commerce for the development of capital markets in Kenya.

Section 11 (3) of the Act lists the powers, duties and functions of the authority to enable it carry out its objectives, and section 12 of the Act empowers the Authority to issue rules, regulations and guidelines.

4) Retirement Benefits Sector
The Retirement Benefits sector is governed by the Retirement Benefits Act, Act No 3 of 1997. The principal regulatory body in this sector is the Retirement Benefits Authority (RBA). The RBA is established under section 3 of the Act. It is a body corporate with perpetual succession and a common seal.

The objectives and functions of the RBA are given in section 5 of the Act. These are to regulate and supervise the establishment and management of Retirement Benefits Schemes, protect the interests of members and sponsors of retirement benefits sector, promote the development of the retirement benefits sector, advise the Minister on the national policy to be followed with regard to retirement benefits schemes and to implement all Government policies relating thereto and to perform such other functions as are conferred on it by the Act or any other written law.

What clearly stands out in the different pieces of legislation governing the respective sectors of the financial services industry is that there is a similarity in the types of regulation imposed by the governing legislation in each sector. Thus, there is entry and licensing regulation, prudential regulation, including minimum capital requirements, reporting obligations and conduct of business, and deposit/policyholder/investor protection regulations and liquidation regulations.
1.1.3 Recent Market Developments

In the past ten (10) years, Kenya’s financial markets have witnessed many changes. These changes have been part and parcel of the broad Government policy of economic liberalization, which is supported by the World Bank and IMF. With increased liberalization has come increased competition among the players in the financial markets, that is the financial intermediaries. The competitive pressure has come not only from within the country but also from outside the country.

Liberalization in the financial markets has also been accompanied by attempts to deepen the financial markets by providing the relevant regulatory framework. Hence the promulgation of such laws as the Retirement Benefits Act and the Capital Markets Authority (Amendment) Act, 1994, the Capital Markets Authority (Amendment) Act 2000, and the Central Depositories Act, 2000, and the myriad of regulations and rules made there under.

In response to the environment created by liberalization and in order to remain competitive, financial intermediaries, mainly banks and insurance companies, have sought to diversify their product offerings and upgrade their technological bases. Financial intermediaries have sought to take up more roles. Indeed banks licensed under the Banking Act have taken up new roles under the Capital Markets Act and under the Retirement Benefits Act. For instance, under the Capital Markets Act, authorized depositories are mainly Commercial banks. Under the Retirement Benefits Act too, custodians are mainly commercial banks. In order to act as either an authorized depository or a custodian, a bank must also be licensed under the relevant act by the relevant authority, that is the CMA or the RBA. Similarly, insurance companies are licensed under the Retirement Benefits Act in order to act as managers of pension funds.

The Market has seen banks trying to venture into the insurance products, where they would be able to use their product distribution channels to sell insurance products as well. These efforts however, have faced stiff resistance from the insurance regulator on the grounds that the banks are not licensed to sell insurance...
products. However, the banks argue that this additional line of business would enable them to remain competitive and give their customers the best service.

To find their way around regulatory hurdles especially on licensing some financial intermediaries have adopted the strategy of conglomerations. Thus, the CFC Group in Kenya comprises, CFC Bank, Heritage All Insurance Company Ltd and CFC Financial Services Limited, an investment bank. Many of the commercial banks have wholly owned subsidiaries, which are licensed as investment advisers by the CMA. This is a trend which is likely to pick up pace as financial intermediaries in Kenya seek to be one stop shops for financial services, in line with current trends in the international arena. Another strategy witnessed more recently is the trend of consolidations in both the banking and insurance industries. Thus, the merger of the general divisions of Apollo Insurance Company Ltd with that of Pan-African Insurance Company Limited to form APA Insurance Company Ltd. So also the merger of Commercial Bank of Africa Ltd with First American Bank Ltd and the merger of East African Building Society with Akiba Bank Ltd. With such trends and developments as noted above, the question arises whether the current regulatory framework, with multiple sectoral regulators, is satisfactory. Is there a need to review the current regulatory structure of the financial markets in Kenya with a view to restructuring it in line with the changes in the way financial intermediaries are doing business? Are there too many financial regulators with overlapping mandates?

1.2 Statement of the Problem

The regulatory structure in Kenya has historically been organized along sectoral lines, with each sector having its own regulator. This is the model traditionally adopted by most countries. In recent times, however, many countries have reformed and continue to reform their regulatory frameworks in a bid to cope with changes in their financial systems (markets) and the developments within financial institutions, in particular diversification of services offered by financial institutions, consolidations within the banking sector, conglomerations of institutions to form one-stop financial services companies, and the common phenomenon of financial
crisis. Other changes include technological advancements. These developments have led to the blurring of distinctions between financial institutions. With the blurring of distinctions between financial institutions, the responsibility of the different regulators in a framework built along sectoral lines also becomes blurred (Shen, 2005). These changes have also been witnessed in Kenya. In light of these changes the adequacy of Kenya’s regulatory structure and supervisory activity assumes significant importance. Is the current regulatory structure efficient? Does it allow for the efficient operation of financial institutions? Is there a need to reform? If so, what direction should the reform action take i.e. which regulatory structure or model ought to be adopted? This study will limit itself to the question whether Kenya should adopt a single regulator system or whether it should retain the current multiple regulator system.

1.3 Objectives of the Study

The objectives of the study are the following:

1) To determine whether there is a perceived need to restructure Kenya’s financial regulatory framework and to identify the key drivers of this need.

2) To determine the perception of financial intermediaries in Kenya regarding the case for a single financial regulator.

1.4 Importance of the Study

The findings of this study will be important to the following:

1) Policy makers in Government in enhancing their understanding of the regulation and supervision of financial institutions and providing a basis to consider whether there is a need to reform of the regulatory and supervisory structure of the financial services industry.

2) Regulators in the financial services industry in understanding their central role in maintaining the stability and efficient operation of the financial services industry and the financial institutions.
3) Financial intermediaries in enhancing their appreciation of the goals and objectives of regulation and supervision and the benefits and costs of regulation and supervision.

4) Researchers/academics who will use the findings as a basis for further research.

5) Students of finance and management who will be provided with further information in the area of regulation and supervision of financial institutions.
CHAPTER TWO: LITERATURE REVIEW

2.1 The Economic Rationale for Regulation

Llewellyn (1999) divides the economic rationale for regulation and supervision in banking and financial services into seven components as follows: First, potential systemic problems associated with externalities (a particular form of market failure), second, the correction of other market imperfections and failures, third, the need for monitoring of financial firms and the economies of scale that exist in this activity, fourth, the need for consumer confidence which also has a positive externality, fifth, the potential for Grid Lock, with associated adverse selection and moral hazard problems, sixth, moral hazard associated with the revealed preference of governments to create safety net arrangements: lender of last resort, deposit insurance, and compensation schemes, and seventh, consumer demand for regulation in order to gain a degree of assurance and lower transactions costs.

2.2 Aims of Financial Regulation

Llewellyn (1999) summarises the core aims or objectives of financial regulation as the following: firstly, to sustain systemic stability, secondly, to maintain the safety and soundness of financial institutions, and thirdly, to protect the consumer.

A wider framework might however be set by particular regulatory agencies. Indeed, other objectives have been postulated including the need to maintain and enhance competition in the financial services industry (Di Giorgio et al, 2001).

Llewellyn goes on to say that the case for regulation, which also determines its objectives, depends on various market imperfections and failures (especially externalities and asymmetric information) which, in the absence of regulation, produce sub-optimal results and reduce consumer welfare. In other words, the
purpose of regulation should be limited to correcting for identified market imperfections and failures.

2.3 Types of Regulation

According to Llewellyn (1999) there are two generic types of financial regulation and supervision: prudential regulation, which focuses on the solvency and safety and soundness of financial institutions, and conduct of business regulation which focuses on how financial firms conduct business with their customers.

Prudential regulation

The case for prudential regulation and supervision of financial firms is that consumers are not in practice in a position to judge the safety and soundness of financial firms. Prudential regulation is necessary because of imperfect consumer information, agency problems associated with the nature of financial institutions' business, and because the behaviour of a financial firm after consumers have dealt with it affects the value of their stake in the firm. No amount of information at the time contracts are signed and purchases made protects against subsequent behaviour of the firm. Leaving aside any potential systemic dimension, there is therefore a case for prudential regulation of financial firms when:

i) the institution performs a fiduciary role;

ii) consumers are unable to judge the safety and soundness of institutions at the time purchases or contracts are made;

iii) post-contract behaviour of the institution determines the value of contracts, and when the institution may become more risky because of a change in its behaviour after a long-term contract has been taken out by customers;

iv) there is a potential claim on an insurance fund or compensation scheme because the costs of hazardous behaviour of an individual financial firm can be passed on to others (those who in the end pay the compensation). If, for instance, other firms in the industry are required to pay the compensation
liabilities of failed institutions it would be reasonable for these firms to demand certain minimum standards of behaviour which they are unable to enforce themselves without an external agency's intervention.

**Conduct of business regulation**

Conduct of business regulation and supervision focuses upon how financial firms conduct business with their customers. It focuses upon mandatory information disclosure, the honesty and integrity of firms and their employees, the level of competence of firms supplying financial services and products, fair business practices, the way financial products are marketed, etc. Conduct of business regulation can also establish guidelines for the objectivity of advice, with the aim of minimising those principal-agent problems that can arise when principals (those seeking advice) and agents either do not have equal access to information, or do not have equal expertise to assess it. Overall, conduct of business regulation is designed to establish rules and guidelines about appropriate behaviour and business practices in dealing with customers.

From the foregoing generic types of regulation, one may come up with the specific types of regulation referred to earlier, that is safety and soundness regulation, monetary policy regulation, credit allocation regulation, investor protection regulation, consumer protection regulation and entry and licensing regulation.

### 2.4 Structure of Financial Market Regulation

"Perhaps reflecting the diversity of financial systems, as well as other factors like history and governmental institutions, regulatory structures vary widely. Nonetheless, in approximately half the countries contained in a recent study [of 73 countries, see Table 1 below] the revealed preference is for a regulatory structure based on specialist agencies, with the banking, insurance and securities sectors each supervised by a dedicated agency." (Abrams, R.K & Taylor, M.W., 2000)
Table 2.1: The Regulatory Structures in Selected Countries

<table>
<thead>
<tr>
<th>Structure</th>
<th>Count</th>
</tr>
</thead>
<tbody>
<tr>
<td>Separate agencies for each main sector</td>
<td>35</td>
</tr>
<tr>
<td>Combined securities and insurance regulators</td>
<td>3</td>
</tr>
<tr>
<td>Combined banking and securities regulators</td>
<td>9</td>
</tr>
<tr>
<td>Combined banking and insurance regulators</td>
<td>13</td>
</tr>
<tr>
<td>Unified supervision (in central bank)</td>
<td>3</td>
</tr>
<tr>
<td>Unified supervision (outside central bank)</td>
<td>10</td>
</tr>
</tbody>
</table>


“A group of recent studies has considered the issue of whether a single supervisory authority is to be preferred to multiple supervisory authorities. … this literature relies primarily on theory or logical argument and does not provide much empirical evidence.” (Barth, J.R. et al, 2001)

In spite of this, there has recently been significant attention to the structural aspects of regulation. Thus, a unified regulator was announced in the UK in 1997; changes have been considered in Australia and reform has been brought about in Japan. Further, legislative changes in the USA have to some extent diluted the compartmentalization of financial activities and regulatory framework. Irrespective of the actual policy preferences or reforms across the globe, the structural issue of financial regulation has recently gained attention for several reasons (Reddy, Y. V, 2001):

Firstly, the growth and development of the financial sector is characterized by the blurring of distinction between banking, securities and insurance activities.
Secondly, even if these institutions and activities are treated with a compartmental approach and even if the risks are considered separable, the linkages are such that the contagion cannot be avoided.

Thirdly, globalization has resulted in multi-functional global conglomerates warranting appropriate changes in structural aspects of domestic regulation.

Finally, it is argued that banks can still be treated separately for purposes of prudential requirements without necessarily linking them with the central bank, whose primary responsibility should be price stability.

There is neither a unique theoretical model nor just one practical approach to the regulation and supervision of financial markets. Significant differences are found in the literature in terms of both definition and classification of regulatory models and techniques.


Di Giorgio et al (2001) proceed to describe the four approaches as hereunder:

2.4.1 **Multiple Regulation based on Institutional (Sectional) Supervision.**

In the more traditional institutional approach (also known as section, sectoral or "by subjects" or "by markets"), supervision is performed over each single category of financial operator (or over each single segment of the financial market) and is assigned to a distinct agency for the entire complex of activities. In this model, which follows the traditional segmentation of the financial system into three
markets, we thus have three supervisory authorities acting as watchdogs over, respectively, banks, financial intermediaries, mutual funds (investments and securities firms), and insurance companies (and the corresponding markets). The authorities control intermediaries and markets through entry selection processes, that is licencing, constant monitoring of the business activities (controls, inspections and sanctions) and eventual exits from the market (suspensions or removal).

While securities companies and insurance companies will have their own specific regulators with a scope of authority limited to the particular sector, banks will normally be supervised by the central bank, which is also in charge of monetary policy in the economy. Countries with this structure of financial intermediaries’ supervision include Kenya and India. This is the most common structure of supervision adopted worldwide.

**Regulation by the Central Bank**

From a sample of 101 countries, it was found that a “reverse central bank effect” exists, where countries whose central bank also supervises their banks tend to adopt sectoral supervision. (Shen, C. 2005). In considering the pros and cons of single regulator or unified regulation and multiple regulators, a major issue that needs to be addressed is: should banks be supervised by central banks?

A case for keeping supervision with the central bank is generally made out on the following grounds (Reddy, Y.Y, 2001): First, in order to assess the creditworthiness of the participants in the payments systems, the central bank needs to form a judgment on aspects of liquidity and solvency and prudent conduct of banks. Secondly, supervision complements the central bank’s market intelligence system with a detailed knowledge of the strengths and weaknesses of individual banks and, therefore, of the banking system as a whole. Thirdly, knowledge of developments in the banks’ balance sheets can be important in assessment of macroeconomic conditions. Fourthly, lender of last resort function has a potential
for moral hazard in the system and may cause banks to gamble for resurrection, requiring the central bank to ensure that banks are well supervised. Fifthly, there are substantial economies of scale, especially when there is scarcity of skilled professionals in the area of finance. Sixthly, independence of bank supervision is automatically provided if the central bank enjoys autonomy, thus avoiding politicisation of bank regulation. In other words, central banks do enjoy a tradition of independence and lesser politicisation.

The Case against Central Bank Supervision
There are, however, strong advocates of separation of monetary policy function and of banking supervision too. Their main argument as summarized by Reddy (2001) is that monetary policy independence would be compromised due to possible conflict between monetary policy and banking regulation/supervision. For example, the central bank may relax monetary policy in times of extreme weaknesses in the banking system rather than for macroeconomic reasons. Further, bank failures or weaknesses may undermine the credibility of the central bank.

Merits of Institutional supervision
According to Di Giorgio et al (2001) institutional regulation facilitates the effective realization of controls, being performed with regards to subjects which are regulated as to every aspect of their activity and as to all the objectives of regulation. Each intermediary and market has only one supervisory authority as a counterpart. The latter, in turn, is highly specialized. As a result, duplication of controls is avoided and the costs of regulation can be considerably reduced. The institutional approach seems to be particularly effective in cases of intermediaries of a very similar type and which operate in just one of the three traditional segments of financial intermediation.

Demerits of Institutional supervision
Conversely, as Di Giorgio et al (2001) point out, the institutional model may give rise, in the presence of more subjects entitled to perform the same financial
intermediation activities, to distortions in the supervisory activity caused by the enforcement of different prescriptions for operations of the same nature that are executed by different entities. The disadvantages of this approach are represented by the previously mentioned trend toward multiple-sector activities and by the progressive de-specialization of the intermediaries. In turn, these phenomena are connected to the growing integration of both markets and instruments that frequently leads to the building of large financial conglomerates. In a context where the boundaries separating the various institutions are progressively being erased, it is no longer possible to establish whether a particular subject is a bank, a non-banking intermediary or an insurance company; or whether a group is involved more in one or another of such activities. Therefore, there is the risk that “parallel” systems of intermediaries may be created, reflecting the diversity of the respective control authorities. In this case, the way the controls are set up may become a destabilizing rather than stabilizing factor. Moreover, the intermediaries might be induced to choose their juridical status in a way that is contingent on the different rules that discipline different subjects (Regulatory arbitrage).

A further possible element of weakness in the model lies in the fact that when a single authority supervises a category of subjects and pursues more than one objective, the result of the control activity might not be effective in the event that different objectives are in conflict.

2.4.2 Multiple Regulation based on Supervision by Objectives.

According to Di Giorgio, et al (2001), the supervisory model by objectives (or by finalities) postulates that all intermediaries and markets be subjected to the control of more than one authority, each single authority being responsible for one objective of regulation regardless of both the legal form of the intermediaries and of the functions or activities they perform. According to this scheme, several authorities, different from the Central Banks, which is in charge of monetary policy and macro-stability, are established. For example, one such authority will watch over prudential regulation and micro-stability of markets and all intermediaries,
whether in banking, finance or insurance (safety and soundness regulation). A second authority will be responsible for the transparency of financial markets and will control the behaviour of banks, financial intermediaries and insurance companies toward customers (consumer protection regulation). A third authority will guarantee and safeguard competition over the entire financial market and among intermediaries. Hence it will be charged with the licencing function. Note that Di Giorgio et al (2001) consider competition as a key objective of regulation in contrast to Llewellyn (1999) above.

This particular model, in spite of its theoretical sophistication has not been adopted in whole in any country. (Di Giorgio, et al, 2001).

Merits

The basic advantage of this 4-peak model lies in the fact that it is particularly effective in a highly-integrated market context and in the presence of polifunctional operators, conglomerates and groups operating in a variety of different business sectors. At the same time, it does not require an excessive proliferation of control units.

The most attractive feature of this scheme is that it provides uniform regulation for the different entities engaged in the same activities.

Demerits

Compared to the institutional model, a regulatory framework organized by objectives may produce a certain degree of multiplication of the controls. And sometimes it could lead to a lack of certain controls. Indeed, the specific assignment of competencies with respect to the objectives of regulation is not necessarily univocal and all-inclusive in practice. In such a model, each intermediary is subject to the control of more than one authority, and this may be more costly. The intermediaries might in fact be required to produce several reports relating to supervision, often containing identical or similar information. At the
same time, the intermediaries may have to justify the same action to a whole set of authorities contemporaneously, even though for different reasons.

Conversely, a deficit of controls might occur whenever the exact areas of responsibility are not clearly identifiable in specific cases.

### 2.4.3 Multiple Regulation through Functional Supervision.

Di Giorgio, et al (2001) describe the third regulatory model as the so-called functional supervision, or supervision “by activity”. It considers as “given” the economic functions performed in the financial system; unlike other lines of thought regarding supervisory activities, this approach does not postulate that existing institutions, whether operative or regulatory, must necessarily continue to exist as such, in terms of both their structure and role. The “functions” or activities undertaken are considered to be more stable than the institutions that perform them. Competition among financial systems is thought to drive existing institutions to evolve in a dynamic perspective in the direction of new and more efficient forms.

In the functional supervisory model, each type of such financial services should be regulated by a given authority independently of the operator who offers it. Hence, also this approach has the important advantage that it calls for the same rules to be applied to intermediaries who perform the same activity of financial intermediation even though such operators may fall into different categories from a legal standpoint. For example, activities including investment management, the gathering of deposits, lending, and savings invested in insurance/retirement funds are each subject to homogeneous rules established by individual authorities, which independently supervise such activities regardless of the institutions engaged.
Merits
According to Di Giorgio et al (2001), this approach fosters economies of specialization within the supervisory authorities and might represent a rather attractive solution for the regulation of integrated, advanced financial markets.

Demerits
However, they point out that it is not without drawbacks. This model envisions an overlapping of bodies controlling the same subject: there is the risk of an excessive division of competencies among the regulatory agencies.

A further disadvantage of the functional approach is that finally what is subject to failure is not the activity performed, but the institution. In case of serious problems of stability, it would be essential to guarantee protection and oversight with regard to the institutions rather than to individual operations (Padoa-Schioppa, 1988).

This model has also not been adopted in whole by any country. Close examples however include Germany, France and South Africa.

2.4.4 Single-regulator Supervision.
The single-regulator supervisory model is based on just one control authority, separated from the central bank, and with responsibility over all markets and intermediaries regardless of whether in the banking, financial or insurance sector. This authority would be concerned with all the objectives of regulation.

Examples of countries which have adopted this model include the United Kingdom, Sweden, Korea and Singapore.

Merits
According to some advocates for this structure of supervision (Briault, C. 1999) the advantages of this approach lie in the economies of scale that it produces. Fixed costs and logistical expenses, the costs of administrative personnel and the
compensation for the top management are all considerably reduced. Moreover, this scheme calls for a unified view which is particularly useful and effective with respect to poli-functional groups and conglomerates. By the same token, the costs of supervision charged to the subjects regulated and/or to the taxpayer decrease, and there is less room for regulatory arbitrage.

Demerits

However, as Di Giorgio et al (2001) point out, the validity of this model depends to a high degree on its internal organization: if the numerous areas of competence and specialization are not well-structured and coordinated, the risk is to slow the decision-making process. As underlined by Wilson (1989), what counts is a clear definition of the agency's "mission". In addition, the presence of a sole regulator might render collusive relations more immediate and direct ("regulatory capture"). Finally, it might exacerbate problems of self-contradiction in the event that the authority should find itself forced to pursue conflicting supervisory objectives. This sort of problem might in part be overcome thanks to an internal organization divided "by objectives", but the fact that there is only one top management would end up in the prevalence of a single objective as final consequence of the decision-making process.

2.5 Evaluation of alternative regulatory structures

The foregoing presentation of the main regulatory models of the financial system shows how hard it is to establish which alternative offers a decisively superior arrangement. Di Giorgio et al (2001) say that "in real life we find a prevalence of 'mixed' approaches which borrow in heterogeneous fashion elements that are proper to more than just one model."

However, "the structure of financial regulation must depend in part on what is being regulated and why it is being regulated" (Briault 1999).
Briault (1999) further says that the institutional structure of financial services regulation is important because of the impact of the efficiency and effectiveness of this regulation on the direct and indirect costs of regulation and on the success of regulation in meeting its statutory objectives. He poses important questions which must be addressed by policy makers when deciding on what structure of financial regulation to adopt. Thus, to what extent should the structure of financial regulation be driven by the functions which financial services firms undertake, reflecting market developments in the financial services industry? Is there a first-best institutional arrangement which is independent of these market developments, arising perhaps from economies of scale and scope in undertaking financial regulation, or from some underlying logic linking the structure of regulation with the objectives of regulation or with the institutional arrangements for monetary policy and for addressing systemic risk? Are there also implications here for the structure of regulation internationally, not just within national borders?

Goodhart et al (1998, page 181) may well be correct in stating that "there is no universal ideal model", not least because financial markets have developed – and will continue to develop – differently in different countries.

### 2.6 The Practice Internationally

The international status in regard to the regulatory structures has been recently reviewed by the International Monetary Fund (IMF, December 2000). The study notes that in approximately half of the 73 countries examined, the revealed preference is for a regulatory structure based on specialized agencies. The study shows that 35 countries have separate agencies for each main sector, 3 have combined securities and insurance regulators, 9 have combined banking and securities regulators, 13 have central banking and insurance regulators, 3 have unified supervision (in central bank) and 10 have unified supervision (outside central bank).
2.7 The Case for a Single Regulator

The arguments in favour of a single regulator can be summarized as follows (Reddy, 2001):

First, there are economies of scale for the regulator since unification may permit cost savings on the basis of shared infrastructure, administration and support systems.

Secondly, the regulated units also benefit since unification mitigates the costs which supervised firms with diverse activities (i.e. financial conglomerates) bear for dealing with multiple regulators.

Thirdly, accountability is enhanced since complexity of the multiple supervisory system could lead to lack of clarity of roles and consequently lack of accountability.

Fourthly, regulatory arbitrage can be avoided in the case of a single regulator. In a multiple regulatory regime, fragmentation of supervision could lead to competitive inequalities as different units, possibly offering similar products or services, are supervised differently.

Fifthly, reducing the number of regulators could allow scarce supervisory resources especially in specialist areas to be pooled.

Sixthly, a single regulator can respond more effectively to market innovation and development as there would be no regulatory gray areas.

Finally, unification aids in international cooperation as there is a single contact point for all regulatory issues. In developing countries where banks dominate in
banking insurance and securities business, there may be a case for unified regulation.

It is also important to note the many arguments against a single regulator. The arguments against a single regulator are summarised as follows (Reddy, 2001):

First, unification could lead to lack of clarity in functioning as multiple regulators tend to have different objectives. This objective may be depositor protection for banks versus investor protection for capital markets versus consumer protection for other financial firms.

Second, concentration of power could vitiate democratic policies.

Third, there may actually be diseconomies of scale since monopolistic organizations can be more rigid and bureaucratic than specialist agencies because they would typically be large and too broad based structures for effective regulation of the entire system.

Fourth, there may be unintended consequence of public tending to assume that all creditors of supervised institutions will receive equal protection.

Finally, the focus of banks, securities and insurance supervisors being different, pooling of skills and objectives, pooling of resources may not produce the synergy that is expected.

From the foregoing look at the literature and international practice what comes out is that there is no general consensus on which regulatory structure is to be preferred generally. Many factors need to be considered in determining whether there is a need for change in the financial regulatory structure in any country and if so which structure to adopt. It follows therefore that Kenya would also have to consider many factors in making this decision.
CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Research Design

This research took the nature of a survey, where a sample of the institutions regulated under the financial regulatory framework in Kenya were studied to determine their view on whether Kenya financial regulatory framework requires restructuring and whether Kenya should adopt a single regulator model of financial regulation.

3.2 Population

The population of the study on the side of the regulated institutions comprised all institutions licenced under the Banking Act, all institutions licenced under the Insurance Act and carrying on insurance business, all institutions licenced under the Capital Markets Act and pension funds registered under the Retirement Benefits Act.

As at December, 2005, there were 45 institutions in the wider banking sector, made up of 41 commercial banks, 1 building society, 1 non-bank financial institution and 2 mortgage finance companies. (Source: Central Bank of Kenya website, May, 2006)

The Insurance sector comprised a total of 43 companies made up as follows: 22 general insurance companies, 6 life insurance companies and 15 composite companies which conduct both life and general business. (Source: Association of Kenya Insurers, AKI website, May, 2006)

In the period 1st January, 2005 to 31st December, 2005, licencees of the Capital Markets Authority were classified as follows: 5 Approved Institutions (Nairobi Stock Exchange, Central Depository and Settlements Corporation, 2 venture capital companies and Global Credit Rating Company Ltd), 2 Collective Investment
Schemes, 10 stockbrokers, 11 investment banks, 14 investment advisers, 14 fund managers and 6 authorised depositories (Source: Capital Markets Authority website, May, 2006).

Under the Retirement Benefits Act, the number of registered pension schemes that had been issued with a final Registration Certificate was 508. There were 8 registered custodians, 13 registered managers, 8 actuaries and 44 administrators of schemes. (Source: Retirement Benefits Authority Annual Report 2003/2004, RBA Website, May, 2006)

The population above is represented in tabular form as hereunder:

Table 3.1: Population of the study

<table>
<thead>
<tr>
<th>SECTOR</th>
<th>LICENCEE</th>
<th>NUMBER</th>
</tr>
</thead>
<tbody>
<tr>
<td>Banking</td>
<td>• Commercial Banks</td>
<td>41</td>
</tr>
<tr>
<td></td>
<td>• Building Societies</td>
<td>1</td>
</tr>
<tr>
<td></td>
<td>• Mortgage Companies</td>
<td>2</td>
</tr>
<tr>
<td></td>
<td>• Non-Bank Financial Institutions</td>
<td>1</td>
</tr>
<tr>
<td>Insurance</td>
<td>• General Insurance Companies</td>
<td>22</td>
</tr>
<tr>
<td></td>
<td>• Life Insurance Companies</td>
<td>6</td>
</tr>
<tr>
<td></td>
<td>• Composite Insurance Companies</td>
<td>15</td>
</tr>
<tr>
<td>Capital Markets</td>
<td>• Approved Institutions</td>
<td>5</td>
</tr>
<tr>
<td></td>
<td>• Collective Investment Schemes</td>
<td>2</td>
</tr>
<tr>
<td></td>
<td>• Stockbrokers</td>
<td>10</td>
</tr>
<tr>
<td></td>
<td>• Investments Banks</td>
<td>11</td>
</tr>
<tr>
<td></td>
<td>• Investment Advisers</td>
<td>14</td>
</tr>
<tr>
<td></td>
<td>• Fund Managers</td>
<td>14</td>
</tr>
<tr>
<td></td>
<td>• Authorised Depositories</td>
<td>6</td>
</tr>
<tr>
<td>Retirement</td>
<td>• Pension Schemes</td>
<td>508</td>
</tr>
</tbody>
</table>
3.3 **Sample Plan**

In view of the fact that currently Kenya’s regulatory framework is organized along sectoral lines, samples of the regulated institutions were taken from each sector. Disproportionate stratified sampling was used to sample the institutions in each of the sectors. For the banking sector, each institution was assigned a number from 1-45. For the insurance sector, each institution was assigned a number from 1-43 while in the capital markets sector each institution was assigned a number from 1-62. The incremental interval was 3, meaning that every third institution in each sector was picked for the sample. This gave a representative sample of each sector and reduced the number of institutions to be studied to a manageable size of a total of 49 institutions from these three sectors. For the retirement benefits sector, due to the large number of registered pension schemes in relation to the other institutions in the sector and the similar legal requirements for and operational structures of pension schemes, only 15 pension schemes were randomly sampled. This number is also consistent with the number of institutions sampled in the other sectors. Other institutions in the retirement benefits sector were assigned a number from 1-72 and the incremental value was 4. This gave a representative sample of this sector and reduced the number of institutions to be studied to a manageable size of 33.

The total sample is represented in tabular form as hereunder:
Table 3.2: Sample size

<table>
<thead>
<tr>
<th>SECTOR</th>
<th>POPULATION SIZE</th>
<th>SAMPLE SIZE</th>
</tr>
</thead>
<tbody>
<tr>
<td>Banking</td>
<td>45</td>
<td>15</td>
</tr>
<tr>
<td>Insurance</td>
<td>43</td>
<td>14</td>
</tr>
<tr>
<td>Capital Markets</td>
<td>62</td>
<td>20</td>
</tr>
<tr>
<td>Retirement Benefits</td>
<td>580</td>
<td>33</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>730</strong></td>
<td><strong>82</strong></td>
</tr>
</tbody>
</table>

3.4 Data Collection: Primary Data

Data collection was by means of a questionnaire. The questionnaire was structured with open ended and closed ended questions (See Appendix). The open ended questions collected qualitative data whereas the closed ended collected quantitative data. Opinions, views and perceptions were captured through scaling questions. Administration of the questionnaire was done through drop and pick later. In a situation where clarification is required the researcher was available.

The respondents were either the chief executive officer or the company secretary or an officer in charge of regulatory affairs.

The aim was to determine to what extent financial intermediaries think the current framework of financial regulation is adequate and whether any reforms are necessary. If reforms to the regulatory structure are deemed necessary, what form should such reforms take and specifically, whether Kenya should adopt a single regulator structure or retain multiple sectoral regulators. The data collection methods also sought to identify those issues which in Kenya which are driving the perceived need for financial regulatory reform and the risks perceived in any drive for reform.
3.5 Data Analysis

Data analysis involved the use of descriptive statistics to analyse responses as they relate to the respondent institutions' characteristics, such as the sector the respondent operates in, whether the institution operates in more than one sector, the unique features of each sector, the perceived challenges and weaknesses if any in the current financial regulatory structure and the key drivers of the need to reform the regulatory structure.

The Pearson's Product Moment Correlation Coefficient was used to establish the relationship between variables. Specifically, this statistical technique was used to establish the relationship, if any, between the type of institution and the following variables:

- Perceived need for reform of the financial regulatory structure
- Whether there should be only one regulator for the financial services industry.

Measures of central tendency such as mean and mode were used to summarize average responses so that general conclusions can be drawn therefrom.
CHAPTER FOUR: DATA ANALYSIS AND INTERPRETATION

4.1 Introduction

This chapter presents analysis and findings of the research. From the study sample target of 82 respondents, 56 responded to the questionnaire, constituting 68.3% response rate.

Tables, bar charts and pie charts were used to analyze the data.

The following Likert type scale was used to score attitude responses:

Key
1-least important
2-mildly important
3-important
4-more important
5-most important

4.2 Data Analysis and Interpretation

The responses to the questionnaire are summarized and analyzed as hereunder:

Sector of financial industry that your organization conducts its business

Table 4.1: Sectors in which financial institutions operate

<table>
<thead>
<tr>
<th></th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Banking</td>
<td>15</td>
<td>26.8</td>
</tr>
<tr>
<td>Insurance</td>
<td>9</td>
<td>16.1</td>
</tr>
<tr>
<td>Investments</td>
<td>20</td>
<td>35.7</td>
</tr>
<tr>
<td>Pension</td>
<td>12</td>
<td>21.4</td>
</tr>
<tr>
<td>Total</td>
<td>56</td>
<td>100.0</td>
</tr>
</tbody>
</table>
From the above table, 26.8% of the responding companies conducted their business in the banking sector, 16.1% conducted their business in the insurance sector, and 35.7% conducted their business in the investment sector, while 21.4% conducted their business in the pension sector.

**Does your organization operate in more than one sector of the financial markets i.e., banking, insurance, investments and pension?**

Table 4.2: Institutions operating in more than one sector

<table>
<thead>
<tr>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>10</td>
</tr>
<tr>
<td>No</td>
<td>46</td>
</tr>
<tr>
<td>Total</td>
<td>56</td>
</tr>
</tbody>
</table>

The respondents were also asked to state whether their organization operates in more than one sector of the financial markets. As the table above shows, the majority, representing 82.1%, said that they do not operate in more than one sector, while 17.9% said they operate in more than one sector.

**Challenges facing the regulatory structure of Kenya's financial markets**

Table 4.3: Responses to challenges facing the regulatory structure of Kenya’s financial markets

<table>
<thead>
<tr>
<th>Challenges</th>
<th>Mean</th>
<th>Mode</th>
</tr>
</thead>
<tbody>
<tr>
<td>Development of new financial products</td>
<td>2.91</td>
<td>4</td>
</tr>
<tr>
<td>Diversification of activities by financial institutions</td>
<td>3.5</td>
<td>5</td>
</tr>
</tbody>
</table>
The above table shows the summary of the respondents’ views on the challenges facing the regulatory structure of Kenya’s financial markets.

From their views, development of new financial products, diversification of activities by financial institutions, technological advances, and international competition were the most important challenges facing the regulatory structure of Kenya’s financial markets since they had a mode of 4 or 5. This means that the majority of respondents’ suggestions were concentrated between 4 and 5 in the response scale of 1-5, where 4 and 5 were very important. Financial institution consolidation and conglomeration and financial sector liberalization were not big challenges because their mode was 2 and 3.

Using the mean, technological advances had the highest mean of 4.25, meaning that it was very important as a challenge, while development of new financial products had the lowest mean of 2.91.

**Is Kenya's regulatory structure adequate to meet these challenges?**

**Figure 4.1: Responses to whether Kenya's regulatory structure is adequate to meet the challenges.**

From the above figure, the majority of respondents’ views as shown by 78.6%, said that
Kenya's regulatory structure is not adequate to meet the challenges facing the regulatory structure of Kenya's financial markets, while 21.4% said that it is adequate.

Weaknesses/shortcomings of Kenya's financial regulatory structure

Table 4.4: Responses on the perceived weaknesses of Kenya's financial regulatory structure

<table>
<thead>
<tr>
<th>Weakness</th>
<th>Mean</th>
<th>Mode</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regulatory gaps</td>
<td>3.73</td>
<td>5</td>
</tr>
<tr>
<td>Areas of excessive overlap</td>
<td>3.02</td>
<td>4</td>
</tr>
<tr>
<td>Lack of structure to regulate financial conglomerates</td>
<td>3.52</td>
<td>5</td>
</tr>
<tr>
<td>High cost of regulatory compliance in view of presence of multiple</td>
<td>3.29</td>
<td>4</td>
</tr>
<tr>
<td>regulators</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Lack of regulatory capacity</td>
<td>3.26</td>
<td>4</td>
</tr>
<tr>
<td>Lack of finances</td>
<td>2.33</td>
<td>1</td>
</tr>
<tr>
<td>Antiquated legal framework</td>
<td>2.41</td>
<td>2</td>
</tr>
<tr>
<td>Insufficient number of trained regulatory personnel</td>
<td>2.87</td>
<td>1</td>
</tr>
</tbody>
</table>

The respondents were asked to give their views on the above factors as weaknesses of Kenya's regulatory structure. From their views, regulatory gaps, areas of excessive overlap, lack of structure to regulate financial conglomerates, high cost of regulatory compliance in view of presence of multiple regulators and lack of regulatory capacity were found to be the most important weaknesses of Kenya's regulatory structure since they had a mode of 4 and 5, i.e. the majority said they were most important, and they had a mean of 3.26 to 3.73. Lack of finances, antiquated legal framework and insufficient number of trained regulatory personnel were not found to be very important to be considered as weaknesses since they had a mode of 1 and 2 respectively and a low mean of 2.33 to 2.87.
The degree that you agree that the development of financial markets and institutions in Kenya is leading to a blurring of the distinctions between financial institutions

Table 4.5: Frequency and degree of responses on whether the development of financial markets is blurring the distinctions between financial institutions

<table>
<thead>
<tr>
<th></th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Strongly agree</td>
<td>18</td>
<td>32.1</td>
</tr>
<tr>
<td>Agree</td>
<td>22</td>
<td>39.3</td>
</tr>
<tr>
<td>Disagree</td>
<td>16</td>
<td>28.6</td>
</tr>
<tr>
<td>Total</td>
<td>56</td>
<td>100.0</td>
</tr>
</tbody>
</table>

From the above table, 32.1% strongly agree that the development of financial markets and institutions in Kenya is leading to a blurring of the distinctions between financial institutions, 39.3% agree, while 28.6% disagree. This information can also be represented by the bar chart below.

Figure 4.2: Degree of responses on whether the development of financial markets is blurring the distinctions between financial institutions
Drivers of the developments in financial markets

Table 4.6: Responses on the drivers of the developments in the financial markets

<table>
<thead>
<tr>
<th></th>
<th>Mean</th>
<th>Mode</th>
</tr>
</thead>
<tbody>
<tr>
<td>Product similarities</td>
<td>4.1</td>
<td>5</td>
</tr>
<tr>
<td>Technological advances</td>
<td>3.9</td>
<td>5</td>
</tr>
<tr>
<td>Consolidation of financial institutions</td>
<td>2.83</td>
<td>3</td>
</tr>
<tr>
<td>Same target markets</td>
<td>4.08</td>
<td>5</td>
</tr>
<tr>
<td>Linkages between different financial institutions</td>
<td>2.8</td>
<td>3</td>
</tr>
</tbody>
</table>

From the respondents views, product similarities, technological advances and same target markets were found to be the most important drivers of the development in financial markets. This is because their mode was 5 representing most important and a mean of between 3.9 and 4.1, while consolidation of financial institutions and linkages between different financial institutions were found to be just important as was represented by the mode of 3 and a mean of 2.8 and 2.83 respectively. This means that they were important to a lesser extent.

The degree you think there is a need to change the regulatory structure of Kenya’s financial markets

Table 4.7: Responses to the need for change in the regulatory structure of Kenya’s financial markets

<table>
<thead>
<tr>
<th></th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Strongly agree</td>
<td>26</td>
<td>46.4</td>
</tr>
<tr>
<td>Agree</td>
<td>28</td>
<td>50.0</td>
</tr>
<tr>
<td>Disagree</td>
<td>2</td>
<td>3.6</td>
</tr>
<tr>
<td>Total</td>
<td>56</td>
<td>100.0</td>
</tr>
</tbody>
</table>
From the above table, the majority of respondents representing 96.4% of the respondents suggested that there is a need to change the regulatory structure of Kenya's financial market, while a small proportion comprising of 3.6% of the respondents said that they disagree.

**Critical factors in deciding whether or not to change the regulatory structure**

Table 4.8: Critical factors in deciding whether or not to change the regulatory structure

<table>
<thead>
<tr>
<th>Factor</th>
<th>Mean</th>
<th>Mode</th>
</tr>
</thead>
<tbody>
<tr>
<td>Historical development</td>
<td>3</td>
<td>5</td>
</tr>
<tr>
<td>Level of skills</td>
<td>3.6</td>
<td>4</td>
</tr>
<tr>
<td>Size of the financial market</td>
<td>3.95</td>
<td>5</td>
</tr>
<tr>
<td>State of development of the financial markets</td>
<td>4.11</td>
<td>5</td>
</tr>
<tr>
<td>Level of concentration in the financial services industry</td>
<td>3.75</td>
<td>5</td>
</tr>
<tr>
<td>Prevalence of financial conglomerates</td>
<td>3.04</td>
<td>3</td>
</tr>
<tr>
<td>Adequacy of current regulatory structures</td>
<td>3.2</td>
<td>4</td>
</tr>
<tr>
<td>Potential economies of scale to be obtained</td>
<td>3.47</td>
<td>4</td>
</tr>
<tr>
<td>Linkages between financial institutions</td>
<td>3.05</td>
<td>4</td>
</tr>
<tr>
<td>Institutional structure of the financial services industry</td>
<td>3.04</td>
<td>4</td>
</tr>
</tbody>
</table>

The above table seeks to find the extent the factors in the table are critical in deciding whether or not to change the regulatory structure.

The factors were analysed using the mean and the mode and the following results were obtained.

All the factors except prevalence of financial conglomerates, which had a mode of 3 and a mean of 3.04, were found to be very critical in deciding whether or not to change the regulatory structure.

These critical factors were, Historical development, level of skills, size of the financial market, state of development of the financial markets, level of concentration in the financial services industry, adequacy of current regulatory structures, potential economies of scale to be obtained, linkages between financial institutions and institutional structure.
of the financial services industry.
They had a mean of 3 to 4.11 and a mode of 4 and 5.

The degree you think that Kenya should adopt a single regulator model for its financial markets

Table 4.9: Responses on whether Kenya should adopt a single regulator model for its financial markets

<table>
<thead>
<tr>
<th></th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Strongly agree</td>
<td>19</td>
<td>32.7</td>
</tr>
<tr>
<td>Agree</td>
<td>17</td>
<td>30.9</td>
</tr>
<tr>
<td>Disagree</td>
<td>11</td>
<td>20.0</td>
</tr>
<tr>
<td>Strongly disagree</td>
<td>9</td>
<td>16.4</td>
</tr>
<tr>
<td>Total</td>
<td>56</td>
<td>100.0</td>
</tr>
</tbody>
</table>

From the respondents views, the majority of them as shown by 63.6% agree that Kenya should adopt a single regulator model for its financial markets, while 36.4% disagreed that Kenya should adopt a single regulator model.

Do you think there would be any merit in having a single regulator model for Kenya’s financial markets?

Figure 4.3: Responses on the merits of a single regulator model for Kenya’s financial markets
The majority of respondents as shown by 67.9% in the above figure thought that there would be merits in having a single regulator model for its financial markets, while 32.1% thought that there would be no merits in having a single regulator model.

**If yes, the merits of adopting a single regulator model in Kenya**

Table 4.10: Merits of adopting a single regulator model for Kenya’s financial markets

<table>
<thead>
<tr>
<th>Merit</th>
<th>Mean</th>
<th>Mode</th>
</tr>
</thead>
<tbody>
<tr>
<td>Economies of scale and scope</td>
<td>4.05</td>
<td>5</td>
</tr>
<tr>
<td>Ease/efficiency of decision making</td>
<td>4.18</td>
<td>5</td>
</tr>
<tr>
<td>Shared resources</td>
<td>3.58</td>
<td>4</td>
</tr>
<tr>
<td>Cost reduction for regulated institutions</td>
<td>3.77</td>
<td>4</td>
</tr>
<tr>
<td>Enhancing accountability by clarifying the roles of the regulatory agency</td>
<td>3.77</td>
<td>4</td>
</tr>
<tr>
<td>More effective response to market innovation and development due to better monitoring of issues affecting the entire financial system</td>
<td>3.75</td>
<td>4</td>
</tr>
<tr>
<td>Removal of gaps and overlaps in the regulation</td>
<td>3.59</td>
<td>3</td>
</tr>
<tr>
<td>Overcoming deficiencies in communication and cooperation among existing regulatory agencies</td>
<td>2.97</td>
<td>2</td>
</tr>
<tr>
<td>Unified approach to regulation thereby reducing regulatory arbitrage</td>
<td>3.28</td>
<td>4</td>
</tr>
</tbody>
</table>

The respondents who said adopting a single regulator model has merits were asked to state what these merits were and the extent of their importance as merits.

The following were the summary of their views:
Economies of scale and scope, ease/efficiency of decision making, shared resources, cost reduction for regulated institutions, enhancing accountability by clarifying the roles of the regulatory agency, more effective response to market innovation and development due to better monitoring of issues affecting the entire financial system and unified approach to regulation thereby reducing regulatory arbitrage were very important as merits of a single regulator model as their mean ranged from 3.28 to 4.18 and a mode of 4 and 5.

Removal of gaps and overlaps in the regulation and overcoming deficiencies in communication and cooperation among existing regulatory agencies were not very
important as merits as they had a mean of 3.59 and 2.97 respectively and a mode of 3 and 2.

The extent you agree that significant economies of scale can be achieved through unification

Table 4.11: Extent of agreement that significant economies of scale can be achieved through unification of the financial regulators

<table>
<thead>
<tr>
<th></th>
<th>Frequency</th>
<th>Valid Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Strongly agree</td>
<td>16</td>
<td>29.6</td>
</tr>
<tr>
<td>Agree</td>
<td>30</td>
<td>51.9</td>
</tr>
<tr>
<td>Disagree</td>
<td>10</td>
<td>18.5</td>
</tr>
<tr>
<td>Total</td>
<td>56</td>
<td>100.0</td>
</tr>
</tbody>
</table>

From the majority of respondents as shown by 81.5% agreed that significant economies of scale can be achieved through unification, while 18.5% disagreed that significant economies of scale can be achieved through unification.

The extent you agree that there are significant synergies to having multiple supervisory agencies under one roof.

Table 4.12: Extent of agreement that there are significant synergies to unification of financial regulators

<table>
<thead>
<tr>
<th></th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Strongly agree</td>
<td>18</td>
<td>32.2</td>
</tr>
<tr>
<td>Agree</td>
<td>28</td>
<td>50.0</td>
</tr>
<tr>
<td>Disagree</td>
<td>6</td>
<td>10.7</td>
</tr>
<tr>
<td>Strongly disagree</td>
<td>4</td>
<td>7.1</td>
</tr>
<tr>
<td>Total</td>
<td>56</td>
<td>100.0</td>
</tr>
</tbody>
</table>
In the above table, the respondents were asked whether there are significant synergies to having multiple supervisory agencies under one roof. 50% said that they agree, 32.2% said that they strongly agree, 10.7% said they disagree while 7.1% said that they strongly disagree that there are significant synergies to having multiple supervisory agencies under one roof.

**Are there any demerits of having a single regulator in Kenya?**

Figure 4.4: Demerits of a single regulator model in Kenya

Alongside having merits, the majority of respondents as shown by 81.5% in the above figure said that it also have demerits, while 18.5% said that having a single regulator in Kenya has no demerits.

**Demerits of a single regulator model**

Table 4.13: Demerits of a single regulator model

<table>
<thead>
<tr>
<th>Demerits of a single regulator model</th>
<th>Mean</th>
<th>Mode</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mistakes in regulatory prescriptions</td>
<td>3.88</td>
<td>5</td>
</tr>
<tr>
<td>Over-powerful regulator</td>
<td>4.1</td>
<td>5</td>
</tr>
<tr>
<td>Inconsistent or conflicting mandate or objective</td>
<td>3.73</td>
<td>4</td>
</tr>
<tr>
<td>Increased bureaucracy</td>
<td>3.9</td>
<td>4</td>
</tr>
<tr>
<td>Increased risky behaviour by regulated firms or their customers</td>
<td>2.57</td>
<td>3</td>
</tr>
</tbody>
</table>

The above table summarizes the responses of the respondents who said that a single
regulator model has demerits and were asked to state them and the extent of their importance.

The respondents' views were as follows:

Mistakes in regulatory prescriptions, over-powerful regulator, inconsistent or conflicting mandate or objective, and increased bureaucracy were found to be the most significant demerits of the single regulator model as they had a mode of 4 and 5 and a mean of 3.73-4.1.

Although increased risky behaviour by regulated firms or their customers was a demerit it was not a very strong demerit as it was found to have a mean of 2.57, which is a low mean on a response scale of 1-5, and a mode of 3.

Would a single regulator for the financial market in Kenya achieve the objectives of regulation?

Table 4.14: Responses on whether a single regulator would achieve the objectives of regulation

<table>
<thead>
<tr>
<th></th>
<th>Frequency</th>
<th>Valid Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>30</td>
<td>51.9</td>
</tr>
<tr>
<td>No</td>
<td>26</td>
<td>48.1</td>
</tr>
<tr>
<td>Total</td>
<td>56</td>
<td>100.0</td>
</tr>
</tbody>
</table>

As asked whether a single regulator for the financial market in Kenya achieve the objectives of regulation, the majority of respondents as shown by 51.9% said it can achieve, while 48.1% said that it cannot achieve.

If no why?

The respondents who said that a single regulator for the financial market in Kenya cannot achieve the objectives of regulation were asked to give reasons and they gave the following:

Does not consider all checks in control, increased bureaucracy, heavy workload,
regulation and implementation of policies, many financial institutions and minimal competition, poor control and coordination of policies, there is need for liberalization, too much monopoly and also it was too powerful

**Are there any similarities in the functions, operations or products of the various financial institutions that would facilitate the consolidation of regulation under one regulator?**

Table 4.15: Responses on the similarities of different types of financial institutions

<table>
<thead>
<tr>
<th></th>
<th>Frequency</th>
<th>Valid Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>41</td>
<td>73.2</td>
</tr>
<tr>
<td>No</td>
<td>15</td>
<td>26.8</td>
</tr>
<tr>
<td>Total</td>
<td>56</td>
<td>100.0</td>
</tr>
</tbody>
</table>

According to the respondents view, 73.2% said that there are similarities in the functions, operations or products of the various financial institutions that would facilitate the consolidation of regulation under one roof, while 26.8% said there are no similarities.

**If so, which are the similarities?**

The respondents who said that there are similarities in the functions, operations or products of the various financial institutions that would facilitate the consolidation of regulation under one roof were asked to give those similarities.

The respondents gave the following similarities,

They deal with financial activities, their operations are almost similar, they invest their surplus income, they deal almost in the same products, they are regulated by almost similar body, e.g. Central Bank of Kenya, they serve similar markets and needs, their delivery systems are similar, and that they have similar regulations.
Do you think Kenya’s financial regulatory structure is ready for change?

Table 4.16: Responses on the readiness for change of Kenya’s financial regulatory structure

<table>
<thead>
<tr>
<th></th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Strongly agree</td>
<td>16</td>
<td>28.6</td>
</tr>
<tr>
<td>Agree</td>
<td>26</td>
<td>46.4</td>
</tr>
<tr>
<td>Disagree</td>
<td>8</td>
<td>14.3</td>
</tr>
<tr>
<td>Strongly disagree</td>
<td>6</td>
<td>10.7</td>
</tr>
<tr>
<td>Total</td>
<td>56</td>
<td>100.0</td>
</tr>
</tbody>
</table>

75% of the respondents thought that Kenya’s regulatory structure is ready for a change, while according to 25% of the respondents it is not ready for a change.

Should Central Bank continue playing a role in the regulation of banks and other financial institutions or should its role be limited strictly to monetary policy

Table 4.17: Responses on whether the Central Bank should play a role in the regulation of banks and other financial institutions

<table>
<thead>
<tr>
<th></th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>It should be limited to monetary policy</td>
<td>31</td>
<td>55.4</td>
</tr>
<tr>
<td>It should continue playing its role in the regulation of banks and other financial institutions</td>
<td>25</td>
<td>44.6</td>
</tr>
<tr>
<td>Total</td>
<td>56</td>
<td>100.0</td>
</tr>
</tbody>
</table>

The above table shows the summary of the respondents’ views on whether Central Bank
should continue playing a role in the regulation of banks and other financial institutions or its role should be limited strictly to the monetary policy.

The majority of respondents as shown by 55.4% suggested that its role should be limited strictly to monetary policy, while 44.6% said that it should continue playing its role in the regulation of banks and other financial institutions.

Are there any unique features of the banking industry that would prevent the regulation of banking institutions together with other types of financial institutions like insurance companies, investment companies and pension funds?

Table 4.18: Frequency of responses on unique features of banking institutions

<table>
<thead>
<tr>
<th></th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>4</td>
<td>7.1</td>
</tr>
<tr>
<td>No</td>
<td>52</td>
<td>92.9</td>
</tr>
<tr>
<td>Total</td>
<td>56</td>
<td>100.0</td>
</tr>
</tbody>
</table>

The respondents were asked whether there are any unique features of the banking industry that would prevent the regulation of banking institutions together with other types of financial institutions like banks, investment companies and pension funds. The majority of respondents as shown by 92.9% said that there are no unique features, while 7.1% said that there are unique features.

If yes, which features are these?
The respondents who said that there are unique features of banking industry that would prevent the regulation of banking institutions together with other types of financial institutions were asked to state these features. They were stated as follows:
Management structure, deposit mobilisation, lending, international trade and treasury activities.
Are there any unique features of the insurance industry, especially life insurance companies that would prevent the regulation of the insurance companies together with other types of financial institutions like banks, finance companies and mutual funds?

Table 4.19: Frequency of responses on unique features of insurance institutions

<table>
<thead>
<tr>
<th></th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>3</td>
<td>5.4</td>
</tr>
<tr>
<td>No</td>
<td>53</td>
<td>94.6</td>
</tr>
<tr>
<td>Total</td>
<td>56</td>
<td>100.0</td>
</tr>
</tbody>
</table>

The respondents were also asked whether there are any unique features of the insurance industry, especially life insurance companies that would prevent the regulation of the insurance companies together with other types of financial institutions like banks, finance companies and mutual funds,

The majority shown by 94.6% said there are no unique features while 5.4% said there are unique features.

If yes, which are these features

The respondents who said that there are unique features, were asked to state them,

They stated them as follows;

Compensation being done after death, that is to the next of kin, day to day operations, and insurance policies.

Are there any unique features of the finance company and mutual fund industry that would prevent the regulation of insurance companies together with other types of financial institutions?
Table 4.20: Frequency of responses on unique features of capital market institutions

<table>
<thead>
<tr>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>2</td>
</tr>
<tr>
<td>No</td>
<td>54</td>
</tr>
<tr>
<td>Total</td>
<td>56</td>
</tr>
</tbody>
</table>

The researcher also asked the respondents whether there any unique features of the finance company and mutual fund industry that would prevent the regulation of insurance companies together with other types of financial institutions. The majority of respondents as shown by 96.4% said that there are no unique features, while 3.6% said that there are unique features.

The few respondents who said that there are unique features of the finance company and mutual fund industry that would prevent the regulation of insurance companies together with other types of financial institutions were asked to state these features. They gave the following responses: inability to clear cheques and pooling and investing individuals' funds in various sectors.

Any features of the pension fund industry that would prevent the regulation of pension funds together with other types of financial institutions like banks, finance companies and mutual funds and insurance companies?

Table 4.21: Frequency of responses on unique features of pension institutions

<table>
<thead>
<tr>
<th>Frequency</th>
<th>Valid</th>
</tr>
</thead>
<tbody>
<tr>
<td>yes</td>
<td>1</td>
</tr>
<tr>
<td>no</td>
<td>55</td>
</tr>
<tr>
<td>Total</td>
<td>56</td>
</tr>
</tbody>
</table>
The respondents were also asked whether there are any features of the pension fund industry that would prevent the regulation of pension funds together with other types of financial institutions like banks, finance companies and mutual funds and insurance companies. The majority as shown by 98.2% said that there are no unique features, while 1.8% said that there are unique features.

The respondents who said that there are unique features were asked to state these features and they gave the following:
That there is very tall bureaucracy.

**Pearson’s product moment correlation coefficient**

Table 4.22: Relationship between the type of the institution and the perceived need to reform the financial regulatory structure

<table>
<thead>
<tr>
<th></th>
<th>Value</th>
<th>Asymp. Std. Error</th>
<th>Approx. T</th>
<th>Approx. Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interval by Interval</td>
<td>-104</td>
<td>.122</td>
<td>-.770</td>
<td>.445(c)</td>
</tr>
<tr>
<td>Ordinal by Ordinal</td>
<td>-.110</td>
<td>.131</td>
<td>-.815</td>
<td>.419(c)</td>
</tr>
<tr>
<td>N of Valid Cases</td>
<td>56</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

a Not assuming the null hypothesis.
b Using the asymptotic standard error assuming the null hypothesis.
c Based on normal approximation.

From the above table on the Pearson’s product moment correlation coefficient between the type of the institution and the perceived need to reform the financial regulatory structure there was found to be no relationship between the two since there was a negative value of -104.

This means that the type of the institution does not affect the perceived need to reform the financial regulatory structure.
The above table also shows the relationship between the type of the institution and whether there should be only one regulator for the financial services industry. The value was –0.24, which means that although it was a negative it was very small, therefore, there is some relationship between the types of the organization and their view on whether there should be one regulator in the financial services industry.
CHAPTER FIVE: DISCUSSIONS, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

The study had two main objectives. The first one was to determine whether there is a perceived need to restructure Kenya’s financial regulatory framework and to identify the key drivers of this need. The second one was to determine the perception of financial intermediaries in Kenya regarding the case for a single financial regulator.

The data obtained from the respondents was analyzed using frequency tables and percentages, bar charts and pie charts. The measures of central tendency were also used to summarize average responses. The Pearson’s Product Moment Correlation Coefficient was used to establish the relationship between the type of institution and firstly, the perceived need for reform and secondly, whether there should be a single financial regulator.

From the analysis of the data collected the following discussions, conclusions and recommendations were made.

5.2 Discussion

The researcher intended to obtain responses from some financial organizations so as to investigate the perception of financial intermediaries in Kenya regarding the case for a single financial regulator.

From the study, 26.8% of the respondents were from banking sector, 16.1% were from insurance sector, 35.7% were from the investment sector, and 21.4% were from pension sector.

From the research the challenges that were found to be facing the regulatory structure of Kenya’s regulatory structure were development of new financial products, diversification
of activities by financial institutions, technological advances, and international competition.

It was also found out that Kenya's regulatory structure is not adequate to meet the challenges facing the regulatory structure of Kenya's financial markets because of its weaknesses such as regulatory gaps, areas of excessive overlap, lack of structure to regulate financial conglomerates, high cost of regulatory compliance in view of presence of multiple regulators and lack of regulatory capacity.

The researcher was also able to find out that there is a need to change the regulatory structure of Kenya's financial market and the most important factors to be critical in deciding whether or not to change the regulatory structure are historical development, level of skills, size of the financial market, state of development of the financial markets, level of concentration in the financial services industry, adequacy of current regulatory structures, potential economies of scale to be obtained, linkages between financial institutions and institutional structure of the financial services industry. It was also clear from the majority of respondents that Kenya should adopt a single regulator model for its financial markets as it has some merits such as: Economies of scale and scope, ease/efficiency of decision making, shared resources, cost reduction for regulated institutions, enhancing accountability by clarifying the roles of the regulatory agency, more effective response to market innovation and development due to better monitoring of issues affecting the entire financial system and unified approach to regulation thereby reducing regulatory arbitrage.

Although single financial regulator model has merits, it also has some demerits such as Mistakes in regulatory prescriptions, over powerful regulator, inconsistent or conflicting mandate or objective, and increased bureaucracy.

From the majority of respondents, it was also found that a single regulator for the financial markets in Kenya would achieve the objectives of regulation.
The majority of respondents also suggested that Kenya’s financial regulatory structure is ready for a change.

They also suggested that the Central Bank should be limited strictly to monetary policy other than continuing playing a role in the regulation of banks and other financial institutions.

No relationship was found between the type of institution and the perceived need for reform of the financial regulatory framework. This means that the perception of the need for reform of the regulatory structure is universal.

A small relationship was found to exist between the type of institution and whether there should be only one regulator for the financial services industry.

5.3 Conclusions

Kenya’s financial regulatory structure is not adequate to meet the challenges facing the regulatory structure of Kenya’s financial markets, which are development of new financial products, diversification of activities by financial institutions, technological advances and international competition. There is a perceived need to restructure the regulatory framework of Kenya’s financial services industry. Further, the preferred direction of the regulatory structure reform is to have a single regulator model to take the place of the current multiple regulator structure.

5.4 Recommendations

The regulatory structure of Kenya’s financial market should therefore be changed so as to reduce weaknesses such as regulatory gaps, areas of excessive overlap, lack of structure to regulate financial conglomerates, high cost of regulatory compliance in view of presence of multiple regulators and lack of regulatory capacity.
Therefore Kenya should adopt a single regulator model for its financial markets as it will achieve the objectives of financial regulation and has merits such as economies of scale and scope, ease/efficiency of decision making, shared resources, cost reduction for regulated institutions, enhancing accountability by clarifying the roles of the regulatory agency, more effective response to market innovation and development due to better monitoring of issues affecting the entire financial system and unified approach to regulation thereby reducing regulatory arbitrage.

5.5 Limitation of the study

A limitation for the purpose of this research was regarded as a factor that was present and contributed to the researcher getting either inadequate information or responses or if otherwise the response given would have been totally different from what the researcher received.

The main limitation(s) in this research was low response rate.

There were financial institutions where some of the respondents were not willing to provide the required information and some had to be continuously reminded and even persuaded to provide the required information. Sometimes they did not see the use or the benefit of such an exercise.

However, despite this limitation, the study was carried out with the utmost care to reduce any errors that may have arisen due to the limitation.

5.6 Recommendation for further research

The findings of this research indicate that further research needs to be carried out. One suggested area that could be looked into is whether the Central Bank should continue to
be involved in the regulation of banks or whether its role should be limited strictly to
totaly policy.

Another suggested area is which type of institutions prefer the single regulator model of
financial regulation and why. There may be a linkage between the more progressive
financial institutions and their preference for a single regulator model.

It would also be beneficial for a comparative study to be done on jurisdictions in different
parts of the world to determine whether the benefits of a single regulator model have
been achieved.

An in-depth study on the costs and benefits of a single regulator model as opposed to the
multiple-regulator model could also be done to determine whether the support for the
single regulator model is truly justified.

Apart from these areas, it was evident from the study that there is still a great need for
research to be carried out in the broad area of financial regulation and financial regulatory
structure in Kenya as there seems to be limited available data in this area.
REFERENCES


Skipper, H. D. (2000): **Financial Services Integration Worldwide: Promises and Pitfalls,** Georgia State University, Atlanta, USA.


APPENDICES
TO WHOM IT MAY CONCERN

The bearer of this letter, WAWERU GUANDARU MATHENGE, is a Master of Business Administration (MBA) student of the University of Nairobi.

He/she is required to submit as part of his/her coursework assessment a research project report on a management problem. We would like the students to do their projects on real problems affecting firms in Kenya. We would, therefore, appreciate if you assist him/her by allowing him/her to collect data in your organization for the research.

The project is entitled "FINANCIAL REGULATORY STRUCTURE REFORM IN KENYA: THE PERCEPTION OF FINANCIAL INTERMEDIARIES IN KENYA REGARDING THE CASE FOR A SINGLE FINANCIAL REGULATOR."

The results of the report will be used solely for academic purposes and a copy of the same will be availed to the interviewed organizations on request.

Thank you.

J.T. KARIUKI
CO-ORDINATOR, MBA PROGRAM
QUESTIONNAIRE

1. In which sector of the financial industry does your organization conduct its business? (If a regulator, state so).
   - Banking
   - Insurance
   - Investments
   - Pension

2. Does your organization operate in more than one of the following sectors of the financial markets, that is, banking, insurance, investments and pension sectors?
   Yes__________ No______________

3. If yes, which ones?

4. In your view, what are the challenges facing the regulatory structure of Kenya’s financial markets? Rank each of the following in terms of importance on a scale from 1 to 5 with 1 being least important and 5 being most important.
   - Development of new financial products ______
   - Diversification of activities by financial institutions ______
   - Technological advances ______
   - Financial institution consolidation and conglomeration ______
   - Financial sector liberalization ______
   - International competition ______
   - Others (Please specify)

5. Do you think Kenya’s regulatory structure is adequate to meet these challenges?
   Yes__________ No______________

6. If not, to which of the following do you think are the weaknesses or shortcomings of Kenya’s regulatory structure and to what extent are they weaknesses? Rank each of the following in terms of importance on a scale from 1 to 5 with 1 being least important and 5 being most important.
   - Regulatory gaps______
Areas of excessive overlap
Lack of structure to regulate financial conglomerates
High cost of regulatory compliance in view of presence of multiple regulators
Lack of regulatory capacity
Lack of finances
Antiquated legal framework
Insufficient number of trained regulatory personnel
Others (please specify)

7. Do you think that the development of financial markets and institutions in Kenya is leading to a blurring of the distinctions between financial institutions?
- Strongly agree
- Agree
- Disagree
- Strongly disagree

8. If yes, which of the following do you consider are the drivers of these developments in the financial markets? Rank each of the following in terms of importance on a scale from 1 to 5 with 1 being least important and 5 being most important.
- Product similarities
- Technological advances
- Consolidation of financial institutions (conglomeration)
- Same target markets
- Linkages between different financial institutions
- Others (Please specify)

9. Do you think there is a need to change the regulatory structure of Kenya’s financial markets?
- Strongly agree
- Agree
- Disagree
- Strongly Disagree

10. Which of the following factors do you consider to be critical in deciding whether or not to change the regulatory structure? Rank each of the following in terms of importance on a scale from 1 to 5 with 1 being least important and 5 being most important.
- Historical development
- Level of skills
- Size of the financial services market
- State of development of the financial markets
- Level of concentration in the financial services industry
11. Do you think Kenya should adopt a single regulator model for its financial markets?
   o Strongly agree
   o Agree
   o Disagree
   o Strongly disagree

12. Do you think there would be any merit in having a single financial regulator?
    Yes__________
    No__________

13. If yes, what do you consider would be the merits of a single regulator in Kenya? Rank each of the following in terms of importance on a scale from 1 to 5 with 1 being least important and 5 being most important.

   a. Economies of scale and scope________
   b. Ease/Efficiency of decision-making.________
   c. Shared resources________
   d. Cost reduction for regulated institutions________
   e. Enhancing accountability by clarifying the roles of the regulatory agency________
   f. More effective response to market innovation and development due to better monitoring of issues affecting the entire financial system________
   g. Removal of gaps and overlaps in regulation________
   h. Overcoming deficiencies in communication and cooperation among existing regulatory agencies________
   i. Unified approach to regulation thereby reducing regulatory arbitrage________
   j. Others (Please specify)

14. Do you think it is likely that significant economies of scale can be achieved through unification (particularly avoiding wasteful duplication of functions and resources)?
   o Strongly agree
   o Agree
   o Disagree
   o Strongly disagree
15. Do you think there are significant synergies to having multiple supervisory agencies under one roof (such as sharing expensive and specialized experts or making better use of scarce resources)?
   - Strongly agree
   - Agree
   - Disagree
   - Strongly disagree

16. Do you think there are any demerits of having a single regulator in Kenya?
   Yes___________ No______________

17. If yes, what do you consider would be the demerits of a single regulator in Kenya? Rank each of the following in terms of importance on a scale from 1 to 5 with 1 being least important and 5 being most important.
   a. Mistakes in regulatory prescriptions due to failure to recognize the unique characteristics of each sector of the financial services industry_____
   b. Over-powerful regulator_____
   c. Inconsistent or conflicting mandate or objective_____
   d. Increased bureaucracy_____
   e. Increased risky behaviour by regulated firms or their customers_____
   f. Others (Please specify)

18. Do you think a single regulator for the financial markets in Kenya would achieve the objectives of regulation?
   a. Yes___________ No______________

19. If no, why?

20. Are there any similarities in the functions, operations or products of the various financial institutions that would facilitate the consolidation of regulation under one regulator?
   Yes___________ No______________

21. If so, which are these similarities?

22. Do you think Kenya’s financial regulatory structure ready for change?
   - Strongly Agree
   - Agree
23. Do you think the Central Bank should continue playing a role in the regulation of banks and other financial institutions or should its role be limited strictly to monetary policy?

24. Are there any unique features of the Banking industry that would prevent the regulation of banking institutions together with other types of financial institutions like insurance companies, investment companies and pension funds?
Yes __________ No ___________

25. If yes, what features are these?

26. Are there any unique features of the Insurance industry, especially life insurance companies, that would prevent the regulation of insurance companies together with other types of financial institutions like banks, finance companies and mutual funds and pension funds?
Yes __________ No ___________

27. If yes, what features are these?

28. Are there any unique features of the finance company and mutual fund industry that would prevent the regulation of finance companies and mutual funds together with other types of financial institutions like banks, insurance companies and pension funds?
Yes __________ No ___________

29. If yes, what features are these?

30. Are there any unique features of the pension fund industry that would prevent the regulation of pension funds together with other types of financial
institutions like banks, finance companies and mutual funds and insurance companies?  
Yes__________   No___________

31. If yes, what features are these?

Thank you for completing this questionnaire.
SUMMARY OF PROVISIONS OF THE VARIOUS STATUTES GOVERNING THE FINANCIAL SECTOR IN KENYA

THE BANKING ACT, CAP 488 LAWS OF KENYA

The Banking Act itself has detailed provisions relating to the following issues

a) Licensing requirements which include provisions relating to;

i) Minimum capital requirements
ii) Professional and Moral Suitability of persons proposed to manage or control the institution.
iii) Location of Places of Business and Branches
iv) Mergers

b) Prohibited business, which includes provisions relating to

i) Limits and restrictions on advances credit and Guarantees
ii) Restrictions on trading and investments
iii) Restrictions on ownership of share capital of an institution
iv) Restrictions on advances for purchase of land
v) Restrictions on deposit taking

c) Reserves and Dividends, which include provisions relating to

i) Ratio between capital and deposits
ii) Ratio between capital and assets
iii) Minimum liquid assets (liquidity ratios)
iv) Restrictions on dividends before write off of capitalized expenditure and provision for bad and doubtful debts

d) Accounts and Audit including provisions for minimum financial disclosure requirements.

e) Information and Reporting requirements to the Central Bank

f) Inspection and Control of Institutions

g) Liquidation of Institutions by the Central Bank
h) The Deposit Protection Fund

THE INSURANCE ACT, CAP 487 LAWS OF KENYA

The Insurance Act contains the provisions of law which regulate the insurance industry. The provisions in the Act relate to the following:

a) Registration of insurers

The provisions herein include provisions relating to:

a. Prohibition Of registration of certain persons
b. Minimum capital or equivalent and holding by Kenya citizens
c. Requirement as to capital structure and voting rights.
d. Provisions relating to the carrying on of both long term and general insurance business.
e. Minimum assets in Kenya
f. Registration

b) Deposits

This is analogous to the cash ratio requirement of banks

c) Assets, liabilities, solvency margins and investments
d) Accounts, balance sheets, audit and actuarial investigations.
e) Management and Expenses
f) Rates, policy terms and claims settlement
g) Assignments, Mortgages and Nominations
h) Claims on small life policies
i) Transfers and Amalgamations
j) Insolvency and Winding Up
k) The Kenya Reinsurance Corporation
l) Mandatory Reinsurance Sessions
m) Intermediaries, Risk Managers, Loss Assessors, Loss Adjusters, Insurance Surveyors and Claims Settling agents.
n) The Insurance Advisory Board of Kenya which assists and advises the commissioner and the minister.
o) Advertisements and Statements
p) Legal proceeding and appeals
q) Minister’s powers which include
   i) Power to establish a policyholder’s compensation fund
   ii) Power to prescribe
   iii) Power of exemption
r) General Provisions relating to registrations and certificates
s) Supplementary Provisions.

THE CAPITAL MARKETS ACT, CAP 485A

The capital markets enabling legislation comprises the following

Under the Capital Markets Act, the following regulations have been promulgated:
c) The Capital Markets (Licensing Requirements) (General) Regulations 2002
d) The Capital Markets Tribunal Rules, 2002
e) The Capital Markets (Takeovers and Mergers) Regulations, 2002
f) The Capital Markets (Foreign Investors) Regulations, 2002

The following guidelines have also been issued:
b) The Capital Markets Guidelines on The Approval And Registration Of Credit Rating Agencies.
THE RETIREMENT BENEFITS ACT, 1997

The preamble to the Act states that it is an Act of Parliament to establish a Retirement Benefits Authority for the regulation, supervision and promotion of retirement benefits schemes, the development of the retirement’s benefits sector and for connected purposes.

The Act contains provisions relating to the following matters

a) Registration of Retirement Benefits Schemes and Managers
b) Regulation and Supervision of Retirement Benefits Schemes.
c) Inspection and Appointment of Interim Administrator.
d) Appeals
e) Miscellaneous Provisions.

Section 32 (3) and Section 55 of the Act gives the Minister for Finance powers, in consultation with the RBA, to make regulations with regard to the funding, vesting, custody, management, application and the transfer of scheme funds and the accounting for such funds and generally for the better carrying out of the provisions of the Act. Pursuant to, and in exercise of this power, the following regulations have been promulgated.

c) The Retirement Benefits (Managers and Custodians) Regulations, 2000
f) The Retirement Benefits (Tribunal) Rules, 2000
g) The Retirement Benefits (Transitional) Regulations.

The RBA has further issued notices and guidelines pursuant to powers conferred on it by the Act relating to specific areas or issues in the retirement benefits industry. Thus there are notices and guidelines relating to:
a) Administration of Schemes
b) Financial Provision
c) Investment Policies
d) Retirement Benefits Levy
e) Investment Guidelines