THE FUTURE OF COLLECTIVE INVESTMENT SCHEMES IN THE KENYAN CAPITAL MARKET

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D61/P/8827/99

A RESEARCH PROJECT SUBMITTED IN PARTIAL FULFILLMENT OF THE REQUIREMENTS FOR THE DEGREE OF MASTER OF BUSINESS ADMINISTRATION

FACULTY OF COMMERCE
UNIVERSITY OF NAIROBI
FEBRUARY, 2003

DECLARATION

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

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

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DEDICATION

This paper is dedicated to my parents who have untiringly supported all my endeavours.

ACKNOWLEDGEMENT

I am greatly indebted to all the capital market licensees, who shared their views and opinions with me, offering guidance and shedding light on all the areas that have been reported herein.

Sincere gratitude goes to Mrs. Angela Kithinji, Faculty of Commerce, Department of Accounting, for her continued guidance, support, encouragement and helpful criticism and suggestions, throughout the project.

I would also like to thank my family and friends for the support they have offered over the period I have undertaken the MBA programme. Thank you for your understanding and patience.

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ABBREVIATIONS

CBK	-	Central Bank of Kenya
CDS	-	Central Depository System
CIS	-	Collective Investment Schemes
CMA	-	Capital Markets Authority
ICI	-	Investment Company Institute
ILO	-	International Labour Organization
IOSCO	-	International Organization of Securities Commissions
NSE	-	Nairobi Stock Exchange
RBA	-	Retirement Benefits Authority
TEPCOW	-	Technical Preparatory Committee of the Whole (Economic Commission of Africa)

ABSTRACT

This study set out to assess the Kenyan capital market and establish whether the conditions considered necessary for operation of collective investment schemes exist. These conditions were divided into three main groups: general factors, institutional factors and legal, regulatory and supervisory issues.

A cross-sectional census was conducted, by means of a questionnaire and views of capital market licensees were collected. These parties, which included the regulator, the security exchange, the brokers, the dealer, the investment advisors or fund managers and the depositories, were selected as they are expected to be involved in operation of collective investment schemes, once implemented.

An overall analysis showed that the capital market licensees are all very optimistic regarding the future of collective investment schemes in the Kenyan capital market, and they agree that the current institutional, legislative, regulatory and supervisory factors are capable of supporting the operations of collective investment schemes.

A comparative analysis of the data collected highlights the different opinions of the different licensees, and brings out the areas of concern, particularly in reference to their operations. For example, although most players feel the current manual trading system is under-utilised, one investment advisor highlighted that the system would be incapable of handling the magnitude of expected growth that is expected on introduction of CIS. On the issue of current economic stagnation, different licensees gave their opinions as to what current problems were and some even suggested solutions.

CHAPTER 1 – INTRODUCTION

1.1 BACKGROUND

1.1.1 Financial Markets

Financial markets consist of all institutions and procedures for bringing buyers and sellers of financial instruments together (Van Horne and Wachowicz, 2000). The purpose of financial markets in an economy is to allocate savings efficiently to ultimate users, at the least possible cost and inconvenience. In reality, most non-financial corporations use more than their total savings for investing in real assets, while most households have total savings in excess of their total investment. The flow of funds from savers to investors can be direct or indirect through financial intermediaries, such as commercial banks, savings institutions, insurance companies, pension funds, finance companies, and mutual funds.

Capital markets are an essential part of the financial sectors of modern economies. They provide alternative savings tools to savers and non-bank sources of financing for enterprises. Thus, the markets promote economic growth through enhanced savings mobilisation. Capital markets play host to several different players such as the regulators, the exchanges and financial intermediation agencies such as brokers, dealers, financial advisors and credit rating agencies among others.

The Nairobi Stock Exchange used to be a one-product market, selling and buying ordinary shares. Recently, trading in debt instrument and government paper has been amplified. In 2001, the Nairobi Stock Exchange (NSE) was reorganised into three independent market segments with separate listing regulations for each market segment to address the needs of different categories of issuers of tradable securities. Whereas this should encourage more listings on the market, the problem of investor stratification still needs to be addressed. There is need to develop efficient participation in the securities market through development of different investor profiles. With the passage of Capital Markets Amendment Act (2000), which recognises specific investment vehicles, and especially mutual funds and unit trusts, more opportunities for diversification by both institutional and retail investors should emerge (Wagacha, 2001).

The challenge lies in developing a strategy for the development of these vehicles. This calls for a conducive macroeconomic environment that will support the development of and consequently lead to an increase in listings and investors, which will require more investible instruments.

The number of investment opportunities for investors significantly increased in the 1990's with the development of the capital markets and the deregulation of the economy. Investors whose assets are held primarily in traditional investments such as real estate and fixed deposits may wish to diversify into new types of investments including domestic and offshore stock markets, money market securities such as treasury bills and bonds and venture capital funds.

1.1.2 Collective Investment Schemes

Although collective investment vehicles (CIS) may have different structures, they can all be generally defined as devices for pooling and investing the funds of investors in a wide variety of securities and other financial assets to meet their investment objectives. Kenyans have demonstrated an impressive ability over the years to pool together resources through various structures to improve their lives economically, as demonstrated by participation in co-operative societies, land-buying companies, women's groups, investment companies, clubs and groups.

For small investors, CIS generally offer attractive benefits such as diversification, professional management and economies of scale (Raja, 1996).

CIS are not widely operational in the Kenyan market, although the case of Credit and Co-operative Societies and informal merry-go-rounds come close to this understanding. Zimele Asset Management Company seems to be the only real CIS which has started an investment co-operative, where they pool together funds from various small investors and come up with a substantial amount of money which they can then invest in various interest earning instruments like Treasury bills, Bonds and Commercial Paper. The interest is then shared among the members. Zimele have three investment portfolios; offshore, balanced and money markets. The offshore portfolio allows investors to invest in foreign companies, with a minimum sum of Kshs.5,000. The balanced portfolio combines both local and international markets and the minimum investible amount is Kshs.5,000. The money market portfolio for those with short-term financial objectives includes Treasury bills, Treasury bonds, and Commercial papers, and the minimum investible amount is Kshs.2,000 (Kabiru, 2001).

Capital market development and functioning requires regulatory schemes that promote private initiative, whereby investors and savers build confidence in the functioning of markets, but at the same time small investors need to be properly protected through strict enforcement of securities laws and regulations (Senbet, 1998).

1.2 STATEMENT OF THE PROBLEM

Capital markets are an important part of the financial system, providing efficient delivery mechanisms for savings mobilisation and allocation, risk and liquidity management and corporate governance (World Bank Institute, 2001). In recent years, the Kenyan capital market has been experiencing all-time lows, a fact attributed to the low 'effective demand' and the economic recession. This means that investors may be interested in buying shares but they may not have enough funds to do so as individuals.

A Ministry of Labour and Human Resource Development Survey (2000) found that accessibility of savings facilities has been a problem for the Kenyan households. 68% of savings among rural households are in non-financial form and never enter the formal financial sector. Other studies show that the high propensity to save among the poor in developing countries have remained untapped and beyond national efforts to mobilise resources for development.

Ondigo (2001) observes that the main problem facing the securities market in Kenya is that there are insufficient products to satisfy the demand for securities and the main concern should be in developing products that satisfy the demand that exists. The issues of Treasury Bonds by the CBK for July and August 2001, were heavily oversubscribed because the money is there. Thus there is need to diversify the product base so that every investor will find something suitable.

The potential in the Kenyan capital market is far from being fully utilised. There is a lot of uninvested capital that could be tapped into the capital market either by long-term investors or speculators. The industry has a collective responsibility of taking the capital market to the people or by way of persistent informative campaigns/advertising and product diversification. To date, access to these new investment outlets has been limited to the well-informed, large institutional investors, but it is inevitable that access for individual investors will be developed through collective investment vehicles managed by professional fund managers. As the resources required for prospering economically change from primary assets such as land and buildings, to the ownership of financial assets, it is inevitable that Kenyan investors will diversify from traditional assets to newer and potentially more rewarding financial assets. The establishment of collective investment vehicles will be essential in order to enable as many individual Kenyan investors as possible to participate in this evolution (Zimele Asset Management, 2000).

The Capital Markets Authority (CMA) is currently concentrating on introduction of Collective Investment Schemes (CIS), targeting the small investor. However, implementation is proving to be more difficult than anticipated because of the slow pace that has been taken following the amendment of the CMA Act (2000), in developing and gazetting the rules for creation, listing and transactions in mutual funds on the NSE (Ondigo, 2001).

There are factors that must exist in a market in order for it to be conducive for the operation and growth of CIS. These include investor education and confidence, mature securities markets, stable macro-economic environments, qualified licensed and professional operators, integrated technology, supervision and regulation of industry, among others (Melly, 1996; Moore, 1997; Rottersman, 1997; IOSCO, 2001; CFSS, 2002).

The assessment for the future of CIS in the Kenyan capital market is necessary. This study investigates whether the conditions conducive for the establishment of CIS exists in the Kenyan capital market.

The issues raised include: What is the future of CIS in the Kenyan capital market? Are CIS significant to economic growth? Is demand for these products sustainable into the future? Do the existing gazetted rules and legislation provide adequate investor protection? Is there provision for supervision of CIS operators? Are there adequate disclosure requirements?

1.3 OBJECTIVE OF THE STUDY

The objective of the study is to assess whether the conditions conducive for the operation of Collective Investment Schemes exist within the Kenyan capital market.

1.4 IMPORTANCE OF THE STUDY

This study is expected to be of great importance to the following groups:

1. **Capital Markets Authority** – As the regulatory body of the capital markets in Kenya, they are charged with the development of new instruments and regulation of such instruments. This research should highlight issues in the regulatory and legislative framework of the Collective Investment Schemes which may contradict existing legislation or which may be inadequate with regard to existing objectives.

2. **Nairobi Stock Exchange** – CIS instruments may be the missing link required to escalate investor interest in the existing products. This will hopefully boost activity in the plummeting market.
3. **Investment Advisors, Stock Brokers, Credit Rating Agencies, and Investment Bankers** – These are the players who will be involved in the day to day trading involving the CIS instruments once they are introduced. They will thus be guided by the laws and regulations set up by the CMA and will be involved in interpreting these for their own operation as well as for the investors they advise.
4. **Investors (Retail and Institutional)** – The study will help them to understand the rules and regulations of CIS, and assess how geared they are towards investor protection. The study would also act as a means towards investor education and sensitisation that is greatly required in the Kenyan capital market.
5. **Others** – These include academicians, governments, the general public and any other party interested in the future of CIS in the Kenyan capital market.

1.5 SCOPE OF THE STUDY

This study will investigate the future of Collective Investment Schemes in the Kenyan capital market. The research will be cross-sectional and views collected will be at one particular point in time. The respondents who will be expected to give their opinions include the regulators and other market players, expected to be involved in the operation of CIS once implemented. These respondents are considered better placed to comment on matters concerning the institutional, legislative, regulatory and supervisory framework of CIS, by virtue of their experience with other market instruments. Their views would thus be representative of the overall capital market.

CHAPTER 2 - LITERATURE REVIEW

2.1 FINANCIAL MARKETS

The economic function of financial markets is to provide channels for transferring the excess funds of surplus units to deficit units. In other words, financial markets constitute the mechanism that links surplus and deficit units, providing the means for surplus units to finance deficit units with additional options. However, financial markets provide surplus and deficit units with additional options. Surplus units may purchase primary or indirect securities or reduce their debt by purchasing their own outstanding securities. Deficit units, on the other hand, may issue securities or dispose of some financial assets previously acquired (Faure, 1987).

The term financial market encompasses the participants (borrowers, lenders, financial intermediaries and brokers) and their dealings in particular financial claims or groups of claims and the manner in which their demands and requirements interact to set a price for such claims (the interest rate) (Faure, 1987).

There are two types of financial systems: capital market-based (also known as direct or securitised) and credit-based (indirect or intermediary-based) systems. Usually, credit-based systems prevail in developing countries. Here, unlike in the stock market-dominated system, investment is faster, is least affected by speculative activity and is not biased towards short-term profitability (Bhole, 1999).

An efficient financial sector reduces the cost and risk of producing and trading goods and services and thus makes an important contribution to raising the standard of living. An efficient financial system requires an infrastructure of laws, conventions and regulations as well as confidence from the participants. Confidence encourages investors to allocate their savings through financial markets and institutions rather than buying non-productive assets as a store of value (Herring and Santomero, 1991).

The allocation of savings in an economy occurs primarily on the basis of expected return and risk. Different financial instruments have different levels of risk, and in order for them to compete for funds, these instruments must provide different yields. If all securities had exactly the same characteristics, they would provide the same returns, if the market were in balance. However, there are differences in the default risk, marketability, maturity, taxability and embedded options, which account for the different risk levels and hence the different expected returns for investors (Van Horne, 2000; Van Horne and Wachowicz, 2000).

2.1.1. Savings and Investment Mobilisation in Financial Markets

In most developing countries, the banking sector dominates the financial system and securities markets are not well developed. Restrictions on bank behaviour imposed by the government often result in negative real interest rates and an excess demand for credit, requiring banks to ration their lending. Consequently, credit is allocated to favoured sectors and firms by administrative decision rather than by market mechanisms (Pill and Pradhan, 1997).

With liberalisation banks cease to dominate the entire financial system and securities markets emerge to become an increasingly important source of funds for many firms. It is also important to note that while foreign investment can play a valuable role in stimulating capital markets in Africa, the growth and stability of these markets will require the development of a healthy base of domestic investors. Pension reforms and promotion of mutual funds could encourage domestic investment in fledgling stock markets. Over the longer term, deficiencies in human capital, infrastructure and institutions need to be addressed if more African countries are to attract the growing pool of portfolio investment (Bhattacharya, Montiel and Sharma, 1997).

2.1.2. Financial Innovation

Financial innovation can be defined as the introduction of a new financial instrument or service or practice, or introducing of new funds, or finding out new sources of funds, or introducing new processes or techniques to handle day-to-day operations, or establishing a new organisation – all these changes being on the part of existing financial institutions. In addition, the emergence and spectacular growth of new financial institutions and markets is also part of financial innovation (Bhole, 1999).

Financial innovations bring about wide ranging changes as well as effects in the financial system. They lead to the broadening, deepening, diversification, structural transformation, internationalisation and sophistication of the financial system. They result in the financialisation of the economy, whereby financial assets to total assets tend to increase.

Innovations in financial products, such as introduction of new investment products, and in processes, such as automated teller machines (ATM's), result from the exploitation of opportunities arising from operational inefficiencies. Innovations may also result from the drive for complete markets, thus supplying securities with the features desired by investors. In a steady-state equilibrium, the financial markets would be highly efficient and reasonably complete, as financial instruments that should have been provided and the operational efficiencies that should have been achieved will already exist. (Van Horne, 2000).

For financial innovation to occur there must be a change in the environment, in form of either, tax law changes; technological advancements; transaction and agency costs; changes in interest rates, currency levels and volatility; changes in the level of activity; opportunities to reduce or reallocate risk; and regulatory changes. With a change in one or more of these factors, profit opportunities arise and financial promoters to exploit the opportunity introduce new financial products and processes. With competition among providers, the profitability of a financial innovation to its original promoter declines over time. As this occurs, consumers of financial services increasingly benefit from the innovation (Van Horne, 2000).

The Nairobi Stock Exchange (NSE) management has set about introducing various measures to aid the further development of the stock market and to encourage firms to seek listings on the greater variety of segments at the exchange. Regulatory concerns still prevail, especially with regards to the disclosure standards (investor relations), the information content of share prices on the exchange and the extent to which prices could be reliable (Kibe, 2000).

2.2 THE CAPITAL MARKET IN KENYA

Capital markets are an essential part of the financial sectors of modern economies. Well-developed capital markets promote economic growth through increased savings mobilisation, access to foreign savings and the spreading of financial risks in enterprises. They also help governments finance their deficits while reducing the fiscal pressures of debt redemption if the maturities of the securities are lengthened. The market plays a facilitating role in translating savings to investment. A typical capital market has several players: banks, insurance companies, mutual funds, mortgage firms, finance companies and stock markets (Wagacha, 2001).

Kenya's capital market draws its origins in the 1920's when it operated with no formal market, and no rules to govern stock-broking activities. The Nairobi Stock Exchange (NSE) was set up in 1954 as a voluntary association of stockbrokers who were registered under the Societies Act. This was made possible after obtaining clearance from the London Stock Exchange (LSE), which recognised it as an overseas stock exchange. This was necessary to give credibility to the NSE. The establishment of the NSE was demand-induced and came about largely on the initiative of certain stockbrokers who, for a number of years had already been engaging in securities' dealings on a sporadic basis. Activity at the NSE remained low in the 1960's and 1970's. The market remained a members club where stocks were traded over a cup of tea or coffee at the (New) Stanley Hotel using the call-over trading system. In 1966, the NSE started measuring daily trading activity by computing the NSE index, which measured daily average price changes. The basket of stocks used in computing this index consisted of 17 companies representing the most active stocks in the market. The index was computed as a weighted average of the price changes in the selected stocks. After independence, the NSE handled a number of highly over-subscribed public issues and the market grew rapidly with the buoyant economic performance of the time. However, the oil crisis of 1973, the imposition of the capital gains tax at 35% in 1975 (suspended in 1985), and loss of a regional outreach due to nationalisation in neighbouring Tanzania and Uganda, inflicted losses on market growth. In the 1980's the government realised that to foster economic development, there was need to have an efficient and stable financial system. This required a reform package on a financial system to be designed and implemented in 1991. The NSE was then registered as a limited liability company, and phased out the call-over trading system in favour of the current open-outcry system. The NSE also adopted a 20-share index and changed the computational method of the index to a geometric mean without revising the previous indices (Kimura and Amoro, 1999; Melly, 1994, 1996;Wagacha, 2000).

The Capital Markets Authority (CMA) which is the statutory body created by the CMA Act Cap. 485A and enacted in 1989 was created at a time when there was high foreign debt, failing business organisations and persistent capital flight indicating inadequacies in the financial services sector. The CMA is a regulatory authority assisting the securities and other capital markets to grow. The purpose of regulation is to encourage investor confidence in the market, encouraging them to invest their savings in the products available, while encouraging companies, to list by issuing securities, to absorb the investor's savings (Kimura and Amoro, 1999; Wagacha, 2000).

Institutional development in the Kenyan capital market through the Capital Markets Authority (CMA) initiatives of improving trading practices and transparency in the price formation process, increasing number of stock brokerages to 20 and strengthening their operations and capitalisation levels, licensing investment advisors, establishing investor compensation funds and building an appropriate professional capacity to strengthen the management of the NSE and the capacity of the CMA (Wagacha, 2000).

Fundamental structural reform has recently taken place at the bourse. The result is three new market segments, with a fourth due soon. These are the Main Investment Market segment (MIMS), carrying the bulk of companies; Alternative Investment Market segment (AIMS) tailored for small and medium-sized companies that have a high growth potential but cannot meet the stringent listing requirements of the MIMS; Fixed Income Security Market Segment (FISMS) for debt securities such as treasury and corporate bonds, preference shares and debenture stocks; and Futures and Options Market Segment (FOMS) which will incorporate derivative instruments, once operationalised. These reforms have the effect of deepening the market and broadening the choices available to the investing public. The disclosure framework seeks to minimise the market distortions that arise from lack of access to information by certain groups (—, June 2001a).

Developing countries, particularly those in Sub-Saharan Africa, have traditionally relied on flows from official sources to fund the gap between investments and domestic savings. They have also been dependent on bank loans for a high proportion of the inflow; these loans bring with them the increased exposure to exchange rate risk. Much of this lending has been in response to crisis situations. Official capital flow and bank loans are declining and this source is no longer sufficient to sustain the economies of these countries. Accordingly greater reliance has to be placed on private capital flows (Cottrell, 1999).

Emerging economies thus need to attract portfolio investments, which would enhance the liquidity and increase the capability of the local markets with spin off for the economy. The sources of private portfolio investment are institutional investors and households in developed economies. The preferred forms of investments for households are:

- Insurance
- Collective investment schemes
- Retirement funds

Steps have to be taken to achieve and maintain robust financial systems with appropriate institutional and financial market structures, as well as the capacity to provide the information necessary for sound financial decisions and to implement financial transactions efficiently. These require good institutional governance, exercising of discipline by stakeholders, competition and regulation and supervision that support as well as enhance their functioning.

The role and ability of supervisors of financial service regulations will play an important role in creating or dispelling perceptions of investor safety and soundness. Perceptions about the safety and soundness of the investment structures and products will play a role. The appropriateness and adequacy of the relevant corporate and capital raising laws and investor protection safeguards will be important.

Savers with uncertain life spans cannot stick to long-term investment plans when they invest directly in liquid assets. Before horizons are known, all savers will plan to roll over their short-term assets if returns turn out high. Ex post, the short-term investors will consume their liquid assets rather than reinvest them. Delegating investment decisions to an intermediary reduces the commitment problem, leads to more efficient portfolios. The higher return to savings should also increase savings rates (Morgan, 1998).

There exists a relationship between stock market and financial intermediary development. Thus an economy's financial depth will be highly dependent on the development of other financial intermediaries such as banks, insurance companies, non-bank financial institutions (NBFI's) and pension funds. Stock market volatility is impacted by financial intermediary development; in countries with well-developed and large financial intermediaries the stock market will be less volatile. This has important implications for emerging market government policy in the well-functioning stock markets. That is, they should consider the development of an efficient and established financial intermediary sector as an important prerequisite to the stock market. Thus stock market development goes hand in hand with financial intermediary development. In the case of developing countries this explains why the emergence of stock markets has complemented and not replaced bank lending (Kibe, March 2001).

The financial sector in Kenya is also considered one of the deepest and most diversified in Sub-Saharan Africa. The resultant relatively high private savings rates, compared with other countries in the region, are due to circumstances provided by a combination of two factors: the presence of a relatively dense and diversified financial and banking sectors and a policy of institutional 'forced' savings (Mugwanga, 1999; Elbadawi & Mwega, 1998).

In many studies involving the Kenyan situation, a recurring theme is the low level of awareness of what is available in the market. Thus, in the absence of this knowledge, there is a tendency to go for known and familiar investments such as bank savings accounts, buildings, farms, etc. Newer and probably more lucrative instruments such as shares and stocks, unit trusts, mutual funds and other portfolio investments are hardly known (Kimura and Amoro, 1999; Wagacha 2000, 2001).

The NSE continues to utilise manual trading and clearing/settlement systems, which are inherently slow and costly. Although the system has served well in a low volume-trading environment, it cannot sustain significant changes in volumes traded and settled. Such systems also limit the range of services that can be provided. Equally, trading in products that require prompt completion of the transaction cycle is seriously hampered. Manual systems will also hamper international integration of the market as cross border trades can only thrive under automation. The NSE has put this among its key projects for completion in 2002, with the introduction of the Central Depository System (CDS) (Wagacha, 2001).

2.3 COLLECTIVE INVESTMENT SCHEMES

Collective Investment Scheme (CIS) is an umbrella term for pooled investments known by various names such as mutual funds and investment trusts. In recent years such schemes have seen their assets under management grow rapidly in the United States, Europe and Asia (Yuta, 2001).

With the changing investment market place, it has dawned on the investor just how unsustainable double-digit equity returns are, and they are beginning to seek a more credible solution to challenges of creating and sustaining long-term financial security. In order to attain this, there is deliberate effort by investors to diversify their holdings. Many investment advisors are suggesting a properly balanced and risk-adjusting mixture of equity, fixed income and insurance products as being essential to a successfully co-ordinated longer-term financial strategy. Insurance has historically provided financial security for families, income in the event of disability, and a source of estate creation and asset protection. Inflation continues to erode returns across all asset classes and taxes eat away the balance, thus the salient issue today, that has also been proven over time, is that long-term returns are influenced more by diversification and allocation of resources amongst asset classes rather than simply by the investment choice within one asset class (Opiyo, 2002).

Collective investments are share-based products run by experts that allow investors to spread their risk over a wide range of companies, sectors and markets, with a limited amount of money. Collective investments are particularly good for new investors, those who are naturally cautious and those with limited funds. Although many collective investments perform well, one of the disadvantages is that their performance will rarely match that of a winning individual company share. On the other hand, they are less likely to suffer extensive losses.

An important feature of CIS is that they are passive investors; they do not usually exercise control over their investee companies and this sense are quite different from holding companies.

There are three key parties in any CIS, the investors whose assets have been pooled into a fund, the body of fiduciaries who oversee the management and investment of this fund and the management company which does the day-to-day operations of managing and administering the fund as an agent of the fiduciaries (Zimele Asset Management, 2000).

The acid test of a CIS structure is whether it ensures that the interests of the investors are fully protected by the fiduciaries. The various legal structures of CIS around the world try to achieve this with varying degrees of success.

The main advantages of a CIS include:

- *Spreading risk* - Even if you have only a small amount to invest, you can spread your money across a wide range of investments. This is a lower risk strategy than just putting all you money into one or two investments.
- *Professional portfolio management* – This requires a considerable degree of expertise, time, resources, and experiences, attributes most individual investors do not possess – especially since most of them are engaged in other professions.
- *Reduced dealing costs* – Pooling money with that of other investors means you gain from buying in bulk.
- *Liquidity* – Individual investors may need to cash their investments at short notice to meet financial emergencies. An open-ended CIS allows investors to cash in on some or all of their holdings at any time and to receive the current market value of their investments, which is calculated daily.

- *Reduced administration* – If you hold investments directly, there is often a lot of paperwork involved in buying, selling, collecting dividends and so on. Also dealing with foreign stock exchanges and brokers can be tricky and time consuming. With CIS, the fund manager deals with all of that.

However, on closer examination, they also yield the following disadvantages:

- *Paying for a fund manager* – The professional manager running the investment fund on behalf of all the investors takes a fee direct from the investment fund. This is avoidable if an investor were to manage his own investments.
- *Lack of choice* – Although you can choose the type of fund you invest in, you have no control over the choice of the individual shares or bonds, which go into the fund.
- *Loss of owner's rights* – If you own a company's shares directly, you are sometimes entitled to perks (for example, discounts on company's products) and you have the right to attend company's AGM and vote on important matters. Investors in a CIS have none of the rights connected with the individual investments of the fund.

CIS can be organised in the following legal forms:

- Mutual funds
- Unit trusts (generalist funds)
- Investment trusts
- Open-ended investment companies (OEIC's)

Depending on the underlying assets, CIS may have very different characteristics. They incorporate a variety of types of investments.

2.3.1. Mutual Funds/Unit Trusts

These two terms describe the same types of funds in different countries. Mutual funds being the term used in US, and Unit Trust being used in the UK and most European and commonwealth countries (Solnik, 2000).

The first CIS can be traced back to 19th century in Great Britain. The Foreign and Colonial Government Trust, formed in London in 1868, resembled a closed-ended mutual fund as it promised the 'investor of modest means the same advantages as the largest capitalist by spreading the investment over a number of different stocks.' By 1924, the first modern mutual fund was the

Massachusetts Investors Trust was introduced in USA with a modest portfolio of 45 stocks and $50,000 in assets. This was the first so-called open-end mutual fund (Zimele Asset Management, 2000; Faure, 1987).

Mutual Funds/Unit Trusts are funds designed to permit thousands of investors to pool their resources as unit holders, in funds that invest in a number of securities, such as quoted stocks, government and corporate bonds, and money market instruments among others.

The unit holders are the owners of the fund managed by a professional portfolio manager and are therefore entitled to the fund's net income. This is made up of the gross income generated less the operating expenses, such as trustee and accounting fees and statutory fees, such as stock exchange transaction fees among others. Investors share in the fund's gains, losses, income and expenses on a proportional basis.

Each fund has its own investment objectives described in the fund's trust deed. The different funds with different investment objectives are called fund families. In most cases investors can usually withdraw money from one fund and invest it in another of the same family with minimal or no charge. There are two main objectives (Zurich Learning Center, 2002):

1. Growth – increasing the value of the principal investment amount
2. Income – generating a constant flow of income

There are several types of funds, some of which are based on the investment that makes up the predominant investment of the fund (ICI, 1996; Zurich Learning Center, 2002).

- ***Equity or Stock Funds*** invest mostly in stocks and are thus subject to the volatility in stock prices. These funds invest mainly in well-established companies with regular dividends, young high-tech companies and under performing companies. Equity funds are volatile but represent the most potential gains in the long-term.
- ***Fixed Income or Bond Funds*** are comprised primarily of bonds that produce regular income. Bond funds invest in a range of different qualities of bonds, from government bonds and treasury bills to high yield bonds. Maturity of the bonds plays a major role in the return of those funds. The longer the maturity, the greater the amount of dividend paid. The return for bond funds will generally be lower than that of an equity fund, and majority of the return will be from the interests the bonds produce.

- ***Money Market Funds*** are short-term bond funds with high liquidity, very secure investments. They are appealing because they offer regular income, and stability to the principal. They have a low volatility and their value seldom decreases. The low risk of money market funds however, means that the return is comparatively low.
- ***Index Funds*** are passively managed mutual funds. They attempt to match the performance of a specific index, for example in US, the Standard and Poor's 500 Composite Stock Price Index (S&P 500), rather than have fund managers actively select stocks. Thus the cost of index funds tend to be lower than other actively managed mutual funds.
- ***Asset Allocation Funds*** are funds that offer investors a classic approach to investments in a broadly diversified portfolio of money market, stocks and bonds. As market conditions change, asset allocation funds rebalance their investments among different kinds of assets (stocks, bonds, cash and real estate). These funds emphasise a quality-oriented approach that combines the growth potential of stocks with the income and relative stability of bonds invested in different countries.

  There are different types of asset allocation funds available to meet the varying needs of investors:
  - *Income or Conservative Funds* invest in high quality bonds or other mutual funds. These funds are managed with the principal objective of providing current income to investors with little or no emphasis on growth of principal.
  - *Fixed Allocation or Balanced Funds* are proportionally balanced between income and growth elements. These funds generally involve less risk than funds investing exclusively in common stocks. This means that the investor can achieve adequate growth without taking high risks.
  - *Changing Allocation or Growth Funds* lean heavily towards stocks. These funds are managed with the objective of increasing the investor's principal, with little or no emphasis on current income. They are meant to be more aggressive.

- ***Floor or Protection Funds*** are an alternative available to risk-averse, long-term investors. These funds give protection against adverse market movements by limiting the risk of losses. They provide a continuous floor or minimal value, usually not lower the 95% of the bid price at the beginning of the annual or semi-annual cycle. Investing at the price at the beginning of the period limits the loss risk. The funds are managed so that one investment unit does not fall below the floor in case of stock market fluctuations. However, investing during the cycle may increase the risk if the units are traded at a higher price.

The value of a mutual fund/unit trust is often determined by calculating its Net Asset Value (NAV). NAV is the price per unit for a fund and is determined by the difference between the total market value of the funds assets and liabilities divided by the number of outstanding units. NAV is also called the book value per unit.

$$\text{Net Asset Value} = \frac{\text{Total market value of the Mutual Fund/Unit Trust}}{\text{Number of outstanding Units}}$$

The NAV is how much the investor would receive for each share if the mutual fund sold all its assets, paid off all its outstanding debts, and distributed the proceeds to shareholders.

There are many advantages for investing in mutual funds/unit trusts. Firstly, these funds can be joined easily with a low investment, and they can be sold easily. They are highly liquid and thus are easily convertible into cash. In countries where such funds are found, the Bid/Offer spread is the difference between the offer price at which an investor buys units and the bid price at which the investor would immediately be able to sell them again.

Secondly, investment companies, such as banks, enabling efficient management, professionally manage these funds.

Thirdly, funds are diversified in terms of securities, some of them even in different categories. The success and returns therefore do not depend on the performance of just a few assets, but rather the performance of a large group of diversified assets. This reduces the risk by spreading it over a number of investments.

Fourth, when investors buy a unit of the fund, they can profit from a much greater buying power. They can also get a diversified portfolio with comparatively low trading costs.

Fifth international investment companies may further benefit from double taxation treaties. In Kenya, the taxes on capital gains are currently suspended, but withholding taxes on funds distributions to unit holders would be levied. No VAT is levied on the funds.

The costs of buying and managing mutual funds/unit trusts can be quite varied. There are three primary costs to consider (ICI, 1996; Zurich Learning Center, 2002).

1. *Sales Commission or Load* – is the commission the investor pays to the seller when buying units of a fund. The sales commission depends on the country, Fund Company and distribution company.
    1. In general, sales commissions can range from 0% to 5% of the investment.
    2. Some funds are no-load funds, which do not require a sales commission to purchase. They are sold directly to the investor instead of to the broker. No load funds however, may charge higher managing fees to compensate for this.
    3. The seller charges front-end loads when the fund is initially sold to the investor.
    4. Back-end loads or deferred loads are paid when the investor exits the fund.

    In addition to sales commission, the investor sometimes has to pay a redemption commission, which is normally lower than the selling commission.
2. *Managing Fees* cover the costs to manage and administer the fund. The costs can vary from a fraction of a percent to more than 2%.
3. *Trading and Transaction Costs* are administrative fees and brokers commissions incurred when trading instruments within the fund.

(2) and (3) above are costs paid annually. Sometimes an investor has a fixed fee, called and all-in fee, which includes both managing and trading/transaction costs. Since it is a fixed fee, it does not depend of effective trading costs.

The mutual funds industry is growing rapidly worldwide. The growth in Europe has been spectacular especially in countries that do not have a pension fund system. International funds provide an efficient alternative to the direct purchase of foreign shares. Buying a country fund or a regional fund (for example European Equity) allows participation in some markets in a risk diversified or cost efficient way. In turn, mutual funds are institutional investors as they invest large amounts of money that is not their own. Also as mutual funds manage the money internally, they are also asset managers (Solnik, 2000).

Mutual funds and Unit Trusts however, differ in terms of their legal structures. The Capital markets Authority Act, Cap. 485A (1990), defines mutual funds as 'any person who is, or holds himself out as being engaged, or proposes to be engaged in the business of investing, reinvesting, or trading in securities and which is offering for sale or has outstanding any redeemable shares of which he is the issuer'.

Mutual funds are actually open-ended investment companies that continue to sell and purchase their own shares after their initial public offering at a price based on the NAV per share. These are companies that have as their major assets the portfolio of marketable securities referred to as a fund. They have boards of directors who oversee the operations of the company in the best interests of the shareholders, establish its investment and hire a separate investment management company to manage the portfolio of securities as well as the administrative functions involved in dealing with shareholders. The directors acting as fiduciaries in the interests of the investors take major decisions regarding the structure of the fund and announcement of dividends and other distributions, but these decisions are subject to ratification from the shareholders of the company (Zimele Asset Management, 2000).

One key specialised agency involved in the process is the custodian who holds securities and other assets – including bank accounts – on behalf of the fund. This function is normally carries out by banks or financial institutions that have the infrastructure required to manage it cost effectively.

Unit Trusts are similar in structure as they have a fund, a trustee and a management company, each of which performs functions similar to those performed by various elements of an investment company. A unit trust is set up under a Trust Deed, as set out in the Unit Trusts Act Cap. 521, the document that establishes its trust structure and contains full details of its constitution and investment objectives and sets out the provisions relating to its charges. As new investments are made into the unit trust, more units are issued and added to the fund. Unlike the mutual trust this is not a legal person and cannot own assets in its name.

The legal owner of the assets is the trustee who holds these assets as a fiduciary for the benefit of the unit holders. The trustee must at all times protect the interests of the unit holders, safeguard the assets of the trust and ensure that the fund management company complies with the Trust

Deed. The Trustee also controls the receipt and delivery of cash and certificates relating to the issue and redemption of units and ensures that the register of unit holders is properly kept. If the performance of the management company is unsatisfactory, it can also call for a meeting of the unit holders and replace them. The management company administers the unit trust, receiving funds, issuing new units, repurchasing units and managing the investment portfolio of the unit trust (Zimele Asset Management, 2000).

2.3.2. Investment Trusts

Investment trusts are in many ways similar to unit trusts/mutual funds. An investment trust is a public limited company whose shares are listed on the Stock Exchange. Investors purchase shares in the investment company, which in turn buys shares in other companies.

The values of investment trust shares vary with the performance of the company's funds rather like a Unit Trust. Because these investments are shares, the values of each share vary with supply and demand, as well as with the underlying asset value. The value of shares can fall as well as rise, and a long-term view is recommended, when considering these.

The price of shares of an Investment Trust is determined by demand for the shares, as well as the value of the underlying investments. There are usually 2 prices for investment trusts:

1. Net Asset Value $= \dfrac{\text{Total market value of all securities held in the fund}}{\text{Number of outstanding shares}}$
2. Market price for one share in the fund

Generally 1 and 2 will not be the same, and the price per share is generally less than the NAV as measured by percentage discount or percentage difference.

One advantage Investment Trusts have over Units Trusts is that the investors tend to cash in units when stock markets are low. To meet these withdrawals unit trust managers may have to sell underlying assets of the fund at what may be an inappropriate time from an investment perspective. Investment Trust shareholders redeem these holdings by selling the shares on the stock market, not by selling them to fund managers. The investment Trust managers are thus not forced to dispose of stocks when prices are low and are more able to pursue their long-term investment objectives uninterrupted. Thus there is no further sale of shares to the public unless the trust wants to add more securities to its portfolio. Further, the trust does not repurchase outstanding shares from the public (Zurich Learning Center, 2002).

2.3.3. Open-Ended Investment Company (OEIC)

Open-ended investment companies, a fairly recent development in CIS, are hybrid investment funds that have some features of investment trusts and some of mutual fund/unit trusts. They issue shares and have the option of listing on stock exchanges like investment trusts. Unlike Investment Trusts, the investment funds expand and contract as investors join and leave the company, thus there is no fixed capital. In OEIC's shareholding and participation in the investment fund are one and the same thing. The shareholders elect boards of directors to run them.

Their share prices usually reflect the asset value of the fund. They cannot be traded at a discount or a premium and they have to be valued daily and a single price will be quoted to buyers and sellers alike.

The benefits of investing in an OEIC are usually the same as those for investing in mutual funds/unit trusts. Thus by investing in an OEIC, you reduce your risk by spreading your investment and at the same time obtain professional management at a low cost. Units can be bought direct from the OEIC manager, or through a third party such as a stockbroker or financial advisor. OEIC's usually have the facility of operating as 'umbrella funds', where only one OEIC actually exists, but there are sub-funds within the structure, with different objectives. This may result in reduction of trading costs when investors switch from one sub-fund to another.

In practice, in UK, there have been funds changing from unit trusts to OEIC status. This is largely because the corporate code of OEIC's is more transparent and flexible than relying on (unwritten) trust deeds underlying the unit trusts. OEIC is the British equivalent to European SICAV (Societe d'Investissement a Capital Variable) funds (Solnik, 2000; Zurich Learning Center, 2002).

2.3.4. FACTORS CONDUCIVE IN OPERATION OF CIS

Literature is scant in terms of precise factors that would guarantee the operation and growth of CIS, due to the fact that all markets are different, and different factors will work to produce similar results in different markets. However, by examining other markets, conclusions can be drawn on possible factors that may result in the growth in operation of CIS.

United States has one of the earliest Mutual Fund industries and two factors are attributed with the creation of Mutual Funds: mature securities markets and an investing public. The 1920's had given birth to an upwardly mobile consumer society, due to the fact that only US was in a position to provide enough manufactured goods and natural resources for World War I, and later European reconstruction. The purchasing power of the average citizen was growing by almost 3% annually. At the same time, managing investments was tricky, thus most investors turned to professional investment managers. The 1913 creation of a federal income tax yielded a benefit for investors in terms of capital gains, since profits from sale of securities and dividend gains were treated as additions to capital instead of being distributed to shareholders as taxable dividends. These were the humble beginnings of an industry, which now commands $4.5 trillion in assets in more than 160 million shareholder accounts (Rottersman, 1997).

Canada has also experienced supernormal growth in the mutual fund industry (the fastest-growing in financial services sector) with assets increasing from $25billion in 1990 to $426 billion by 2001. Industry analysts attribute the phenomenal growth to several factors. First, the entry of banks into the mutual fund market has popularised the products among ordinary consumers, particularly due to ease of distribution. Second, the aging population approaching retirement, combined with increasing life expectancy, has popularised mutual funds as private means of saving adequate funds for retirement. Third, the 1990's were generally years of lower interest rates, thus lower returns on traditional savings vehicles, and strong equity markets yielding higher returns (CFSS, 2002).

The Russian tax law remains an obstacle to the growth and development of a normally functioning securities market. This stems from legislation drafted in the past and other new legislation, where tax authorities have not filled in the gaps that usually accompany new laws. As mutual funds are investment group formed without the establishment of a legal entity, income received is not subject to profits tax. Under Profits Tax Law and Personal Income Tax Law Russian legal entities and individuals pay tax on interest and dividends from Russian sources only through withholding by the payer. Theses kinds of conflicts, among others, have led to a stagnating mutual funds industry (Moore, 1997).

The collective fund industry has operated in South Africa since 1965, and experienced considerable growth in the early years after inception, although the South African market crash in

1969 left it in disarray for almost a decade. During the 1980's, rising inflation caused growth, as CIS managers were able to deliver inflation-proof returns. The government also created an accommodative regulatory environment. In the 1990's there was elimination of income tax on earnings, allowance of the use of derivative instruments and creation of the money market funds. The South African unit trust market represents a small portion of the world's CIS assets. In comparison with the three largest markets, the market value of the South African CIS' represented 0.2% of the United States market, 2% of the German market and 3% of the Japanese market at the end of 1999. Between 1995 to the end of 1999, market assets grew at a compound rate of 37%. On of the reasons for the significant growth was the 1997 introduction of money market funds. Volatile equity markets had shaken investor confidence, and most opted for the safer haven offered by the money market funds. Secondly, there was a rise in popularity of Rand-dominated funds investing in foreign markets. Off shore markets represented a great opportunity for South African investors to capitalise on high returns (State Street, 2001).

It is critically important to integrate technology at the very beginning of setting up of capital markets to reduce the systematic risk arising from reliance on manual processing that may not be able to cope with an expected surge in activities. It is also important to ensure that licensed professional are of high integrity as a capital market is sensitive to confidence in the operators. It is important to have minimum standards of operations by professionals, such as brokers, investment advisors and dealers. The level of capitalisation must be adequate to support the level of activity they undertake. Professionalism must be emphasised and development in the long run through structured courses or particular professional courses related to the activities of capital markets are essential. The emergence of support professionals such as merchant banks, underwriters and credit rating agencies must be encouraged. Public interest in activities of the capital markets is critical. The necessary level of confidence can only be built where investors receive a reasonable return for their investment, as a situation with losses in the initial stages may make them shy away from participation in capital markets. On the overall, a stable macro-economic environment is necessary for successful development of capital markets and their products, as this entails adoption of consistent market focus policies (Melly, 1996).

One would expect to find a significant degree of correlation between Kenyan economic growth and the growth of the NSE. However, studies show that the former average 3.8% p.a. in the period 1985-1996, while the latter averaged only 0.6% as measured by the number of quoted companies. The major reasons for the low growth at the NSE included lack of awareness and information on the role, functions and operations of the NSE. For companies, the risks associated with the additional disclosure are not adequately compensated by additional returns. Banks also tend to indirectly discourage the NSE as a means of raising capital as they play the dual role of investment advisors and lenders. The NSE has inadequate marketing of itself as well as an insufficient number of products to attract the investing public (Kimura and Amoro, 1999).

Another factor is investor education, which may enhance the investors understanding of the role of the regulator, provide investors with tools to protect themselves against fraud (and other abuses) and to assess the risk associated with particular investments, assist the regulator in enforcement of the securities laws concerning offerings and sales of securities and maximise the regulators limited resources (IOSCO, 2001).

2.3.5. INVESTOR RISKS IN CIS

The Australian Law Reform Commission (1991) identified three types of risks that collective investors face:

- Investment Risk – the risk that the investment will decline in value
- Institution Risk – the risk that the institution that operates the scheme will collapse
- Compliance Risk – the risk that the operator of the scheme will fail to comply with rules governing the scheme or will act dishonestly or fraudulently

Although the government should not intervene to reduce the investment risk, it should intervene to reduce or control compliance and institutional risk.

Rules governing the structure of CIS are specifically designed to preclude the investment manager from owning any asset within the fund under its management. All assets within the fund are owned and registered in the name of the fund through an external custodian and unit holders own the fund. Thus means that a unit is a physical and legal share of a CIS. Because of their size, in monetary and representative terms, their respective governing bodies or governments heavily supervise CIS in order to protect the markets and the interests of investors. CIS play a major part in the day-to-day life of asset markets and are often referred to as Institutional Investors.

2.3.6. INSITUTIONAL ISSUES IN OPERATION OF CIS

Examination of the South African financial market may lend some insight into some of the institutional factors that help collective schemes to thrive as mentioned above. Despite being an emerging economy, South Africa has progressive exchanges in equity, futures and debt securities. The Johannesburg Stock Exchange (JSE) founded in 1887 facilitates trading in company shares. With a capitalisation of $201.7 billion at the end of October 2000, it placed third in all the emerging market exchanges (after Taiwan and Brazil) and nineteenth worldwide. The only derivatives exchange on the African continent is the South African Futures Exchange (SAFEX), which experienced tremendous growth and was placed sixteenth worldwide in 1999. Debt instruments are traded on the Bond Exchange of South Africa (BESA), currently the only debt exchange licensed in Africa (State Street, 2001).

As in many countries, there is a wide range of distribution channels to South African investors. Traditional routes include banks, asset managers and insurance companies. In addition, stockbrokers, accountants, attorneys and financial advisors make unit trusts available to the public. Global competition is also creeping into the industry. Between 1998 and 1999, 68 foreign investment managers were authorised to operate in South Africa. Most fund managers have strong ties in either banking or insurance, making it easier to capture market share, and concentrating the market. In 2000, 10 of 21 management companies controlled 87% of the assets invested in unit trusts. This kind of concentration has caused many foreign firms to shy away. Unit trusts regarded as medium- to long-term investments operate broadly in the same market as life assurer, participation mortgage bond companies and trust companies. With the major portion of unit trust assets being in listed investments, the industry competes principally with long term insurance companies, pension and provident funds and trust companies for such investments (Standard Bank Fund Managers Ltd, 1997; State Street, 2001).

In the United States, the assets of mutual funds have grown much more rapidly than the assets of commercial banks. In 1986, mutual funds held only 9% compared to 16% in 1995 of the total assets in major US financial intermediaries. Besides mutual funds, pension plans and insurance companies have also increased their share. At the end of 1996, mutual funds were second to commercial banks in asset size. Mutual funds are the investment vehicles of choice for many individual retirement plans, thus enhancing the importance of the role of the retirement market in the increasingly important funds industry (ILO, 2002).

With the enactment of Retirements Benefits Authority (RBA) Act in Kenya, major positive changes are expected to occur in the country's financial markets. Retirement benefits schemes are the largest players in the mutual fund and unit trust markets in the developed countries and it is expected that these investment vehicles will quickly develop in the local markets as the schemes begin to apply modern investment models. Further, when it becomes apparent that retirement schemes are holding a large amount of investible funds, it is expected that many companies will try to tap into these funds by opting for stock market listings and issuance of commercial papers and corporate bonds, when raising capital for operations (RBA, 2001).

In examining the structures of CIS, consider the legal structure of mutual funds in United States. Shareholders like in any company, have specific voting rights, such as to elect directors. Their approval is also sought in case of a fund seeking to change its investment objectives or policies deemed fundamental. They are provided with comprehensive information, to help them make informed decisions and receive the funds prospectus which describes the funds goals, fees and expenses, investment strategies and risks, and how to buy and sell shares. They also receive periodic reports to gauge the success of the firm in accomplishing its objectives. Directors are appointed by the fund's shareholders to govern the fund, and oversee the management of fund business affairs. Due to their responsibilities, the law holds them to a very high standard of care. They are expected to exercise sound judgement, establish procedures and undertake oversight and review of performance of the investment adviser and others that perform services. They are required to be independent of the fund's managers to provide an independent check on operations. Investment advisors manage the money accumulated in a mutual fund. The investment adviser invests the funds assets on behalf of shareholders in accordance with the fund's objectives as described in the funds prospectus. The investment advisor or an unaffiliated third party may offer administrative services which include the overseeing of the performance of other companies that provide services to the fund, and ensuring the fund's operations comply with legal requirements. Since open-ended mutual funds continuously offer new shares to the public at a price based on the current value of the fund net assets plus any sales charges, principal underwriters (regulated as brokers or dealers) distribute the shares. Custodians legally protect the portfolio securities, and nearly all mutual funds use qualified bank custodian, who are required to segregate their mutual fund portfolio securities from other bank assets. Transfer agents are employed to maintain records of shareholder accounts, calculate and disburse dividends and prepare and mail shareholder account statements, federal tax information and other shareholder notices. Some even maintain customer service departments to respond to shareholder enquiries (ICI, 1996).

2.3.7. LEGAL, REGULATORY AND SUPERVISORY ISSUES IN OPERATION OF CIS

Regulation refers to prudential guidelines and directives issued by the regulatory authority (Capital Markets Authority) to the institutions it is mandated to regulate and are intended to define the standards of conduct considered necessary to promote best practices and to protect the industry from opportunistic and other practices which are likely to erode public confidence in it. Supervision refers to systems and measures designed to monitor and enforce compliance with regulatory provisions (Mugwanga, 1999).

The International Organisation of Securities Commissions (IOSCO, 1998) gave clear criteria for eligibility to operate a CIS. Investor protection is the key objective and to that extent a regulatory regime imposes specific requirements

- Honesty and integrity of the operator
- Competence to carry out the functions and duties of a scheme operator
- Financial capacity
- Operator specific powers and duties
- Internal management procedures.

The regulatory system should require supervision throughout the life of a particular scheme. Supervision of an operator should promote high standards of competence, integrity and fair dealing. There should be clear powers with respect to:

- Registration and authorisation of the scheme
- Inspections to ensure compliance by scheme operators
- Investigations of suspected breaches
- Remedial action in the event of breach or default.

There should be clear responsibilities for maintaining records of the operations of the scheme. The operation of a CIS raises the potential for conflict between the investor interests and those of the operators or their associates. Regulation should ensure that the possibility of conflict arising is minimized and that any conflicts that so arise are properly disclosed. It is common for some aspects of the operation of CIS to be carried out by delegates. A delegate should comply with all regulatory requirements applicable to the conduct of the principal's business activities.

There should be clear disclosure of investment policies. The goal of disclosure should be to (IOSCO, 1998):

- Provide investors with sufficient information to evaluate whether and to what extent the scheme is an appropriate investment vehicle for them
- Provide information on a timely basis, in an easy to understand format, having regard to the type of investor.

It is important that disclosure of all fees and other charges that may be levied under a scheme be made.

The regulatory system should provide for rules governing the legal form and structure of CIS and the segregation and protection of client's assets. Regulation should ensure that there is proper and disclosed basis for asset valuation and the pricing and the redemption of units in a CIS.

IOSCO (1998) addresses the regulator on the issue of licensing and supervision. It guides that the licensing process should require a comprehensive assessment of the applicant. The regulator should have the power to reject applications that do not meet the desired standards, as well as the power to withdraw or suspends licensed operators, who subsequently fail to meet the required standards. Regulation should set the conditions of entry that make clear the basis of participation in the market, such as capital requirements, qualifications of applicants and prudential requirements, among other issues.

The reasons for supervision are hereby explained (IOSCO, 1997, 1998):

1. *Investor Protection* – supervision should seek to ensure that assets of a CIS are managed in the best interests of investors and in accordance with the CIS objectives. This will usually require an independent custodian to be responsible for safekeeping of the assets on behalf of the investors.

   Operators should also be supervised to ensure that assets are properly valued.

   Ensuring CIS contains the appropriate spread of investments, regulatory and prospectus disclosures have been complied with and CIS is invested according to investment objectives will also protect investors' interests.
2. *Market Integrity* – Inadequate supervision may adversely affect investors' interests in CIS as vehicle for investment. This will dissuade the public from investing their saving and diminish confidence in the financial markets.

   Without proper supervision, an investor may not be able to make a decision as to which market is appropriate, and safe, to invest in, especially with regard to developing and emerging markets which might not have an established track record.

3. *Integrity of Operator* – Their activities include managing the investments with accordance with the objectives of a CIS, valuation, administration, accounting, promotion and distribution. Level of supervision on each activity will vary depending on the nature of risk related.
4. *Global developments of CIS as an Investment Vehicle* – For the CIS industry to satisfy the market of a global investment vehicle, it is important that operators are properly supervised. Failure to properly supervise may result in valuation, custodial and other types or errors, which may adversely affect large numbers of investors.

Capital markets must be characterised by public confidence and an even playing field, with strict enforcement of rules. The government's role is vital with regard to ensuring enforceability of private contracts and accounting procedures and legal standards. The mere existence of legislation, which declares and grants property rights, is insufficient. There ought to be an independent judiciary strongly enforcing and protecting these rights (Senbet, 1998).

The regulatory environment in Kenya tends to be of the traditional fault finding, heavy-handed type, even in the securities market. This is in danger of strangling an infant industry that has great potential for the economic development of Kenya (Kimura and Amoro, 1999).

CMA has recently proposed regulatory and legislative reforms to improve its supervisory framework and ensure protection of market participants, as well as facilitate market innovation. Regulatory reforms also seek to establish a simple but comprehensive regulatory requirement aimed at minimising the cost of participants, operators and other stakeholders as well as combating such unfair practices as price manipulation, insider trading, among others (Melly, 2002).

CHAPTER 3 - RESEARCH METHODOLOGY

3.1 POPULATION OF THE STUDY

The study was cross-sectional a census was taken. The targeted institutions were the Capital Markets Authority (CMA), the Nairobi Stock Exchange (NSE), eighteen stockbrokers, one dealer and twenty-six investment advisors/fund managers.

It may have been worthwhile to also collect the opinions of the investors on this matter, but this was not possible due to the diversity of potential CIS investors, retail and institutional, inexperience with this type of instruments and the time limitation of the study. The study however assumed that the selected groups of respondents to a large extent represented their views.

The respondents were the capital market players licensed as at 31 December 2001, which constituted the NSE, CMA, stock brokers, dealer and investment advisors. The following table shows the representative sample chosen as a percentage of the total population, based on information obtained from the Capital Markets Authority annual reports and a list of licensees as at 31 December 2001. For a detailed list of these capital market players and their addresses, please see Appendix B.

Capital Market Players Licensed as at 31 December 2001	Number	Percentage of Total Population (%)
Capital Market Regulator	1	2
Securities Exchanges	1	2
Stock Brokers	18	35
Dealers	1	2
Investment Advisors/Fund Managers	26	50
Depositories	5	9
TOTAL	**52**	**100**

3.2 DATA COLLECTION

Data for this research was collected using a questionnaire (Appendix C). The questionnaire was administered personally by the researcher to Chief Executives and senior management of the capital market institutions. The questionnaire used was divided into four major parts, which are explained briefly here:

Part A – This section was designed to give the respondents the definitions used such as collective investment schemes.

Part B – This part dealt with the need for CIS as alternative investment vehicles in the Kenyan capital market. It was designed to collect data relating to the demand and marketability of CIS as alternative investment vehicles.

Part C – This section dealt with the environment for operation of CIS, including institutional, legislative and regulatory framework of investments, particularly CIS, on the Kenyan capital market.

Part D – This part dealt with the respondent's attitudes on the future of CIS in the Kenyan capital market.

Part E – This part was specifically meant for the regulator, CMA. It deals with the institutional, legislative, regulatory and supervisory issues to be addressed by the CMA as the capital markets regulator.

3.3 DATA ANALYSIS

Data was analysed using descriptive statistics such as means and percentages, indicating the perceptions of the different market players on various issues. Data was also analysed by use of comparative analysis of the responses of the different market players groups.

CHAPTER 4 – RESEARCH FINDINGS

The census included all capital market players and the responses were as follows:

Licensee	Number Responding	% of Total Responses
Regulator	1	3
Stock Exchange	1	3
Brokers	9	26
Dealers	1	3
Investment Advisors/Fund Managers	18	53
Depositories	4	12
Total	34	100

Of the design total of 52, only 34 (65.4%) usable responses were received in spite of active follow up and use of personal contacts. Several non-respondents cited 'questionnaire fatigue' and chose not to participate in the research.

4.1 OVERALL ANALYSIS

From the analysis of the responses received, it is clear that all the capital market players strongly opine there is a need for CIS in the Kenyan capital market. The same applies to the 'strongly agree' opinion given for the positive potential of the CIS in the Kenyan capital market. In the areas of the factors influencing the operation of CIS, there were varied opinions. In the case of institutional issues and regulatory and supervision issues, on the overall, it seems that most players feel the measures instituted by the CMA in the regulatory guidelines (discussed later in this paper), are suitable, although a weaker opinion is offered in the case of the general factors required for CIS to thrive in an economy.

4.2 COMPARATIVE ANALYSIS

It is important to gauge the capital market players' responses comparatively against others, to understand the areas of conflict and other matters raised.

4.2.1 Need for CIS

While nearly all the players unanimously agree on the following issues:

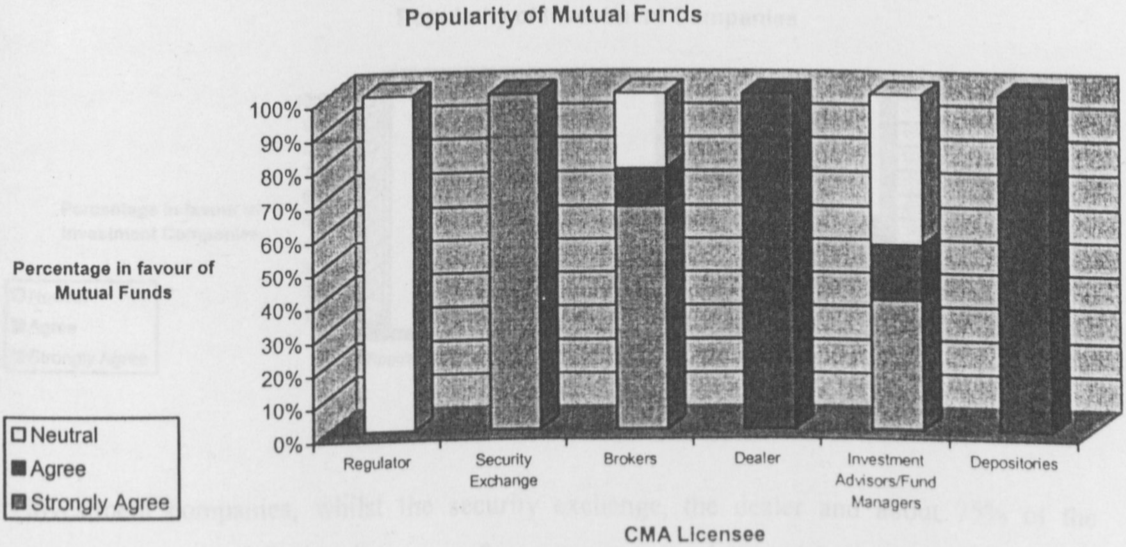
- CIS are going to be useful in broadening and deepening the Kenyan financial system
- Promotion of CIS instruments will encourage growth of the domestic investment in the Kenyan capital market
- Individual investors do not have the capacity to diversify their investment portfolios and they stand to gain from introduction of CIS

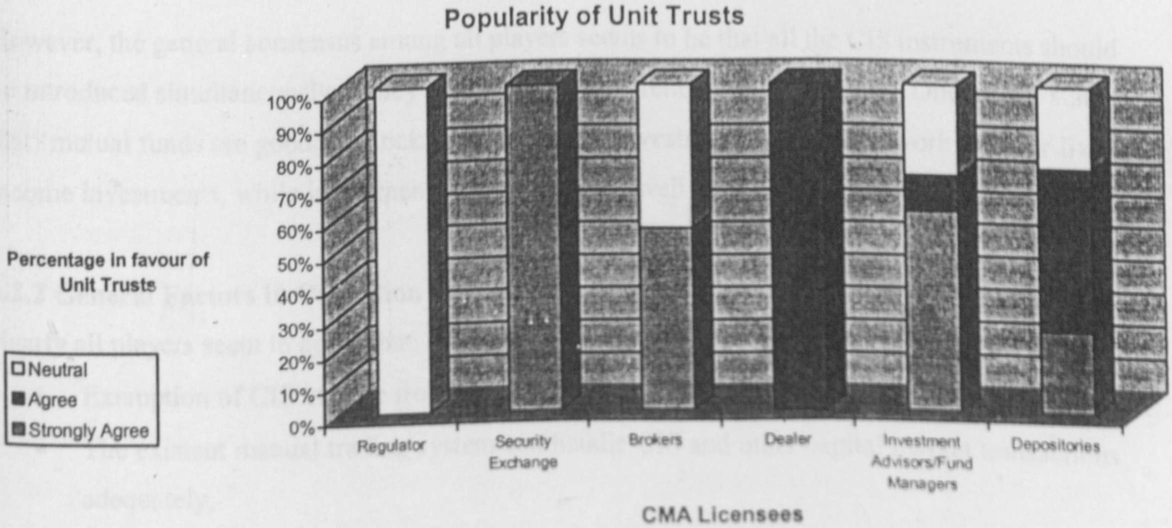
- Quick liquidation of units and shares is important to investors, and
- There is a large amount of untapped capital outside the formal financial system.

One investment advisor stated, 'Kenya is perceived as a high risk/low return (market) by foreign investors, so does not attract investment. If CIS were strictly, either, low risk/low return, medium risk/medium return or high risk/high return, funds would flow into Kenya instead of out of it. Emerging market funds overseas are always looking for investment opportunities, but Africa is often ignored'.

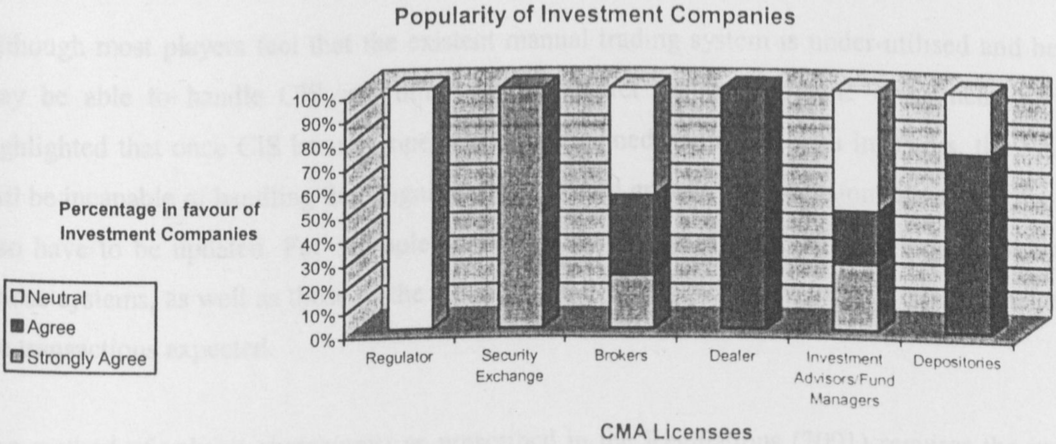
Another investment advisor stated, 'Liquidity is a key concern for investors, particularly small investors who would be the main participants in CIS. At the NSE, it has not been easy for investors to do so, making it difficult to take advantage of buy/sell opportunities in the market. Reforms by CMA and NSE are yet to bear fruit as project implementation for the trade automation and CDS programme has just started. Perhaps when the project implementation is complete, it should be possible to transact in real time'.

There does not seem to be any clear indication as to which type of CIS should be introduced before the others. Some respondents felt that an investment company already exists in our market, although this is registered under the Company's Act (Cap. 486), rather than the CMA Act, as required for CIS. However, most respondents seem not to be able to distinguish mutual funds from unit trusts. Although, they are essentially the same, unit trusts have the additional element of the Trustees and the Trust Deed.





From the above, it appears that while there is unanimous favour for mutual funds from the security exchange, dealer and depositories, the unit trusts are only favoured unanimously by the securities exchange and the dealer. The regulator declined to favour any one product over another, to reduce the likely interpretation of favouritism of one instrument at the expenses of the others. More brokers seem to favour mutual funds over unit trusts, while more investment advisers seem to favour unit trusts over mutual funds.



For investment companies, whilst the security exchange, the dealer and about 75% of the responding depositories favour them even fewer investment advisers (about 40%) favour these instruments.

However, the general consensus among all players seems to be that all the CIS instruments should be introduced simultaneously as they will appeal to different kinds of investors. One broker stated that 'mutual funds are good for stock market (shares) investments, unit trusts work well for fixed income investments, while investment companies work well with both'.

4.2.2 General Factors in Operation of CIS

Nearly all players seem to agree that:

- Exemption of CIS income from tax will encourage entry of firms into the industry,
- The existent manual trading system can handle CIS and other capital market transactions adequately,
- Information to be contained in the information memorandum is sufficient for investors to make informed decisions, and
- The timing and manner of valuation of shares/units and determination of income as prescribed are satisfactory.

Although exemption of CIS income from tax would encourage entry of firms into the industry, legislation is seen to be inflexible and unaccommodating, therefore choking initiative. An investment advisor highlighted that, 'NSE listing requirements are rather stringent. There may be a need to introduce lower market segments than exist to make it easier to get listed. This has played a large part in stifling the growth in number of listed companies'.

Although most players feel that the existent manual trading system is under-utilised and hence may be able to handle CIS and other capital market transactions, one investment advisor highlighted that once CIS become operational and gained popularity with investors, the system will be incapable of handling the magnitude of expected growth. By extension, other systems will also have to be updated. For example, custodian duties are to be handled by registered banks whose systems, as well as those of the clearinghouse (CBK), will have to be upgraded to handle the transactions expected.

The method of valuing shares/units as prescribed in the Regulations (2001) requires the use of Net Asset Value (NAV). One investment advisor agreed this to be the best method as it eliminates the bid/offer spread the can be misleading. NAV also gives a 'true' return, as the resulting figures seen are net of all charges and fees.

Consensus is however lacking on other issues particularly those relating to the existing macroeconomic environment. Most players disagreed or chose to remain neutral/undecided in response to:

- The stability and encouragement of investment by the current macroeconomic environment in the Kenyan capital market, and
- Growth of the capital market matching Kenyan economic growth.

One investment advisor stated, 'the current state of the Kenyan economy cannot allow for the development of a savings culture which is critical for the growth of CIS as viable investment avenues. A robust economy enables the development of a financial system that can address most investor concerns as well as offer opportunities for long term investment'.

The dealer stated, 'the Kenyan stock market has been in existence since 1954, and other markets have advanced yet they were established after NSE. There should be more listings and products'.

One stockbroker felt that while the economy is not growing, there is a greater problem in that the outflows out of the Kenyan economy are greater than the inflows.

The security exchange opines that transaction costs are restrictive to individual investors, although the regulator, brokers and dealer do not agree. Depositories and investment advisors remained neutral or undecided. One investment advisor stated, 'transaction costs are still quite high, compared to developed markets and this discourages investors from actively participating in the market. Regulating authorities (CMA/NSE) would therefore need to address this issue'.

4.2.3 Institutional Issues in the Operation of CIS

All the players seem to agree on the sufficiency of the following issues as per the legislation:

- Registration and approval requirements of operators, and
- Custodian, fund manager and trustee roles and capitalisation requirements.

From legislation, it is clear that the custodian and fund manager should not be related, although there is no restriction on the custodian and trustee being the same person. With regard to the fund manager, one investment advisor pointed out that there is a conflict as to the definition and roles as outlined by the CMA Act and regulation and the RBA Act. In Zimbabwe and South Africa, the fund manager is independent of the management company in order to ensure transparency, whereas Kenyan legislation the two parties have not been separated. The same investment advisor also felt the Kshs.10 million capital requirement is too low to effectively act as a barrier to entry for those wishing to obtain licenses to operate as fund managers.

The players also agree on:

- Separation of duties of the custodian, directors, fund manager and trustee will act as a check on self regulation, and
- Continuous professional education of all capital market operators will build investor confidence.

One reason highlighted by an investment advisor is, 'the field of Finance is highly dynamic and it is therefore important for all market participants to be continuously informed of new developments at the global level. This is especially important with regard to the critical role played by technology, making it possible for information to be transmitted in real time. In addition, new financial instruments keep coming up and investors need to be kept aware of them'.

However, the security exchange, brokers, investment advisors and depositories gave an overall neutral/undecided opinion to 'CIS portfolio composition as stipulated by legislation is not restrictive'. One investment advisor felt that 'greater leeway for the fund manager to take advantage of off shore opportunities as long as these are within reasonable limits. This creates diversity that in turn reduces risk. It also creates a natural hedge against currency fluctuation. Regulators need to take a more positive view that off shore investments do not mean capital flight. Various instruments may be brought to regulators for approval before fund managers invest in them.'

All the players agreed, except the security exchange that was neutral, that the manner and determination of custodian's, trustee's and fund managers as addressed by legislation is satisfactory. One investment advisor stated, 'realistically a floor and ceiling should be set for the management companies. Custodian fees ceilings are set already.'

Another investment advisor stated, 'there is need for performance rankings on an annual basis, in terms of return on funds under management, so that investors can know how well (or otherwise) their funds are being managed. The reporting should also include the top ten holdings and size of funds in each. This would help investors see what their exposure to any one industry or company (or even geographical region) is.'

4.2.4 Legal Regulatory and Supervision Issues in the Operation of CIS

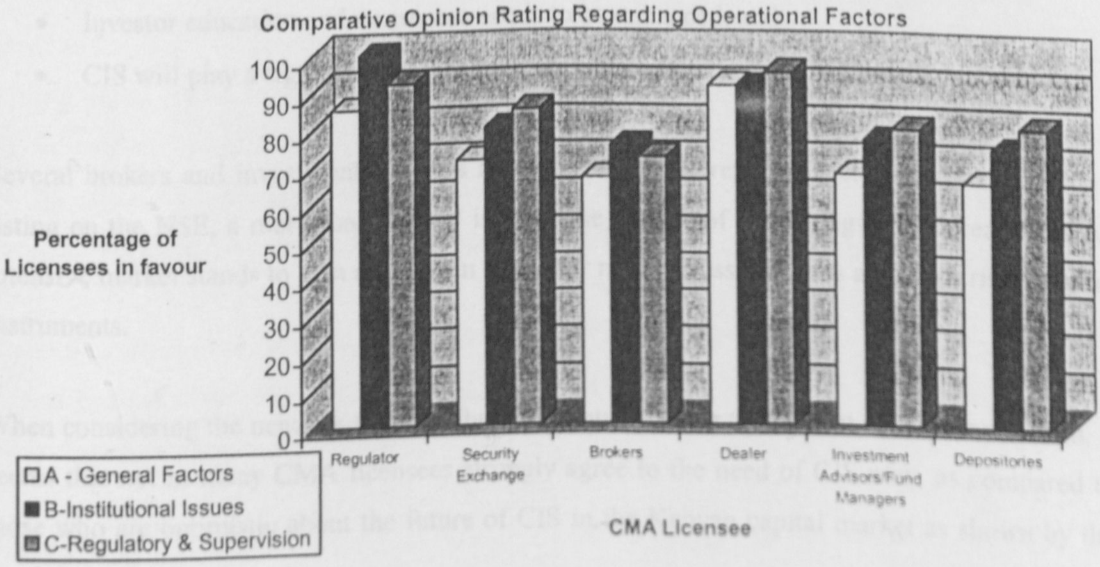
There seems to be unanimous agreement amongst the players on the following matters:

- Investor protection as provided under legislation is sufficient,
- Screening rules for entrants into the CIS industry will limit institution risk,
- Legislation clearly addresses and seeks to control compliance risk,
- The integrity and reputation of fund managers, custodians and trustees are important to investors, and
- Disclosure requirements as provided for under legislation is encompassing.

One investment advisor added, 'experience in financial services regulation indicates that regulators need to constantly keep up with participants, who always appear to be a step ahead. This explains the scenario where even highly developed markets, such as in USA, still have corporate scandals, such as the Enron and Worldcom debacles, despite the fact that USA has some of the most stringent disclosure requirements in the world. In addition, the Securities and Exchange Commission (SEC) has wide legislative powers over participants in the US stock market. This has however not stopped crafty institutions from taking advantage of loopholes to mislead investors. Regulation is therefore a continuous process and it is important that the bodies charged with this responsibility have highly competent and proficient staff. Regulation should not just stop at compliance, but also look ahead at possible loopholes that may be exploited by crafty individuals.' One broker adds that 'CMA and NSE will be required to be more innovative'.

Most players agree that there is little chance of machination between the CIS operators to the investors' detriment, although the security exchange and brokers chose to remain neutral. Unlike the other parties who agreed, the brokers also chose to remain neutral on the Capital Market Tribunal having judicial independence and competence to enforce and protect investors' rights. The regulator also clarified that the Capital Market Tribunal is charged with the responsibility of giving a hearing to those persons who have been aggrieved by any direction given by the CMA.

The security exchange opined that the current regulatory framework is too severe, while the regulator, depositories and dealer agree it is not too severe. All other players chose to remain neutral on this matter.



From the above graph, it appears that on the overall the regulator and the dealer are fairly more optimistic about the operational factors, than other licensees particularly the brokers.

It is also clear that most licensees favour the institutional factors and the regulatory and supervision factors proposed, compared with the general factors they expect should be existent in an economy before the introduction of CIS.

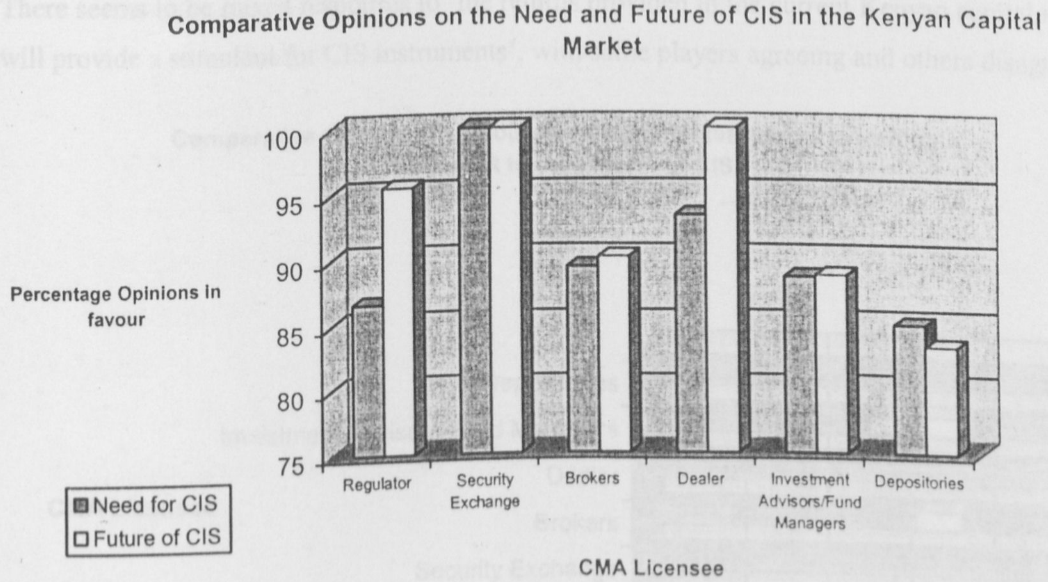
4.2.5. Future of CIS in the Kenyan Capital Market

It is important to highlight that all parties agree that:

- The government needs to create a conducive macroeconomic environment to support the development of all capital market instruments,
- There is need to increase the number of listings on the NSE to provide a well-diversified range of investment products,
- Automation of trading, clearing and settlement operations may boost trading activity and reduce costs,
- Cross border listing will provide more diversified portfolio alternatives,
- More tax incentives will need to be given to individual investors to encourage them to invest in CIS rather than directly
- Introduction of derivative instruments will provide instruments for CIS portfolio diversification,
- Investor education and awareness needs to be enhanced, and
- CIS will play a significant role in promoting economic growth in Kenya.

Several brokers and investment advisors agree that with reference to increasing the number of listing on the NSE, a more fundamental issue is the quality of the listings. Our already equity-intensive market stands to gain more from a broader range of asset classes and more risk-hedging instruments.

When considering the need for CIS and the likely future, under the current economic situation, it seems that not as many CMA licensees strongly agree to the need of CIS now, as compared to those who are optimistic about the future of CIS in the Kenyan capital market as shown by the graph below.



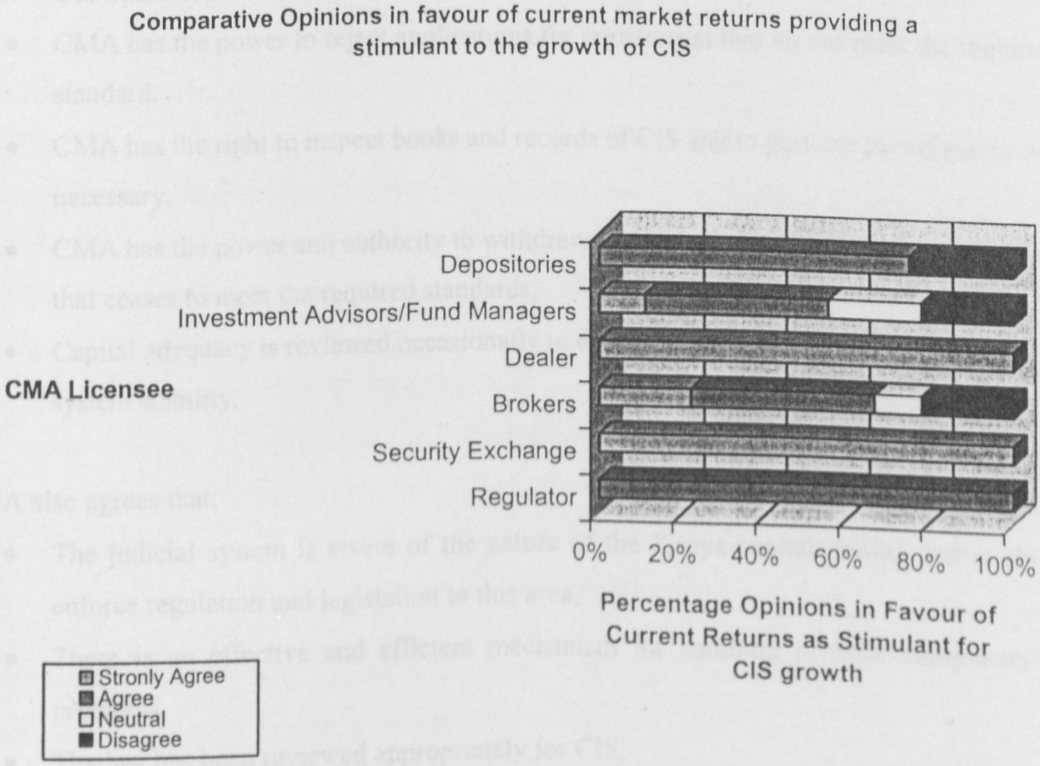
From above, it seems that the regulator and the dealer are very optimistic about the future of CIS in the Kenyan capital market, even though they may not see as great a need for CIS in the Kenyan capital market currently. All the other licensees seem to be balanced about the need for and future of CIS in the Kenyan capital market, except the depositories, more of whom see a greater need for CIS than those who perceive the optimistic future for these instruments.

Some depositories and brokers would also like the performance of central depository systems in Africa evaluated and an informed decision arrived at pertaining to the automation of trading, clearing and settlement operations.

Almost all parties seem to agree that derivatives are very risky and can be dangerous if not well understood. Investor awareness and education need to be taken on before their introduction, as potential investors may be exploited due to lack of knowledge arising from the complexities of trading in them.

One investment advisor stated, 'CMA with the help of institutions such as NSE, Institute of Economic Association and African Economic Research Consortium, would aggressively organise workshops for the public to inform them on the various market operations and their merits and demerits or functions. More investors would thus get involved in CIS.'

There seems to be mixed responses to 'the returns provided in the current Kenyan capital market will provide a stimulant for CIS instruments', with some players agreeing and others disagreeing.



Some state that they would agree for interest bearing assets, while they would disagree for equities. However, they all agree that a stable and predictable economic environment, where returns are at least as good as other developing countries will encourage foreign fund flows to Kenya. There is far more potential in attracting off shore funds than in extracting limited funds from Kenyan nationals. There are some Kenyans heavily invested off shore already, who will only repatriate funds for better returns.

4.2.6. CMA Assessment

The CMA strongly agrees with the following:

- CMA is keen to create a conducive regulatory and legislative framework support the development of all capital market instruments.
- There is need to encourage new listings on the NSE to provide a well-diversified range of investment products.
- There is a fair and expeditious process dealing with the indiscipline of capital market

licensees.

- It is not possible for promoters of a failed capital market intermediary to be licensed as CIS operators.
- CMA has the power to reject applications for registration that do not meet the required standard.
- CMA has the right to inspect books and records of CIS and to perform investigation where necessary.
- CMA has the power and authority to withdraw or suspend the licence of an intermediary that ceases to meet the required standards.
- Capital adequacy is reviewed occasionally to ensure investor protection and financial system stability.

CMA also agrees that:

- The judicial system is aware of the nature of the Kenya capital market and is able to enforce regulation and legislation in this area,
- There is an effective and efficient mechanism for handling investor complaints and problems,
- The law has been reviewed appropriately for CIS,
- There are set mechanisms for dealing with the failure of a market intermediary,

4.3 THE CAPITAL MARKETS AUTHORITY (COLLECTIVE INVESTMENT SCHEME REGULATIONS) (2001)

The Capital Markets Authority Collective Investment Schemes Regulations (2001) provide guidelines on the registration and approval of CIS, management of CIS, pricing and valuation of shares and winding up CIS among other issues.

A promoter of a proposed CIS will be required to submit an application to CMA, highlighting the legal form of the CIS (mutual fund, unit trust or investment company), the constitution, key officers, professional/business and bank references, as well as functionaries to be involved in the operation of the CIS (fund manager, administrators, investment advisors, custodians and trustees), among other issues. Incorporation documents to be lodged include particulars of the promoters, information memorandum, trust deed, management agreement, custody agreement and rules of the scheme. Once approved the CMA will issue a certificate of registration.

A fund manager is appointed to manage the daily operations of the CIS, and must hold a licence to operate as such from the CMA. A fund manager is required to maintain a paid-up share capital and unimpaired reserves of not less than Kshs.10 million for the operation of the CIS. Their key duties include advising the board of directors on the asset classes that are available for investment, formulating investment policy, investing scheme's assets, reinvesting any income not required for immediate payments, ensuring shares/units are correctly priced, publishing price of shares/units in at least two daily newspapers (at least monthly, if not dealing daily), preparing and despatching cheques, warrants, notices, accounts, summaries, declarations, offers and statements, making records and books available for inspection by trustees or board of directors and giving all explanations as required by them, among others. The fund manager is not liable for investment risk, unless this resulted due to fraudulent or negligent dealings. They are entitled to remuneration for services and to cover expenses and fees in performing duties. A fund manager shall be removed automatically as a result of involuntary liquidation or receivership, being ordered against them by a court, or by 3-month written notice from board of directors or trustees in the interest of the holders. The may also give a 3-month written notice to resign.

The trustee is required to be a bank or financial institution approved to act in that capacity by CMA, and unrelated as a holding or subsidiary company of the fund manager. In the case of a unit trust, the trustee shall cause to be kept by the fund manager, proper books of accounts and avail audited accounts and a summary of amendments annually. The trustee of a CIS also ensures the custodian takes into custody all CIS portfolio in trust for the holders, executes all documents necessary to secure acquisitions or disposals, collects any income due to be paid to the scheme and claims tax credits necessary and directs them to the custodian, keeps all records necessary for compliance with regulation, exercises voting rights, oversees the activity of the fund manager, among other duties. A trustee may give 3-month written notice of resignation to CMA and the fund manager, and the fund manager shall appoint a new trustee within two months. A trustee may be automatically removed on the involuntary liquidation or appointment of a receiver over any of its assets, or if the trustee ceases to operate as a bank or a financial institution. The trustee may also be removed by 3-month written notice by the fund manager with the approval of the CMA if the trustee fails or neglects to satisfy their duties as trustee or if the holders by extra ordinary resolution resolve that such notice be given.

The custodian is required to be a bank or financial institution approved by the CMA to act in such a capacity and unrelated in terms of holding or subsidiary company to the fund manager. A custodian shall render custodial services to the CIS pursuant of an agreement between the custodian, board of directors, fund manager or trustee. They maintain custody of the CIS portfolio; receive and keep in safe custody title documents, securities, cash; open bank accounts in the name of the CIS; transfer, exchange or deliver in the required form and manner securities hold by the custodian upon receipt of proper instructions from the fund manager, board of directors or trustee; among other duties. They also maintain books, records and statements necessary to give a complete record of the entire fund of CIS portfolio and all transaction by the custodian on behalf of the CIS. The custodian only be entitled to resign on the appointment of a new custodian and if the custodian gives a 3-month written notice to the board of directors or fund manager and the CMA. The fund manager will then appoint another custodian within 2 months, failing that, the custodian may appoint a qualified company. The custodian may also desire to retire or cease to be registered as a custodian with the CMA, and the fund manager with the approval of CMA will appoint another eligible person to be custodian. A custodian will be automatically removed in case of involuntary liquidation, appointment of a receiver over any of its assets, or on ceasing to carry on business as a bank or financial institution. A custodian may also be removed by 3-month written notice on failing or neglecting to carry out their duties satisfactorily or by the holders resolving to give notice by extra ordinary resolution.

The selling price and repurchase price quoted by the fund manager shall be based on the net asset value (NAV) of the fund. In case of unlisted securities, the valuation shall be based on methods that are fair and reasonable and acceptable to the fund manager and approved by the trustee. In the event of a suspension, in the fortnightly quotation of the securities, the valuation of such securities shall be based on other methods such as net tangible assets of the issuer of the securities and the nominal value of the securities. In addition to the selling price, the fund manager may charge a service fee as disclosed in the information memorandum and such a charge shall be disclosed separately in the application form. On redemption, the fund manager is required to pay the proceeds from redemption less redemption charges, dilution levy and any withholding taxes.

The book value of the investments of a CIS portfolio shall not exceed the following limits (this does not apply to sub-funds of an umbrella scheme):

- Securities listed on a securities exchange in Kenya - 80%
- Securities issued by the government of Kenya - 80%
- Immovable property - 25%

- Other CIS including umbrella schemes - 25%

- Any other securities not listed on a securities exchange in Kenya - 25%

- Off-shore investments - 10%

No CIS shall lend all or any part of its portfolio or guarantee or endorse liability or indebtedness of any person.

The fund manager shall appoint a qualified auditor who shall be independent of the trustee, board of directors, fund manager and custodian, their agents or associates. Every CIS shall have an annual accounting period ending 31st December, but the fund manager shall publish and submit to CMA an un-audited interim report for the half-year ending 30th June. The CIS annual report must be audited.

There are disclosure requirements in place to ensure full, accurate and timely disclosure to prospective investors, providing all the information necessary for an investor to make an informed decision in relation to the CIS. Financial data and other information relating to the management and operations of a CIS must be provided on a regular (annual or semi-annual) basis for the benefit of existing and prospective investors in the CIS. Every information memorandum shall clearly state the days when dealings in its shares shall be computed. In the event of the CIS not dealing on a daily basis, there shall be at least one regular dealing day every two weeks. Only in very exceptional circumstances can this be suspended.

A CIS shall be wound up as per the provisions of the Companies Act (Cap. 486) by court order, by extra ordinary resolution to that effect, by expiry of duration (if fixed, in incorporation documents), or on occurrence of an event of which its instrument of incorporation provides that the CIS be wound up. The consequences and manner of winding up are covered in the regulations.

Regulation provides investors with certain rights in relation to CIS:

- Fundamental right of an investor to withdraw funds from the CIS within a reasonable period,

- Enabling investors to participate in significant decisions concerning the CIS and extent applicable under the structure of the CIS, and

- CMA and NSE having the capacity to act in the interests of the investors.

In addition to normal access to legal procedures in the courts the investors should be able to refer matters to the CMA for consideration. The CMA has powers of investigation, means to review investment managers and adequate powers to enforce its decisions on the fund manager and on the custodian, in order to protect investor's interests. Any dispute or difference which may arise between the holders, fund manager, trustee or the board of directors, custodian and others shall be referred to the Capital Markets Tribunal, established under Section 35A of the CMA Act (Cap. 485a).

CHAPTER 5 – SUMMARY OF FINDINGS, CONCLUSIONS, LIMITATIONS, SUGGESTIONS FOR FURTHER RESEARCH AND RECOMMENDATIONS TO POLICYMAKERS

5.1 SUMMARY OF FINDINGS AND CONCLUSIONS

The capital market plays an important role in the Kenyan economy, although it has been plagued by economic recession and low effective demand in recent years. The introduction of CIS instruments will no doubt, if marketed properly to the right target market, boost the level of trading at the NSE, and enhance the demand for financial assets and economic growth.

The market players comprising, the regulator, the security exchange, the dealer, the brokers, the investment advisors/fund manager and the depositories, having been selected as a representative sample of the Kenyan investors, expressed their opinions on the institutional, legislative, regulatory and supervisory framework of CIS. They were also considered better placed by virtue of their experience with other capital market instruments, and because they will be involved in the operation of CIS. Their opinions have been analysed above.

The CMA has taken steps in developing and gazetting the rules for the creation, listing and transaction, supervision and regulation of CIS instruments, save for the few conflicts yet to be resolved. They have also commenced licensing qualified professionals interested in operating CIS. There is also a great sense of optimism, following the political transition, in the recovery of the economy and the expected economic growth.

However, CMA is still yet to integrate technologies and automate trading on the Kenyan bourse, which will enhance trading in CIS instruments. Manual trading systems are operational but inefficient and this may shrink the number of transactions that are expected with the introduction of CIS, therefore the urgent need to put in place an operational CDS.

On the other hand, investor education has not been undertaken aggressively meaning that the target audience for these instruments is not aware of their existence. Such education and awareness creation would also increase investor confidence, as well as develop a savings culture. The investor education would also encourage demand for these products, which would be sustainable into the future periods, and would have a direct effect on economic growth.

On the overall, it appears that there is consensus among the respondents, that the institutional, legislative, regulatory and supervisory factors would be capable of supporting CIS operations. This would also mean that they are optimistic regarding the future of Collective Investment Schemes in the Kenyan capital market.

5.2 LIMITATIONS OF THE STUDY

This study was a cross-sectional census of capital market players, who were considered a representative sample of the potential CIS investors, retail and institutional, who vary in terms of experience with this kind of product. There was also a limitation on the time for the study, which would have greatly restricted collection of the opinions of the potential CIS investors.

Of the 52 capital market players approached, only 34 (65.4%) responded by means of the questionnaire. This was in spite of aggressive follow up via telephone and personal visits, as well as use of personal contacts. Several players cited 'questionnaire fatigue' and declined to participate in this particular research. Three players could not be located and seemed to have ceased operations.

Considering CIS have just been recently introduced in the Kenyan capital market, there were some players who were not familiar with this instruments and their mode of operations. There were also some who were not familiar with the rules and regulations as tabled by the CMA.

With the recent introduction of CIS in the Kenyan capital market, it also means that there are very few local publications that have dealt with CIS. This has meant that we have had to rely more on foreign publications to give a background understanding of the environment that fosters CIS operations.

5.3 RECOMMENDATIONS TO POLICYMAKERS

In many studies involving the Kenyan capital market, a recurring theme is the low level of awareness of what is available in the market. Investors then fail to take advantage of more lucrative instruments in the market. It is of absolute importance that investor education is undertaken as soon as possible, to empower investors to know the different products available to them as well as their rights. It is even more important to institute a programme of continuous education for the capital market players, to enlighten them on new technologies and products around the world, as well as other operational issues.

The NSE continues to utilise the manual trading and clearing/settlements system, although the introduction of the CDS had been targeted for completion in 2002. The manual system cannot sustain significant changes in volumes traded and settled, which may greatly hamper growth in CIS trading. The NSE needs to introduce the CDS as soon as possible as it will be key to promoting trading in itself, which is expected to grow very soon, owing to the optimism in the growth of the Kenyan economy, following the political transition.

There is also a need to sort out in these early stages any conflicts in existing legislation, such as that between the Capital Markets Authority (Collective Investment Schemes Regulations) and the Retirement Benefits Authority Act, regarding Trustees. These may become more complicated once CIS are fully operational.

5.4 SUGGESTIONS FOR FURTHER RESEARCH

Capital markets are an important part of the financial system, providing efficient delivery mechanisms for savings mobilisation and allocation, risk and liquidity management and corporate governance (World Bank Institute, 2001). It would be useful for a survey to be carried out amongst individuals from all walks of life and corporate bodies in Kenya, in order to obtain their opinions on the capital market in Kenya, and whether it is accessible for savings mobilisation and allocation as well as providing mechanisms for risk and liquidity management.

Once CIS are fully operational, it may be useful to gauge all capital market instruments and assess their contribution to economic growth, on the overall and comparatively over time. This information would be useful to examine the role the capital market as a whole and that of its instruments.

It was earlier highlighted that the preferred forms of investment for households in other counties are insurance, CIS and retirement funds. A study into how applicable this is among the Kenyan households would be helpful in gauging the awareness and demand for these products.

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APPENDIX A – REQUEST LETTER TO PARTICIPATE IN RESEARCH

WAMBUI KOGI

P. O. BOX 43640

NAIROBI, 00100

Date..............

ADDRESSEE

Dear Sir/Madam,

RE: REQUEST TO PARICIPATE IN A RESEARCH ON THE FUTURE OF COLLECTIVE INVESTMENT SCHEMES (CIS) IN KENYA

I am a final year student at the University of Nairobi, pursuing a Master of Business Administration degree, with Finance major. As part of the requirements of this degree, I am required to carry out research on an approved research topic such as the above, and present my findings to the Faculty Board for the final approval.

I enclose a questionnaire for your kind attention and will appreciate your views on the future of CIS in Kenya.

This research will be useful to the regulator, capital market players and investors because it will point out the factors that are considered necessary for operation of CIS, as well those which may hinder the growth of the industry. The findings of the research will be strictly used for academic purposes only. Your views will also be treated with utmost confidentiality and views of individual respondents will not be mentioned without their written consent.

If you require clarification on any part of the questionnaire please do not hesitate to contact me on telephone numbers (02) 2710672, 2715160 or 2719936, during office hours. Once you have completed the questionnaire, please return it to me using the above address (a self addressed envelope is enclosed) or simply call me and I will arrange to collect it from your office.

Thanking you for your kind attention.

Yours faithfully

Wambui Kogi

Enc.

Appendix B

LIST OF CMA LICENCEES AS AT 31 DECEMBER 2001

Licensee	Licensed as	Address	Location
1. Capital Markets Authority	Capital Market Regulator	P. O. Box	Nairobi
2. Nairobi Stock Exchange	Securities Exchange	P. O. Box 43633	Nairobi
3. Ashbhu Securities Ltd.	Stock Broker	P. O. Box 41684	Nairobi
4. Crossfields Securities Ltd.	Stock Broker	P. O. Box 34137	Nairobi
5. Discount Securities Ltd.	Stock Broker	P. O. Box 42489	Nairobi
6. Dyer & Blair Ltd.	Stock Broker	P. O. Box 45396	Nairobi
7. Equity Stockbrokers Ltd.	Stock Broker	P. O. Box 47198	Nairobi
8. Faida Securities Ltd.	Stock Broker	P. O. Box 45236	Nairobi
9. Francis Drummond & Co. Ltd.	Stock Broker	P. O. Box 45465	Nairobi
10. Francis Thuo & Partners Ltd.	Stock Broker	P. O. Box 46524	Nairobi
11. Hak Securities Ltd.	Stock Broker	P. O. Box 43676	Nairobi
12. Kenya Wide Securities Ltd.	Stock Broker	P. O. Box 43858	Nairobi
13. Kestrel Capital (EA) Ltd.	Stock Broker	P. O. Box 40005	Nairobi
14. Ngenye Kariuki & co. Ltd.	Stock Broker	P. O. Box 12185	Nairobi
15. Nyaga Stockbrokers Ltd.	Stock Broker	P. O. Box 41868	Nairobi
16. Reliable Securities Ltd.	Stock Broker	P. O. Box 50338	Nairobi
17. Shah Munge&	Stock Broker	P. O. Box 14686	Nairobi

Partners Ltd.			
18. Solid Investment Securities Ltd.	Stock Broker	P. O. Box 43046	Nairobi
19. Standard Stocks Ltd.	Stock Broker	P. O. Box 13714	Nairobi
20. Suntra Stocks Ltd.	Stock Broker	P. O. Box 74016	Nairobi
21. CFC Financial Services Ltd.	Dealer	P. O. Box 44074	Nairobi
22. ABN Amro Investment Services Ltd.	Investment Adviser/ Fund Manager	P. O. Box 30262	Nairobi
23. AIG Global Investment Co. (EA) Ltd.	Investment Adviser/ Fund Manager	P. O. Box 67262	Nairobi
24. Barclays Bank of Kenya Ltd.	Investment Adviser/ Fund Manager	P. O. Box 30120	Nairobi
25. Barclaytrust Investment Services Ltd.	Investment Adviser/ Fund Manager	P. O. Box 30356	Nairobi
26. Bridges Capital Ltd.	Investment Adviser/ Fund Manager	P. O. Box 62341	Nairobi
27. CBA Capital Ltd.	Investment Adviser/ Fund Manager	P. O. Box 30437	Nairobi
28. CFC Financial Services Ltd.	Investment Adviser/ Fund Manager	P. O. Box 44074	Nairobi
29. Citibank, NA	Investment Adviser/ Fund Manager	P. O. Box 30711	Nairobi
30. Cititrust	Investment Adviser/ Fund Manager	P. O. Box 30711	Nairobi
31. Co-optrust Investment Services Ltd.	Investment Adviser/ Fund Manager	P. O. Box 48231	Nairobi
32. Co-operative Merchant Bank Ltd.	Investment Adviser/ Fund Manager	P. O. Box 48231	Nairobi
33. Creative Finance and Provident Services Ltd.	Investment Adviser/ Fund Manager	P. O. Box 57312	Nairobi
34. Dry Associated Ltd.	Investment Adviser/ Fund Manager	P. O. Box 20541	Nairobi
35. First Africa Capital Ltd.	Investment Adviser/ Fund Manager	P. O. Box 56179	Nairobi
36. First American Bank Ltd.	Investment Adviser/ Fund Manager	P. O. Box 30691	Nairobi
37. Genesis Kenya	Investment Adviser/	P. O. Box 79217	Nairobi

Investment Management Ltd.	Fund Manager		
38. ICEA Investment Services Ltd.	Investment Adviser/ Fund Manager	P. O. Box 46143	Nairobi
39. Kenya Capital Partners Ltd.	Investment Adviser/ Fund Manager	P. O. Box 43233	Nairobi
40. Loita Asset Management Ltd.	Investment Adviser/ Fund Manager	P. O. Box 39466	Nairobi
41. Natbank Trustee and investment Services Ltd.	Investment Adviser/ Fund Manager	P. O. Box 72866	Nairobi
42. Old Mutual Asset Managers (K) Ltd.	Investment Adviser/ Fund Manager	P. O. Box 11589	Nairobi
43. Professional Investment Consultants Ltd.	Investment Adviser/ Fund Manager	P. O. Box 30847	Nairobi
44. Stanbic Investment Management Services Ltd.	Investment Adviser/ Fund Manager	P. O. Box 30550	Nairobi
45. Tradition Security (K) Ltd.	Investment Adviser/ Fund Manager	P. O. Box 49584	Nairobi
46. Venture Capital Investment Management Ltd.	Investment Adviser/ Fund Manager	P. O. Box 62213	Nairobi
47. Zimele Asset Management Co. Ltd.	Investment Adviser/ Fund Manager	P. O. Box 76528	Nairobi
48. Barclays Advisory & Registrar Services	Depositories	P. O. Box 30120	Nairobi
49. Barclaytrust Investment Services	Depositories	P. O. Box 30356	Nairobi
50. Kenya Commercial Bank Ltd.	Depositories	P. O. Box 48400	Nairobi
51. National Bank of Kenya Ltd.	Depositories	P. O. Box 72866	Nairobi
52. Stanbic Bank of Kenya Ltd.	Depositories	P. O. Box 30550	Nairobi

Appendix C - THE FUTURE OF COLLECTIVE INVESTMENT SCHEMES IN THE KENYAN CAPITAL MAKETS.

ORGANISATION……………………………………………………………………

LICENSED AS……………………………………………………………………

POSTAL ADDRESS………………………………………………………………

NAME OF OFFICER………………………………………………………………

POSITION OF OFFICER…………………………………………………………

PART A

The purpose of this section is to provide the respondent with explanations and definitions of some terminology, which may be necessary to assist the respondent in answering the questions given. These definitions include the following:

Collective Investment Schemes (CIS) - Although collective investment vehicles (CIS) may have different structures, they can all be generally defined as devices for pooling and investing the funds of investors in a wide variety of securities and other financial assets to meet their investment objectives.

Compliance Risk – the risk that the operator of the scheme will fail to comply with rules governing the scheme or will act dishonestly or fraudulently

Institution Risk – the risk that the institution that operates the scheme will collapse.

Regulation - the prudential guidelines and directives issued by the regulatory authority (Capital Markets Authority) to the institutions it is mandated to regulate and are intended to define the standards of conduct considered necessary to promote best practices and to protect the industry from opportunistic and other practices which are likely to erode public confidence in it.

Supervision - the systems and measures designed to monitor and enforce compliance with regulatory provisions.

Part B

Listed below are statements dealing with the need for CIS in the Kenyan capital market. Please tick the appropriate box below. There are no right or wrong answers. The scaling is from 1 to 5, with 1 representing strongly disagree and 5 representing strongly agree.

	Strongly agree	Agree	Neutral or Undecided	Disagree	Strongly Disagree
1. CIS are going to be useful in broadening and deepening the Kenyan financial system.	5	4	3	2	1
2. Promotion of CIS instruments will encourage the growth of domestic investment in the Kenyan capital market.	5	4	3	2	1
3. Individual investors will greatly benefit from the introduction of CIS.	5	4	3	2	1
4. Most individual investors do not have the capacity to diversify their investment portfolios.	5	4	3	2	1
5. Quick liquidation of units and shares is important to investors.	5	4	3	2	1
6. There is a large amount of untapped capital outside the formal financial system.	5	4	3	2	1
Please indicate which one of the following types of CIS you feel should be introduced first:					
7. Mutual funds	5	4	3	2	1
8. Unit trusts	5	4	3	2	1
9. Investment companies	5	4	3	2	1

Please give reasons to support your answers for Nos. 7-9:

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Please list any other pertinent issues that may not have been covered above:

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Part C

This section aims at examining the Kenyan capital market players' attitudes concerning the factors that ensure a conducive environment for the operation of CIS, with reference to the Capital Markets Authority (Collective Investment Scheme) Regulations and other applicable legislation. Please tick the appropriate box below. There are no right or wrong answers. The scaling is from 1 to 5, with 1 representing strongly disagree and 5 representing strongly agree.

A) General Factors in Operation of CIS

	Strongly agree	Agree	Neutral or Undecided	Disagree	Strongly Disagree
1. The exemption of CIS income from tax will encourage entry of firms into this industry.	5	4	3	2	1
2. The current macroeconomic environment is stable, encouraging investment in the Kenyan capital market.	5	4	3	2	1
3. Capital market growth matches Kenyan economic growth.	5	4	3	2	1
4. The existent manual trading system is capable of handling CIS and other capital market transactions.	5	4	3	2	1
5. Charges imposed on issue and redemption of shares and units are not restrictive for the individual investor.	5	4	3	2	1
6. Information to be contained in the information memorandum is sufficient for investors to make informed decisions.	5	4	3	2	1
7. The timing and manner of valuation of shares/units and determination of income, as prescribed are satisfactory.	5	4	3	2	1

Please list any other pertinent issues that may not have been covered above:

B) Institutional Issues in the Operation of CIS

	Strongly agree	Agree	Neutral or Undecided	Disagree	Strongly Disagree
1. Registration and approval requirements of the custodian, trustee and fund manager's of CIS are clearly outlined in legislation.	5	4	3	2	1
2. CIS portfolio composition as stipulated by legislation is not restrictive.	5	4	3	2	1
3. Custodian's role in CIS is clearly defined and does not conflict with existing legislation.	5	4	3	2	1
4. Fund Manager's role in CIS is clearly defined and does not conflict with existing legislation.	5	4	3	2	1
5. Trustee's role in CIS is clearly defined and does not conflict with existing legislation.	5	4	3	2	1
6. The level of capitalisation of fund managers, custodians and trustees will be adequate to support their level of activity.	5	4	3	2	1
7. The manner of determination of custodian's, trustee's and fund manager's remuneration is satisfactory.	5	4	3	2	1
8. The separation of duties of the custodian, directors, fund manager and trustee will act as a check on self-regulation.	5	4	3	2	1
9. Continuous professional education of all capital market operators will build investor confidence.	5	4	3	2	1

Please list any other pertinent issues that may not have been covered above:

C) Legal, Regulatory and Supervision Issues in the Operation of CIS

	Strongly agree	Agree	Neutral or Undecided	Disagree	Strongly Disagree
1. Investor protection as provided under the various laws is sufficient.	5	4	3	2	1
2. Screening rules for entrants into the CIS industry will limit institution risk.	5	4	3	2	1
3. Legislation clearly addresses and seeks to control compliance risk.	5	4	3	2	1
4. The integrity and reputation of fund managers, custodians and trustees are important to investors.	5	4	3	2	1
5. Disclosure requirements as provided for under the various legislation is encompassing.	5	4	3	2	1
6. There is little chance of machination between the custodian, trustee, board of directors and fund manager, to the investors' detriment.	5	4	3	2	1
7. The Capital Market Tribunal will have the judicially independent and competent to enforce and protect investors rights.	5	4	3	2	1
8. The current regulatory framework is not too severe.	5	4	3	2	1

Please list any other pertinent issues that may not have been covered above:

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Part D

Listed below are statements referring to the future of CIS in the Kenyan capital market. Please tick the appropriate box below. There are no right or wrong answers. The scaling is from 1 to 5, with 1 representing strongly disagree and 5 representing strongly agree.

	Strongly agree	Agree	Neutral or Undecided	Disagree	Strongly Disagree
1. The government needs to create a conducive macroeconomic environment to support the development of all capital market instruments.	5	4	3	2	1
2. There is need to increase the number of listings on the NSE to provide a well-diversified range of investment products.	5	4	3	2	1
3. Automation of trading, clearing and settlement operations may boost trading activity and reduce costs.	5	4	3	2	1
4. Cross border listing will provide more diversified portfolio alternatives.	5	4	3	2	1
5. More tax incentives will need to be given to individual investors to encourage them to invest in CIS rather than directly.	5	4	3	2	1
6. The introduction of derivative instrument will provide instruments for CIS portfolio diversification.	5	4	3	2	1
7. Investor education and awareness needs to be enhanced.	5	4	3	2	1
8. CIS will play a significant role in promoting economic growth in Kenya.	5	4	3	2	1
9. The returns provided in the current Kenyan capital market, will provide a stimulant for CIS .	5	4	3	2	1

Please list any other pertinent issues that may not have been covered above:

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Part E

Listed below are statements referring to institutional, regulatory and supervisory issues to be addressed by the CMA. Please tick the appropriate box below. There are no right or wrong answers. The scaling is from 1 to 5, with 1 representing strongly disagree and 5 representing strongly agree.

	Strongly agree	Agree	Neutral or Undecided	Disagree	Strongly Disagree
1. CMA is keen to create a conducive regulatory and legislative framework support the development of all capital market instruments.	5	4	3	2	1
2. There is need to encourage new listings on the NSE to provide a well-diversified range of investment products.	5	4	3	2	1
3. The judicial system is aware of the nature of the Kenya capital market and is able to enforce regulation and legislation in this area.	5	4	3	2	1
4. There is an effective and efficient mechanism for handling investor complaints and problems.	5	4	3	2	1
5. There is a fair and expeditious process dealing with the indiscipline of capital market licensees.	5	4	3	2	1
6. It is not possible for promoters of a failed capital market intermediary to be licensed as CIS operators.	5	4	3	2	1
7. CMA has the power to reject applications for registration that do not meet the required standard.					
8. CMA has the right to inspect book and records of CIS and to perform investigation where necessary.	5	4	3	2	1
9. The law has been reviewed appropriately for CIS.	5	4	3	2	1

10. There are set mechanisms for dealing with the failure of a market intermediary.	5	4	3	2	1
11. CMA has the power an authority to withdraw or suspend the licence of an intermediary that ceases to meet the required standards.	5	4	3	2	1
12. Capital adequacy is reviewed occasionally to ensure investor protection and financial system stability.	5	4	3	2	1

Please list any other pertinent issues that may not have been covered above:

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APPENDIX D – RESPONDENTS RANKING TABLES

The final data presentation will be done in the form of the following tables

TABLE 1 - RANKING ON THE NEED FOR CIS IN THE KENYAN CAPITAL MARKET

	Strongly Agree	Agree	Neutral or Undecided	Disagree	Strongly Disagree
Score intervals	45-37	36-28	27-19	18-10	9

TABLE 2 - RANKING ON THE GENERAL FACTORS IN OPERATION OF CIS

	Strongly Agree	Agree	Neutral or Undecided	Disagree	Strongly Disagree
Score intervals	35-29	28-22	21-15	14-8	7

TABLE 3 - RANKING ON THE INSITITUITIONAL ISSUES IN OPERATION OF CIS

	Strongly Agree	Agree	Neutral or Undecided	Disagree	Strongly Disagree
Score intervals	45-37	36-28	27-19	18-10	9

TABLE 4 - RANKING ON THE LEGAL, REGULATORY AND SUPERVISION ISSUES IN OPERATION OF CIS

	Strongly Agree	Agree	Neutral or Undecided	Disagree	Strongly Disagree
Score intervals	40-33	32-25	24-17	16-9	8

TABLE 5 - RANKING ON THE FUTURE OF CIS IN THE KENYAN CAPITAL MARKET

	Strongly Agree	Agree	Neutral or Undecided	Disagree	Strongly Disagree
Score intervals	45-37	36-28	27-19	18-10	9

TABLE 6 - RANKING ON THE CMA ASSESSMENT OF VARIOUS ISSUES IN THE KENYAN CAPITAL MARKET

	Strongly Agree	Agree	Neutral or Undecided	Disagree	Strongly Disagree
Score intervals	60-49	48-37	36-25	24-13	12

Data Analysis - Summary

PART B – Need for CIS

No.	Name	1	2	3	4	5	6	7	8	9	T	Opinion
1	Regulator	5	5	5	5	5	5	3	3	3	39	SA
2	Security Exchange	5	5	5	5	5	5	5	5	5	45	SA
3	Brokers	5	5	5	5	5	5	4	4	4	40	SA
4	Dealer	5	5	5	5	4	5	5	5	3	42	SA
5	Investment Advisors/Fund Managers	5	5	5	4	5	5	4	4	4	40	SA
6	Depositories	5	4	4	5	4	4	4	4	4	38	SA
	Average	5	5	5	5	5	5	4	4	4	41	SA

Part C – A - General Factors

No.	Name	1	2	3	4	5	6	7	T	Opinion
1	Regulator	4	3	5	4	4	5	5	30	SA
2	Security Exchange	5	2	5	4	1	4	4	25	A
3	Brokers	4	2	3	4	4	3	4	23	A
4	Dealer	5	5	2	5	5	5	5	32	SA
5	Investment Advisors/Fund Managers	5	3	3	3	3	4	4	24	A
6	Depositories	4	2	3	3	3	4	4	23	A
	Average	4	3	3	4	3	4	4	26	A

B-Institutional Issues

No.	Name	1	2	3	4	5	6	7	8	9	T	Opinion
1	Regulator	5	5	5	5	5	5	5	5	5	45	SA
2	Security Exchange	4	3	4	4	4	4	4	4	5	36	A
3	Brokers	4	3	4	4	4	4	3	4	4	34	A
4	Dealer	5	5	5	5	5	4	4	4	4	41	SA
5	Investment Advisors/Fund Managers	4	3	4	4	4	4	4	5	5	35	A
6	Depositories	4	3	4	4	4	4	4	4	4	34	A
	Average	4	4	4	4	4	4	4	4	4	37	SA

C-Regulatory & Supervision

No.	Name	1	2	3	4	5	6	7	8	T	Opinion
1	Regulator	4	4	5	5	5	5	4	5	37	SA
2	Security Exchange	5	5	5	5	5	3	4	2	34	SA
3	Brokers	4	4	4	4	4	3	3	3	29	A
4	Dealer	5	5	5	5	5	4	4	5	38	SA
5	Investment Advisors/Fund Managers	4	4	4	5	4	4	4	3	32	A
6	Depositories	3	4	4	5	4	4	4	4	32	A
	Average	4	4	5	5	4	4	4	4	34	SA

Part D – Future of CIS

No.	Name	1	2	3	4	5	6	7	8	9	T	Opinion
1	Regulator	5	5	5	5	4	5	5	5	4	43	SA
2	Security Exchange	5	5	5	5	5	5	5	5	5	45	SA
3	Brokers	5	5	5	4	4	4	5	5	4	41	SA
4	Dealer	5	5	5	5	5	5	5	5	5	45	SA
5	Investment Advisors/Fund Managers	5	5	5	5	4	4	5	5	3	40	SA
6	Depositories	5	4	4	4	4	4	5	5	4	38	SA
	Average	5	5	5	5	4	4	5	5	4	42	SA

Part E – CMA Assessment

No.	Name	1	2	3	4	5	6	7	8	9	10	11	12	13	T	Opinion
1	Regulator	5	5	4	4	5	5	5	5	4	4	5	5	4	60	SA

Data Presentation

PART B — Need for CIS

No.	Name	1	2	3	4	5	6	7	8	9	T	Opinion
1	CMA	5	5	5	5	5	5	3	3	3	39	SA
2	NSE	5	5	5	5	5	5	5	5	5	45	SA
3	Ashbu Securities	4	3	4	3	4	4	5	5	4	36	A
4	Crossfields Securities	0	0	0	0	0	0	0	0	0	0	0
5	Discount Securities	5	5	5	4	3	3	3	3	3	34	A
6	Dyer and Blair	0	0	0	0	0	0	0	0	0	0	0
7	Equity Stock Brokers	5	5	5	5	4	5	5	5	3	42	SA
8	Faida Securities	0	0	0	0	0	0	0	0	0	0	0
9	Francis Drummond	0	0	0	0	0	0	0	0	0	0	0
10	Francis Thuo	0	0	0	0	0	0	0	0	0	0	0
11	Hak Securities	0	0	0	0	0	0	0	0	0	0	0
12	Kenya Wide Securities	5	5	5	4	5	5	5	3	3	40	SA
13	Kestrel Capital (EA)	0	0	0	0	0	0	0	0	0	0	0
14	Ngenye Kariuki & Co.	0	0	0	0	0	0	0	0	0	0	0
15	Nyaga Stockbrokers	0	0	0	0	0	0	0	0	0	0	0
16	Reliable Securities	5	5	4	5	5	5	3	3	3	38	SA
17	Shah Munge	4	4	4	5	5	5	5	5	4	41	SA
18	Solid Investment	5	5	5	5	5	5	4	3	5	42	SA
19	Standard Stocks Ltd.	5	5	5	5	5	5	5	5	5	45	SA
20	Suntra Stocks Ltd.	5	5	5	5	5	5	5	5	4	44	SA
21	CFC Financial Services	5	5	5	5	4	5	5	5	3	42	SA
22	ABN Amro	0	0	0	0	0	0	0	0	0	0	0
23	AIG Global Investment	5	4	4	5	5	4	3	3	3	36	A
24	Barclays Bank of Kenya	5	5	4	4	4	4	4	4	4	38	SA
25	Barclaytrust Investment	5	5	4	4	4	4	4	4	4	38	SA
26	Bridges Capital Ltd.	0	0	0	0	0	0	0	0	0	0	0
27	CBA Capital Ltd.	5	5	5	5	5	5	3	3	3	39	SA
28	CFC Financial Services	5	5	5	5	4	5	5	5	3	42	SA
29	Citibank NA	5	5	5	5	5	5	5	5	5	45	SA
30	Cititrust	5	5	5	5	5	5	5	5	5	45	SA
31	Co-optrust Investment	5	5	5	4	5	4	3	5	3	39	SA
32	Co-operative Merchant Bank	5	5	5	4	5	4	3	5	3	39	SA
33	Creative Finance & Provident	0	0	0	0	0	0	0	0	0	0	0
34	Dry Associates Ltd.	4	4	5	5	5	5	4	5	3	40	SA
35	First Africa Capital Ltd.	0	0	0	0	0	0	0	0	0	0	0
36	First American Bank	0	0	0	0	0	0	0	0	0	0	0
37	Genesis Kenya Investment	4	4	5	3	5	4	3	5	4	37	SA
38	ICEA Investment Services	5	5	5	5	5	5	3	3	5	41	SA
39	Kenya Capital Partners	0	0	0	0	0	0	0	0	0	0	0
40	Loita Asset Management	4	4	3	4	4	5	5	3	4	36	A
41	Natbank Trustee and Invest.	0	0	0	0	0	0	0	0	0	0	0
42	Old Mutual Asset Managers	5	5	5	5	5	5	5	5	5	45	SA
43	Professional Investment Cons	5	5	5	1	4	4	5	5	3	37	SA
44	Stanbic Investment Mgmt.	4	4	5	5	5	5	3	5	5	41	SA
45	Tradition Security Ltd.	5	5	5	5	4	5	3	5	3	40	SA
46	Venture Capital Investment	0	0	0	0	0	0	0	0	0	0	0
47	Zimele Asset Management Co.	5	5	5	4	5	5	5	3	3	40	SA
48	Barclays Advisory & Registry	5	4	3	5	4	4	4	3	3	35	A
49	Barclaytrust Investment Services	5	5	4	4	4	4	4	4	4	38	SA
50	Kenya Commercial Bank Ltd.	4	4	5	5	4	4	5	4	4	39	SA
51	National Bank of Kenya Ltd.	0	0	0	0	0	0	0	0	0	0	0
52	Stanbic Bank of Kenya Ltd.	4	4	5	5	5	5	3	5	5	41	SA
	Overall										40	

Part C — A - General Factors

No.	Name	1	2	3	4	5	6	7	T	Opinion
1	CMA	4	3	5	4	4	5	5	30	SA
2	NSE	5	2	5	4	1	4	4	25	A
3	Ashbu Securities	4	2	2	2	3	4	3	20	N
4	Crossfields Securities	0	0	0	0	0	0	0	0	0
5	Discount Securities	3	2	2	4	2	4	3	20	N
6	Dyer and Blair	0	0	0	0	0	0	0	0	0
7	Equity Stock Brokers	5	5	2	5	5	5	5	32	SA
8	Faida Securities	0	0	0	0	0	0	0	0	0
9	Francis Drummond	0	0	0	0	0	0	0	0	0
10	Francis Thuo	0	0	0	0	0	0	0	0	0
11	Hak Securities	0	0	0	0	0	0	0	0	0
12	Kenya Wide Securities	5	1	3	4	4	3	4	24	A
13	Kestrel Capital (EA)	0	0	0	0	0	0	0	0	0
14	Ngenye Kariuki & Co.	0	0	0	0	0	0	0	0	0
15	Nyaga Stockbrokers	0	0	0	0	0	0	0	0	0
16	Reliable Securities	4	2	2	4	4	4	4	24	A
17	Shah Munge	4	1	4	4	2	3	2	20	N
18	Solid Investment	4	2	2	2	4	1	3	18	N
19	Standard Stocks Ltd.	4	1	2	4	4	3	4	22	A
20	Suntra Stocks Ltd.	4	3	5	4	4	4	5	29	SA
21	CFC Financial Services	5	5	2	5	5	5	5	32	SA
22	ABN Amro	0	0	0	0	0	0	0	0	0
23	AIG Global Investment	5	1	2	2	4	4	4	22	A
24	Barclays Bank of Kenya	4	3	3	3	3	4	4	24	A
25	Barclaytrust Investment	4	3	3	3	3	4	4	24	A
26	Bridges Capital Ltd.	0	0	0	0	0	0	0	0	0
27	CBA Capital Ltd.	4	3	3	4	2	2	3	21	N
28	CFC Financial Services	5	5	2	5	5	5	5	32	SA
29	Citibank NA	5	4	2	1	1	4	5	22	A
30	Cititrust	5	4	2	1	1	4	5	22	A
31	Co-optrust Investment	4	4	3	4	4	5	4	28	A
32	Co-operative Merchant Bank	4	4	3	4	4	5	4	28	A
33	Creative Finance & Provident	0	0	0	0	0	0	0	0	0
34	Dry Associates Ltd.	5	4	2	3	3	4	3	24	A
35	First Africa Capital Ltd.	0	0	0	0	0	0	0	0	0
36	First American Bank	0	0	0	0	0	0	0	0	0
37	Genesis Kenya Investment	5	2	3	2	2	4	2	20	N
38	ICEA Investment Services	5	2	5	1	2	1	2	18	N
39	Kenya Capital Partners	0	0	0	0	0	0	0	0	0
40	Loita Asset Management	5	3	4	4	4	4	4	28	A
41	Natbank Trustee and Invest.	0	0	0	0	0	0	0	0	0
42	Old Mutual Asset Managers	5	2	1	2	5	5	5	25	A
43	Professional Investment Cons	5	1	5	1	1	4	4	21	N
44	Stanbic Investment Mgmt.	4	2	3	1	2	4	4	20	N
45	Tradition Security Ltd.	5	2	2	2	4	4	4	23	A
46	Venture Capital Investment	0	0	0	0	0	0	0	0	0
47	Zimele Asset Management Co.	4	4	2	2	4	4	4	24	A
48	Barclays Advisory & Registry	5	1	2	4	4	3	3	22	A
49	Barclaytrust Investment Services	4	3	3	3	3	4	4	24	A
50	Kenya Commercial Bank Ltd.	4	2	4	4	4	4	4	26	A
51	National Bank of Kenya Ltd.	0	0	0	0	0	0	0	0	0
52	Stanbic Bank of Kenya Ltd.	4	2	3	1	2	4	4	20	N
	Overall								23.9	

B-Institutional Issues

No.	Name	1	2	3	4	5	6	7	8	9	T	Opinion
1	CMA	5	5	5	5	5	5	5	5	5	45	SA
2	NSE	4	3	4	4	4	4	4	4	5	36	A
3	Ashbu Securities	4	3	4	4	4	3	3	3	4	32	A
4	Crossfields Securities	0	0	0	0	0	0	0	0	0	0	0
5	Discount Securities	5	3	4	4	4	3	3	3	2	31	A
6	Dyer and Blair	0	0	0	0	0	0	0	0	0	0	0
7	Equity Stock Brokers	5	5	5	5	5	4	4	4	4	41	SA
8	Faida Securities	0	0	0	0	0	0	0	0	0	0	0
9	Francis Drummond	0	0	0	0	0	0	0	0	0	0	0
10	Francis Thuo	0	0	0	0	0	0	0	0	0	0	0
11	Hak Securities	0	0	0	0	0	0	0	0	0	0	0
12	Kenya Wide Securities	5	4	4	4	4	5	3	5	5	39	SA
13	Kestrel Capital (EA)	0	0	0	0	0	0	0	0	0	0	0
14	Ngenye Kariuki & Co.	0	0	0	0	0	0	0	0	0	0	0
15	Nyaga Stockbrokers	0	0	0	0	0	0	0	0	0	0	0
16	Reliable Securities	4	2	4	4	4	4	3	5	5	35	A
17	Shah Munge	4	4	3	3	3	4	3	4	5	33	A
18	Solid Investment	4	3	2	2	2	4	2	4	5	28	A
19	Standard Stocks Ltd.	3	3	3	3	3	3	3	3	3	27	N
20	Suntra Stocks Ltd.	4	4	4	4	4	4	4	5	5	38	SA
21	CFC Financial Services	5	5	5	5	5	4	4	4	4	41	SA
22	ABN Amro	0	0	0	0	0	0	0	0	0	0	0
23	AIG Global Investment	4	1	3	3	3	4	3	4	4	29	A
24	Barclays Bank of Kenya	4	2	4	4	4	4	3	5	4	34	A
25	Barclaytrust Investment	4	2	4	4	4	4	3	5	4	34	A
26	Bridges Capital Ltd.	0	0	0	0	0	0	0	0	0	0	0
27	CBA Capital Ltd.	4	3	4	4	4	4	3	5	5	36	A
28	CFC Financial Services	5	5	5	5	5	4	4	4	4	41	SA
29	Citibank NA	4	2	3	3	3	4	4	4	4	31	A
30	Cititrust	4	2	3	3	3	4	4	4	4	31	A
31	Co-optrust Investment	5	2	3	3	3	4	4	5	4	33	A
32	Co-operative Merchant Bank	5	2	3	3	3	4	4	5	4	33	A
33	Creative Finance & Provident	0	0	0	0	0	0	0	0	0	0	0
34	Dry Associates Ltd.	4	2	4	4	4	3	3	4	5	33	A
35	First Africa Capital Ltd.	0	0	0	0	0	0	0	0	0	0	0
36	First American Bank	0	0	0	0	0	0	0	0	0	0	0
37	Genesis Kenya Investment	4	3	4	4	4	4	4	5	5	37	SA
38	ICEA Investment Services	5	5	5	5	5	5	5	5	5	45	SA
39	Kenya Capital Partners	0	0	0	0	0	0	0	0	0	0	0
40	Loita Asset Management	4	4	4	3	4	3	4	4	5	35	A
41	Natbank Trustee and Invest.	0	0	0	0	0	0	0	0	0	0	0
42	Old Mutual Asset Managers	5	4	4	4	4	2	4	5	5	37	SA
43	Professional Investment Cons	4	1	4	4	4	1	2	4	5	29	A
44	Stanbic Investment Mgmt.	4	3	3	4	3	3	4	4	4	32	A
45	Tradition Security Ltd.	4	4	4	5	5	4	4	4	5	39	SA
46	Venture Capital Investment	0	0	0	0	0	0	0	0	0	0	0
47	Zimele Asset Management Co.	4	2	4	4	4	4	3	5	5	35	A
48	Barclays Advisory & Registry	4	3	4	4	4	4	4	4	4	35	A
49	Barclaytrust Investment Services	4	2	4	4	4	4	3	5	4	34	A
50	Kenya Commercial Bank Ltd.	4	3	4	4	4	3	4	4	4	34	A
51	National Bank of Kenya Ltd.	0	0	0	0	0	0	0	0	0	0	0
52	Stanbic Bank of Kenya Ltd.	4	3	3	4	3	3	4	4	4	32	A
	Overall										35	

C-Regulatory & Supervision

No.	Name	1	2	3	4	5	6	7	8	T	Opinion
1	CMA	4	4	5	5	5	5	4	5	37	SA
2	NSE	5	5	5	5	5	3	4	2	34	SA
3	Ashbu Securities	3	3	3	3	3	3	3	3	24	N
4	Crossfields Securities	0	0	0	0	0	0	0	0	0	0
5	Discount Securities	3	4	3	5	3	3	3	1	25	A
6	Dyer and Blair	0	0	0	0	0	0	0	0	0	0
7	Equity Stock Brokers	5	5	5	5	5	4	4	5	38	SA
8	Faida Securities	0	0	0	0	0	0	0	0	0	0
9	Francis Drummond	0	0	0	0	0	0	0	0	0	0
10	Francis Thuo	0	0	0	0	0	0	0	0	0	0
11	Hak Securities	0	0	0	0	0	0	0	0	0	0
12	Kenya Wide Securities	4	4	5	5	4	5	2	2	31	A
13	Kestrel Capital (EA)	0	0	0	0	0	0	0	0	0	0
14	Ngenye Kariuki & Co.	0	0	0	0	0	0	0	0	0	0
15	Nyaga Stockbrokers	0	0	0	0	0	0	0	0	0	0
16	Reliable Securities	4	5	4	5	3	3	4	3	31	A
17	Shah Munge	2	4	4	4	4	3	4	4	29	A
18	Solid Investment	4	4	3	5	2	2	1	1	22	N
19	Standard Stocks Ltd.	3	3	3	3	3	3	4	3	25	A
20	Suntra Stocks Ltd.	4	4	4	5	5	4	4	4	34	SA
21	CFC Financial Services	5	5	5	5	5	4	4	5	38	SA
22	ABN Amro	0	0	0	0	0	0	0	0	0	0
23	AIG Global Investment	2	4	4	5	3	3	3	2	26	A
24	Barclays Bank of Kenya	3	4	4	5	4	4	4	4	32	A
25	Barclaytrust Investment	3	4	4	5	4	4	4	4	32	A
26	Bridges Capital Ltd.	0	0	0	0	0	0	0	0	0	0
27	CBA Capital Ltd.	3	4	4	5	3	3	3	3	28	A
28	CFC Financial Services	5	5	5	5	5	4	4	5	38	SA
29	Citibank NA	3	3	4	4	4	3	3	2	26	A
30	Cititrust	3	3	4	4	4	3	3	2	26	A
31	Co-optrust Investment	5	4	4	5	4	5	5	3	35	SA
32	Co-operative Merchant Bank	5	4	4	5	4	5	5	3	35	SA
33	Creative Finance & Provident	0	0	0	0	0	0	0	0	0	0
34	Dry Associates Ltd.	4	4	3	5	4	5	4	4	33	SA
35	First Africa Capital Ltd.	0	0	0	0	0	0	0	0	0	0
36	First American Bank	0	0	0	0	0	0	0	0	0	0
37	Genesis Kenya Investment	4	4	4	5	4	5	4	4	34	SA
38	ICEA Investment Services	3	4	4	5	5	3	3	3	30	A
39	Kenya Capital Partners	0	0	0	0	0	0	0	0	0	0
40	Loita Asset Management	4	4	4	5	5	3	3	3	31	A
41	Natbank Trustee and Invest.	0	0	0	0	0	0	0	0	0	0
42	Old Mutual Asset Managers	5	5	5	5	5	5	4	2	36	SA
43	Professional Investment Cons	4	5	4	5	4	4	5	4	35	SA
44	Stanbic Investment Mgmt.	4	3	4	4	4	4	3	3	29	A
45	Tradition Security Ltd.	4	5	4	4	3	3	3	4	30	A
46	Venture Capital Investment	0	0	0	0	0	0	0	0	0	0
47	Zimele Asset Management Co.	5	5	5	5	5	5	5	5	40	SA
48	Barclays Advisory & Registry	2	5	5	5	5	4	5	4	35	SA
49	Barclaytrust Investment Services	3	4	4	5	4	4	4	4	32	A
50	Kenya Commercial Bank Ltd.	4	4	4	5	4	4	4	4	33	SA
51	National Bank of Kenya Ltd.	0	0	0	0	0	0	0	0	0	0
52	Stanbic Bank of Kenya Ltd.	4	3	4	4	4	4	3	3	29	A
	Overall									32	

Part D — Future of CIS

No.	Name	1	2	3	4	5	6	7	8	9	T	Opinion
1	CMA	5	5	5	5	4	5	5	5	4	43	SA
2	NSE	5	5	5	5	5	5	5	5	5	45	SA
3	Ashbu Securities	5	4	4	3	2	4	5	3	4	34	A
4	Crossfields Securities	0	0	0	0	0	0	0	0	0	-	0
5	Discount Securities	5	5	5	3	5	5	5	5	3	41	SA
6	Dyer and Blair	0	0	0	0	0	0	0	0	0	-	0
7	Equity Stock Brokers	5	5	5	5	5	5	5	5	5	45	SA
8	Faida Securities	0	0	0	0	0	0	0	0	0	-	0
9	Francis Drummond	0	0	0	0	0	0	0	0	0	-	0
10	Francis Thuo	0	0	0	0	0	0	0	0	0	-	0
11	Hak Securities	0	0	0	0	0	0	0	0	0	-	0
12	Kenya Wide Securities	5	5	5	5	5	5	5	5	4	44	SA
13	Kestrel Capital (EA)	0	0	0	0	0	0	0	0	0	-	0
14	Ngenye Kariuki & Co.	0	0	0	0	0	0	0	0	0	-	0
15	Nyaga Stockbrokers	0	0	0	0	0	0	0	0	0	-	0
16	Reliable Securities	5	5	5	5	5	5	5	4	4	43	SA
17	Shah Munge	5	5	5	2	2	3	5	4	2	33	A
18	Solid Investment	5	5	5	5	3	3	5	5	4	40	SA
19	Standard Stocks Ltd.	5	5	5	5	5	5	5	5	2	42	SA
20	Suntra Stocks Ltd.	5	5	5	5	4	4	5	5	5	43	SA
21	CFC Financial Services	5	5	5	5	5	5	5	5	5	45	SA
22	ABN Amro	0	0	0	0	0	0	0	0	0	-	0
23	AIG Global Investment	5	4	4	4	4	2	4	3	2	32	A
24	Barclays Bank of Kenya	5	4	4	4	3	3	5	5	4	37	SA
25	Barclaytrust Investment	5	4	4	4	3	3	5	5	4	37	SA
26	Bridges Capital Ltd.	0	0	0	0	0	0	0	0	0	-	0
27	CBA Capital Ltd.	5	5	5	5	5	5	5	5	3	43	SA
28	CFC Financial Services	5	5	5	5	5	5	5	5	5	45	SA
29	Citibank NA	5	5	5	5	3	5	5	5	4	42	SA
30	Cititrust	5	5	5	5	3	5	5	5	4	42	SA
31	Co-optrust Investment	4	5	5	5	4	5	5	5	4	42	SA
32	Co-operative Merchant Bank	4	5	5	5	4	5	5	5	4	42	SA
33	Creative Finance & Provident	0	0	0	0	0	0	0	0	0	-	0
34	Dry Associates Ltd.	5	5	5	5	5	5	5	4	2	41	SA
35	First Africa Capital Ltd.	0	0	0	0	0	0	0	0	0	-	0
36	First American Bank	0	0	0	0	0	0	0	0	0	-	0
37	Genesis Kenya Investment	5	4	5	5	5	4	5	5	2	40	SA
38	ICEA Investment Services	5	5	5	5	5	3	5	5	5	43	SA
39	Kenya Capital Partners	0	0	0	0	0	0	0	0	0	-	0
40	Loita Asset Management	5	4	4	5	5	4	5	5	3	40	SA
41	Natbank Trustee and Invest.	0	0	0	0	0	0	0	0	0	-	0
42	Old Mutual Asset Managers	5	5	5	5	5	4	5	5	2	41	SA
43	Professional Investment Cons	5	5	5	5	3	1	5	5	3	37	SA
44	Stanbic Investment Mgmt.	5	3	4	3	3	3	5	4	4	34	A
45	Tradition Security Ltd.	5	5	5	5	4	4	4	4	3	39	SA
46	Venture Capital Investment	0	0	0	0	0	0	0	0	0	-	0
47	Zimele Asset Management Co.	5	5	5	5	5	3	5	5	4	42	SA
48	Barclays Advisory & Registry	5	5	4	4	5	4	5	5	2	39	SA
49	Barclaytrust Investment Services	5	4	4	4	3	3	5	5	4	37	SA
50	Kenya Commercial Bank Ltd.	5	5	5	4	4	4	5	4	4	40	SA
51	National Bank of Kenya Ltd.	0	0	0	0	0	0	0	0	0	-	0
52	Stanbic Bank of Kenya Ltd.	5	3	4	3	3	3	5	4	4	34	A
	Overall										40	

Part E — CMA Assessment

No.	Name	1	2	3	4	5	6	7	8	9	10	11	12	13	T	Opinion
1	CMA	5	5	4	4	5	5	5	5	4	4	5	5	4	60	SA