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DISCLOSURE PROBLEM IN SECURITIES REGULATION IN KENYA

BY: DICKSON MORARA OMOKE

REG. NO: G62/75852/2014

SUPERVISOR: MR RICHARD KARIUKI

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DECLARATION

I, **DICKSON MORARA OMOKE**, do hereby declare that this thesis is my original work submitted in partial fulfilment of the Masters of Laws (LL. M) at the University of Nairobi, School of Law (Parklands Campus); and has not been submitted or is not pending submission for a diploma, degree or PhD in any other university. Moreover, references made to texts, articles, papers and journals, and other pertinent materials, have been fully acknowledged.

Signature………………………………………………….**Date**………………………………………

DICKSON OMOKE MORARA

(G62/75852/2014)

This thesis has been submitted for examination with my knowledge and approval as the University of Nairobi (School of Law) supervisor.

Signature………………………………………………….**Date**………………………………………

MR. RICHARDKARIUKI

(SUPERVISOR)

DEDICATION

To the everyday Kenyan who seeks to understand the complex workings of the securities markets.

ACKNOWLEDGEMENT

I thank my supervisor, Mr. Richard Kariuki, for his resolute support, guidance and clarifications in the course of writing this research. I also wholeheartedly appreciate my research assistant, Mr. Jeffah Ombati for his critique and review of this work.

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Finance Act No 8 of 2008), Laws of Kenya

Limited Liability Companies Act (UK), 1855

Nairobi Stock Exchange Listing Manual

Statutory Law (Miscellaneous Amendments) Act, No 2 of 2002, Laws of Kenya

The Capital Markets (Securities) (Public Offers, Listing and Disclosures) Regulations 2002

The Capital Markets Guidelines on Corporate Governance Practices by Public Listed Companies in Kenya

The Companies Act, 1948 (UK)

The Companies Act, No 17 of 2015, Laws of Kenya

The Federal Securities Act of 1933 (US)

The Sarbanes-Oxley Act of 2002

US Securities Exchange Act, 1934

ACRONYMS AND ABBREVIATIONS

AGM	Annual General Meeting
CAP	Chapter
CBK	Central Bank of Kenya
CCMC	Center for Capital Markets Competitiveness (US Chamber of Commerce)
CEO	Chief Executive Officer
CMA	Capital Market Authority
IASs	International Accounting Standards
IFRSs	International Financial Reporting Standards
IPOs	Initial Public Offer
NSE	Nairobi Securities Exchange
NYSE	New York Stock Exchange
SEC	Securities and Exchange Commission (US)
UK	United Kingdom of Great Britain and Northern Ireland
UNCTAD	United Nations Conference on Trade and Development
US	United States of America

ABSTRACT

This research was premised on the notion that mandatory disclosure can hinder growth of securities markets if it is not designed and implemented appropriately. This research therefore set out to establish how the legal framework providing for mandatory disclosure can be redesigned, refined and applied suitably with a view to maximizing benefits of mandatory disclosure.

This study utilized qualitative research methodology to evaluate the successes and failures associated with the disclosure regime in Kenya. This study also used comparative methods of inquiry by considering the experiences of the US in applying the disclosure principle to securities regulation thus providing useful insights for Kenya in designing a suitable disclosure framework to achieve the economic objective of growth and development of her securities markets.

The study reveals the shortcomings of Kenya's disclosure framework and makes recommendations on how the framework can be improved to promote the development of the securities markets to meet Kenya's economic growth aspirations.

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CHAPTER ONE

INTRODUCTION

1.1 Background to the Study

Kenya's capital market has undergone significant development over the years. Currently Kenya's securities exchange, the NSE, is the largest in East and Central Africa region.[1] In Africa, the NSE ranks fourth after Nigeria, Egypt and South Africa in terms of market capitalisation.[2] Moreover, Kenya's capital market has generated over Kshs 2.4 trillion through the issue of bonds and equities in the past two decades.[3]

However, the capital market in Kenya faces numerous challenges that impede its development which if resolved can lead to realisation of its full potential. These challenges include inconsistent utilisation of the capital markets for capital mobilisation, inadequacy and non-competitiveness of key systemic infrastructure and the inappropriateness of some aspects of the regulatory framework. This study sought to examine mandatory disclosure as a potential source of problems facing Kenya's securities markets and their regulation.

This study also explored the manner in which the disclosure requirements of Kenya's securities laws can be reformed and refined into an appropriate regime that maximises benefits and minimises costs. The driving force of this study is to ultimately contribute ideas and possible solutions for improvement of Kenya's securities laws into a system that promotes and facilitates the growth of securities markets and not one that potentially constricts their growth.

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[1] Capital Markets Authority, Capital Market Master Plan 2014-2023, p. 3.
[2] *Ibid.*
[3] *Ibid.*

1.2 Background to the Problem

In the last five years, IPOs and secondary listings have been on the decline in Kenya's securities market.[4a] There were no IPOs in the NSE in 2016 and 2017.[4b] The NSE only raised KSh4.2 billion during that period through IPOs.[4c] These statistics reveal that the growth of Kenya's securities markets faces certain impediments which may be connected with the underlying regulatory framework. This study sought to examine whether mandatory disclosure is a potential impediment to the growth of Kenya's securities markets.

1.3 Statement of the Problem

Kenya's securities markets have undergone exponential growth in the past decade. However, the growth is yet to reach its optimum levels. Given that securities markets operate within a climate of regulation, the law can easily stifle their growth instead of enhancing it. This research identified disclosure requirements under Kenya's securities laws as one of the regulatory tools that potentially restrict the growth of her securities markets and set out to establish the manner in which this tool can suitably be refined and applied to maximise its benefits and minimise its costs.

1.4 Objectives of the Study

i. The study aimed at investigating the problems associated with disclosure and reporting requirements in respect of public listing and whether these problems potentially impede the growth of Kenya's securities markets.

ii. The study also explored suitable modes of applying the disclosure principle in a manner that maximises its benefits and minimises its costs so that it

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[4a] PricewaterhouseCoopers (PwC), *2017 Africa Capital Markets Watch*, March 2018 (December 07, 2018, 11:00 AM), https://www.pwc.co.za/en/assets/pdf/african-capital-markets-2018.pdf.
[4b] *Ibid.*
[4c] *Ibid.*

effectively plays the role of promoting the growth of securities markets in Kenya and does not end up producing the undesirable effect of constricting their growth.

1.5 Research Questions

This study answers the following questions:

i. What problems are occasioned by the application of mandatory disclosure to securities regulation in Kenya?
ii. What is the effect of mandatory disclosure on the growth of Kenya's securities markets?
iii. How can Kenya maximise the benefits of mandatory disclosure and minimise its costs?

1.6 Research Hypothesis

This study assumed that Kenya's approach to mandatory disclosure hinders the growth of her securities markets thus the need for adoption of an appropriate form of disclosure that promotes the development of securities markets to meet Kenya's economic growth.

1.7 Theoretical Framework

The theory of economic analysis of law was applied in this study whereby a cost-benefit analysis of the disclosure principle in securities regulation was conducted. The theory of economic analysis of law was vital in examining the purported benefits of disclosure and weighing them against the regulatory costs associated with the current disclosure regime.

Economics offers powerful and indispensable insights about the implications of alternative policy choices.[4] Through simple application of econometrics, data collection and summation, law and economics can generate useful insights for the regulatory debate.[5] In the absence of empirical testing, it is not possible to get a better grasp of how particular laws affect economic behaviour and therefore it is improper to draw broad normative conclusions on legal policy without evidence.[6]

Basic economic analysis is also provides remarkably clear lens through which the disclosure problem in securities regulation can be viewed with clarity and precision. According to this study, economic analysis of law provides an avenue by which society can evaluate the efficacy of its securities regulation and several methodologies by which those regulations can be optimised. This is because the conceptual filter provided by economics allows the debate to shift consideration to matters such as "regulatory cost-benefit analysis", "opportunity costs", "macroeconomic implications" and "efficient enforcement".[7] Since a cost-benefit analysis takes account of both costs and benefits, in assessing the "net regulatory burden" for any market jurisdiction, it is necessary to compare the incremental costs incurred less the marginal benefits realised as a result of the regulation under consideration.[8] A cost-benefit analysis entails a thorough examination of whether market freedom can be

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[4]M Trebilcock, "An Introduction to Law and Economics" (1997) 23(1) Monash University Law Review 123 at 156.
[5]K McGuinness, "Law and Economics – A Reply to Sir Anthony Mason CJ Aust" (1994) 1 Deakin Law Review 117; G Hay, "The Past, Present and Future of Law and Economics" (1996) 3 Agenda 71.
[6]S Deakin, "Law Versus Economics? Reflections on the Normative Foundations of Economic Activity" in M Richardson and G Hadfield (eds), The Second Wave of Law and Economics (1999) p 30 at 39.
[7] M Richardson, "Book Review: Economic Analysis of Law" (1993) 19 Melbourne University Law Review 481 at 482; G Hadfield, "The Second Wave of Law and Economics: Learning to Surf" in M Richardson and G Hadfield (eds), The Second Wave of Law and Economics (1999) p 50.
[8] V Goldwasser, "Current Issues in the Internationalisation of Securities Markets" (1998) 16 Company & Securities Law Journal 464 at 479.

justifiably curtailed on the basis that 'there are clear regulatory objectives and the benefits of intervention outweigh the costs.'[9]

In the regulatory reform debate, the costs of reform are often ignored or dismissed as being easily outweighed by the perceived benefits. "Analysis in terms of divergences between private and social product concentrates attention on particular deficiencies in the system and tends to nourish the belief that any measure which will remove the deficiency is necessarily desirable. It diverts attention from those other changes in the system.....inevitably associated with the corrective measure.....which may well produce more harm than the original deficiency."[10] There is a strong case for paying greater attention to both direct and indirect costs of any reform proposals.[11]

1.8 Methodology of the Study

This research utilized the qualitative method of research. The data used to prove or disprove the hypothesis of this study was extracted from a literature study of books, journals, articles, legislation and case law. Library research and internet searches were utilised in collating information. This information was useful in unpacking the history and the nature of mandatory disclosure.

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[9] Corporate Law Economic Reform Program, Fundraising: Capital Raising Initiatives to Build Enterprise and Employment (CLERP, Proposals for Reform: Paper No.2, 1997) 9 ("CLERP Fundraising"); Corporate Law Economic Reform Program, Financial Markets and Investment Products: Promoting Competition, Financial Innovation and Investment (CLERP, Proposals for Reform: Paper No. 6, 1997) 7 ("CLERP Financial Markets") p 27.

[10] R Coase, "The Problem of Social Cost" (1960) 3 Journal of Law and Economics 1 at 42-43; compare S Schwab, "Coase's Twin Towers: The Relation Between The Nature of The Firm and The Problem of Social Costs" (1993) Journal of Corporation Law 395 at 367-369; for a direct application of the Coase theorem to security market regulation see J Mulherin and J Netter, "Prices Are Property: The Organisation of Financial Exchanges from a Transaction Cost Perspective" (1991) 34 Journal of Law and Economics 591.

[11] *Id.* at 10; B Niskanen, "The Total Cost of Regulation" (1991) 14(3) Regulation 23; T Hopkins, "The Costs of Federal Regulation" (1992) 2 Journal of Regulation and Social Costs 5; Anon, "Overregulating America: Tomorrow's Economic Argument", The Economist 2 August 1996, p 17; C Sunstein, "The Cost-Benefit State" (Chicago Working Papers in Law and Economics (Second Series), University of Chicago, May 1996) p 5.

Comparative methods of inquiry were also employed by considering the experiences of the US in applying mandatory disclosure to securities regulation. This provided useful insights that Kenya can adopt for purposes of designing a suitable mode of disclosure that will lead to economic growth and development of her securities markets.

The methodology of this study was suitable in evaluating the problems that arise from the current application of mandatory disclosure to securities regulation in Kenya. The methodology adopted enabled this study to illuminate the effect of mandatory disclosure on the growth of securities in Kenya and laid a basis for various reforms.

1.9 Limitations of the Study

The scope of this study is mandatory disclosure by listed companies in Kenya. Literature on the application of mandatory disclosure in Kenya was inadequate but this challenge was addressed by reference to literature on mandatory disclosure in the US.

1.10 Literature Review

Literature on the application of mandatory disclosure in Kenya is scarce but there exists a wealth of literature on mandatory disclosure in the US. The US has enforced mandatory disclosure for about nine decades thus offering Kenya insights for proactive measures before her securities markets enter advanced stages of growth. The US experience is useful in studying the problems associated with mandatory disclosure.

Professor Stigler's classic work[12] is the core of the empirical tussle over the utility of mandatory disclosure rules. Stigler[13] is sceptical of the mandated disclosure policy of the US SEC. Stigler states that "information costs money, and no society is rich enough to get all the available information." He argues that information can be provided through many mechanisms both in the government and the private sector and that it is important to compare the costs and benefits of such information mechanisms. Professor Stigler's work is followed by a series of articles by George Benston arguing that mandatory disclosure rules provide no significant protection to investors that were not present prior to 1933.[14] The validity of the findings of Stigler and Benston have sparred a vibrant debate and analysis for decades.[15]

Kitch explores an argument put forth by law and economics scholars in the 1980s, that the purpose and effect of securities regulation is to make securities markets specifically, and capital markets generally, more efficient.[16] According to this argument, securities regulation required the production of more public information by firms than they would provide in an unregulated market.[17] This argument, Kitch observes, was built on the notion that since information is valuable to actors other than the firm itself, a regulated firm would produce more information than an unregulated firm motivated only by its own interests. The proponents of increased

[12] George J. Stigler, Public Regulation of the Securities Markets, 37 J. Bus. 117 (1964).
[13] *Id.* at 420.
[14] George J. Benston, Required Disclosure and the Stock Market: An Evaluation of the Securities Exchange Act of 1934, 63 Am. Econ. Rev. 132, 151–52 (1973); George J. Benston, The Value of the SEC's Accounting Disclosure Requirements, 44 Acct. Rev. 515, 531 (1969).
[15] Irwin Friend & Edward S. Herman, The S.E.C. Through a Glass Darkly, 37 J. Bus. 382, 402–03 (1964); Joel Seligman, The Historical Need for a Mandatory Corporate Disclosure System, 9 J. Corp. L. 1, 10–18 (1983); Merritt B. Fox, Retaining Mandatory Securities Disclosure: Why Issuer Choice is Not Investor Empowerment, 85 Va. L. Rev. 1335, 1369–93 (1999); Allen Ferrell, Mandatory Disclosure and Stock Returns: Evidence from the Over-the-Counter Market, 36 J. Legal Stud. 213, 213–16 (2007).
[16] Edmund W. Kitch, 'Regulation of the Securities Market' (1999) <http://encyclo.findlaw.com/5660book.pdf> accessed 4 October 2014.
[17] *Ibid.*

information argued that it boosts both the accuracy of securities pricing and economic decisions ultimately resulting in greater economic output.[18] Kitch criticizes this argument for assuming that more information always leads to better decisions, no matter what the information is, and ignoring the fact that the production of information itself has costs, which must be balanced against any resulting benefits. According to Kitch, there are direct administrative costs of collecting, organising and presenting mandated information.[19] A firm may not collect such information unless it is obligated by the law. In making the information public, the firm also incurs direct costs connected to the actions of competitors who will have access to the information.[19a] The risk of harm is increased the more competitively and economically relevant the information is.

Easterbrook and Fischel (1984)[20] concur with regulatory proponents that the central issue is the impact of information asymmetry on securities investors but they question whether the federal mandates of the US SEC protect investors better than alternatives such as actions at the state level against fraud, rules adopted by stock exchanges and reputational forces in the marketplace. Their analysis echoes Hayek's[21] observation that "...the method by which such knowledge can be made as widely available as possible is precisely the problem we have to answer."

[18]Easterbrook, Frank H. and Fischel, Daniel R. (1984), 'Mandatory Disclosure and the Protection of Investors', 70 Virginia Law Review, 669-715; Easterbrook, Frank H. and Fischel, Daniel R. (1991), Mandatory Disclosure', Chapter 11 of The Economic Structure of Corporate Law, Cambridge, Cambridge University Press; Gilson, Ronald J. and Kraakman, Reinier H. (1984), 'The Mechanisms of Market Efficiency', 70 Virginia Law Review, 549-644; Kahan, Marcel (1992a), 'Securities Laws and the Social Costs of 'Inaccurate' Stock Prices', 41 Duke Law Journal, 977-1044; and Langevoort, Donald C. (1985), 'Information Technology and the Structure of Securities Regulation', 98 Harvard Law Review, 747-804.
[19]Kitch, Edmund W. (1995), 'The Theory and Practice of Securities Disclosure', 61 Brooklyn Law Review, 763-887.
[19a] *Ibid.*
[20]*Id* at 18.
[21]Hayek, F.A., 1945. The Use of Knowledge in Society, American Economic Review 35, 519–530 at 522.

Zingales[22] argues that when the dissemination of proprietary information is not an issue, it is easy to make the case for mandatory disclosure given the falling clerical cost of disclosure and its great potential benefit. He acknowledges that the case is more complex when we consider the cost of disseminating proprietary information, which might hurt a firm's competitive position. He observes that in the presence of these costs, firms will not fully reveal their information. Zingales submits that if mandatory disclosure discourages investment in research and development then it is socially undesirable. He also argues that the explosion of the private equity market in the last three decades suggests that for some firms, especially small firms in research and development intensive sectors, disclosure costs are substantial. In an earlier paper,[23] he noted that this preference of businesses to remain (or return to) private has increased in recent years. He is unable to determine if this change is due to increasing disclosure costs or decreasing costs of private ownership and concludes that both aspects are likely to be a cause.

Bushee and Leuz[24] who analyse the economic consequences of a regulatory change that requires over-the-counter bulletin board firms to comply with reporting requirements under the US 1934 Securities Exchange Act, find that the imposition of disclosure requirements results in significant costs for smaller firms, forcing them off the over-the-counter bulletin board suggesting that regulation has its costs and benefits. Their study finds that newly compliant firms exhibit significant increases in

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[22]'The Future of Securities Regulation' University of Chicago Booth School of Business, NBER & CEPR' Working Paper No. 08-27 2009. <http://www.law.yale.edu/documents/pdf/cbl/Zingales_Future_Securities.pdf>accessed 23 November 2014.

[23]Zingales L., 2006, "Is the U.S. Capital Market Losing its Competitive Edge?", IGM Working Paper.

[24]Bushee, Brian J. and Leuz, Christian, "Economic Consequences of SEC Disclosure Regulation: Evidence from the OTC Bulletin Board" Journal of Accounting and Economics 39 (2005): 233-264.

liquidity, consistent with improved disclosure which reduces information asymmetry.

Mahoney[25] argues that the US SEC rules as to how and when information on securities offerings is disclosed subtly creates entry barriers that benefit the special interests of incumbent investment banks.

Stiglitz[26] considers the private provision of information to be fraught with pervasive market failures. From his information asymmetry models, he considers the SEC to be in the public interest. He infers support for SEC policies such as Regulation Fair Disclosure[27]which is aimed at fighting selective disclosure whereby issuers disclose material non-public information about the issuer or its securities to selected entities such as securities analysts or institutional investors before disclosing the information to the general public. This regulation is rooted in the idea that lack of full disclosure undermines investor confidence in the fairness of securities markets.

Gakeri delves into the role of the law in emboldening Sub-Saharan Africa's securities markets.[28] He pays specific attention to Kenya and underscores the poignant role of a legal and institutional infrastructure in the governance of securities markets and investor protection. He states that a deeper growth of securities markets is hinged on countries setting up appropriate legal and institutional regimes.

[25]Mahoney, P.G., 2001. The Political Economy of the Securities Act of 1933. Journal of Legal Studies 30, 1–31.
[26]Stiglitz, J.E., 2002. Information and Change in the Paradigm in Economics. American Economic Review 92, 460–501.
[27] See the SEC website at http://www.sec.gov/answers/regfd.htm.
[28]Jacob K. Gakeri, 'Enhancing Securities Markets in Sub-Saharan Africa: An Overview of the Legal and Institutional Arrangements in Kenya' (July 2011) 1(9)IJHSS <http://www.ijhssnet.com/journals/Vol. 1 No. 9 Special Issue July 2011/18.pdf> accessed 4 October 2014.

The literature reviewed revealed a long standing debate on the benefits and costs of disclosure in securities regulation. Proponents and opponents of disclosure have emerged with opposing views on the suitability of mandatory disclosure. There appears to be a consensus that mandatory disclosure has both a positive and negative impact on securities markets. The literature facilitated this study to conduct a critical analysis in pursuit of its objectives. However, according to this study, there is a gap in this literature because adequate efforts have not been made to measure both benefits and costs of mandatory disclosure; and the extent to which it influences the growth of securities markets. Besides, strategies for improved efficacy of mandatory disclosure are yet to be explored conclusively. This study attempted to seal these gaps through a derivation of ideas for better application of mandatory disclosure in Kenya.

1.11 Chapter Breakdown

This study contains five chapters. Chapter one begins with a background to the study. It then examines the problem statement and demarcates the scope and objectives of the study. It also identifies the research questions, the hypothesis and limitations of this study. Finally, it covers the theoretical framework, the research methodology and literature review.

Chapter two critically analyses the historical background to the disclosure principle and discusses the nature of the principle. It also examines theoretical justification of disclosure in securities regulation. This theoretical framework is then challenged by empirical research and opened to legal debate aiding an assessment of the utility of mandatory disclosure requirements. The insights gained by the criticism are used to highlight the major regulatory benefits of mandatory disclosure and the aspects requiring improvement.

Chapter three critically explores the provisions in Kenya's securities laws prescribing mandatory disclosure in order to identify the problems associated with application of this principle in its current form.

Chapter four evaluates the mandatory disclosure experiences of the US with a view to providing useful insights for Kenya. These insights can be incorporated in a more suitable approach to disclosure to enable Kenya advance her economic growth and development of her securities markets.

Chapter five contains the conclusions of the study and recommendations on how Kenya can improve the application and implementation of the mandatory disclosure in the quest for growth and development of her securities markets.

CHAPTER TWO

NATURE AND HISTORY OF DISCLOSURE

2.1 Introduction

Chapter two explores a historical background and the nature of mandatory disclosure. It also examines theoretical justification of disclosure in securities regulation. The findings of empirical research on the utility of mandatory disclosure are used to highlight its regulatory benefits and the aspects requiring improvement.

2.2 The Nature of Mandatory Disclosure

Various authors in the realm of securities law have argued that disclosure is one of the principal pillars of securities regulation,[29] and a central element for the functioning of securities markets.[30] Some authors have labelled mandatory disclosure as the most pervasive securities regulatory methodology.[31]Mandatory disclosure operates within an environment in which issuers seek capital while investors seek information about the issuer and the securities.[32]

The disclosure principle is a public policy tool in which securities regulation is geared towards provision of timely, accurate and complete information to the market.[33] Mandatory disclosure entails the provision of information which enables prospective

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[29]Jacob K. Gakeri, 'Calibrating Regulatory Disclosure in Kenya's Securities Markets: Challenges and Opportunities for Investors' (March 2014) 4(5) IJHSS <http://www.ijhssnet.com/journals/Vol_4_No_5_March_2014/14.pdf> accessed 8 December 2014; Lin-Wen Lin, Corporate Social and Environmental Disclosure in Emerging Securities Markets, N. C. J. INT'L L.& COM. REG. 1, 2 (2009); and Zohar Goshen & Gideon Parchomovsky, The Essentials of Securities Regulation, 55 DUKE L. J. 711, 711 (2006).

[30] Gakeri, *supra note* 29; Seligman, *supra note* 15.

[31]John C. Coffee, Jr., Market Failure and the Economic Case for Mandatory Disclosure System, 70 VA. L. REV. 717 (1984); Paula J. Dalley, The Use and Misuse of Disclosure as a Regulatory System, 34 FLA. ST. U. L. REV. 1089, 1089 -92 (2007).

[32] Roberta Romano, Empowering Investors: A Market Approach to Securities Regulation, 107 YALE L.J.2359, 2374 (1998).

[33] Janis Sarra, Disclosure as a Public Policy Instrument in Global Capital Markets, 42 TEX. INT'L L. J. 875, 876 (2007).

investors to make informed investment decisions on the securities offered by issuers.[34] The basic premise of mandatory disclosure is that delivering to the investing public as much quality information as possible facilitates the making of optimal investment choices.[35] This way, investors are empowered to 'personally' evaluate available investments and bear responsibility for their decisions.[36]

2.3 The History of Mandatory Disclosure

In the wake of the Great Depression and the market collapse in October 1929, Congress chose a mandatory disclosure system for purposes of regulating securities in the US.[37] The cause of the crash – although this view does not go unchallenged[38]– was a lack or delay of information which resulted to an overvaluation of the stock prices.[39] Congress imposed mandatory disclosure through the enactment of the Securities Act of 1933 and the Securities Exchange Act of 1934. The 1933 Act requires full disclosure for public offerings of securities through a registration process and the publication of prospectuses easily accessible to investors while the 1934 Act imposes periodic disclosures by all listed companies.[40] The aim was to restore investor confidence.[41] The Sarbanes-Oxley Act of 2002 was a step beyond disclosure, establishing important procedural and substantive requirements in order to protect

[34] *Id.* at 29.
[35] Friedrich Kessler, The American Securities Act and its Foreign Counterparts: A Comparative study, 44 YALE L.J. 1133, 1133 (1935).
[36] Gakeri, *supra* note 29.
[37] Cox, Hillman & Langevoort, Securities Regulation: Cases and Materials, 3 (5th ed. 2006).
[38] Posner, Economic Analysis of Law, 444 (2007).
[39] Friend & Herman, The SEC Through a Glass Darkly, 37 J. Bus. 382, 389 (1964).
[40] Kai Werner, 'Justifying Mandatory Disclosure in Contemporary US-Securities Regulation' Freilaw-Freiburg Law Students Journal Ausgabe 3/2008, p. 1.
[41] *Id.* at 2.

investors.[42] In spite of the additional safeguards under the Sarbanes-Oxley Act, disclosure remains the core feature of US securities legislation.

In the early 19th century, disclosure in the Europe was already understood and used as an alternative to merit regulation.[43] In 2002, the High Level Group of Company Law Experts in Europe prompted a new debate by advocating disclosure as an efficient regulatory tool.[44] These experts opined that disclosure is in line with a modern understanding of an ideal securities regulation framework.[45]

Kenya's applies mandatory disclosure to regulation of securities. Its origin is attributed to the British Joint Stock Companies Act, 1844 and the Limited Liability Companies Act, 1855.[46] These statutes heralded the Companies Act, 1948, an Act of the UK Parliament, which Kenya adopted in 1962. The Companies Act, 1948 mandated all registered companies to file annual returns with the Registrar of Companies. It also required public companies to send to their shareholders financial statements which give a "true and fair view" of the state of affairs and profit or loss of the company and its subsidiaries, if any.[47] The Companies Act of Kenya, 2015 mandates a wider range of disclosures than the repealed Companies Act, Chapter 486. Other statutes mandating disclosure in Kenya are the Constitution[48], the Capital

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[42]Cox, Hillman & Langevoort, Securities Regulation: Cases and Materials, 10 (5th ed. 2006).
[43]Hanno Merkt, European Company Law Reform: Struggling for a More Liberal Approach, 1 ECFR 3, 13 (2004).
[44]Werner, *supra* note 40.
[45]Report of the High Level Group of Company Law Experts on a Modern Regulatory Framework for Company Law in Europe, Brussels, 4. November 2002, 33-35.
[46] Gordon Walker, Securities Regulation, Efficient Markets and Behavioral Finance: Reclaiming the Legal Genealogy, 36 HONG KONG L. J. 481, 509 (2006); Ben Pettet, Towards a Competitive Company Law, 19 (5) COMP. L. 134, 139 (1998).
[47] See s. 152 and s. 158.
[48] Constitution of Kenya 2010, Laws of Kenya.

Markets Act;[49] and the Capital Markets (Securities) (Public Offers, Listing and Disclosures) Regulations 2002.

2.4 Policy Justifications of Disclosure

2.4.1 Rectification of Information Asymmetry and Market Failure

George A. Akerlof demonstrates the importance of information to a market.[50]According to Akerlof, markets fail if they lack sufficient information because market mechanisms are highly dependent on information. In his paper "Market for Lemons" he explains this phenomenon with the example of the purchase of a used car.[51] The owner of a car knows relatively well whether it is reliable or a "lemon" that he wants to get rid of but a potential buyer lacks this knowledge resulting in informational asymmetry.[52] As long as the buyer is not sure that he will purchase a "good" car, he will not be willing to pay the higher – although justified – price; as long as the market cannot differentiate between good and bad, it will punish this with markdowns of the price. The seller is in a dilemma as he cannot get the true value of his car, and will withdraw from the market. The result is a market failure. This has been applied in analysing capital markets.[53] It is the market that has to determine the price based on information whose dissemination to the market participants is critical.[54]

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[49] Capital Markets Act, Chapter 485A, Laws of Kenya.
[50]Werner, *supra* note 40.
[51]Akerlof, The Market for "Lemons": Quality Uncertainty and the Market Mechanism, 84 Q. J. Eco. 488, 489 (1970).
[52]*Ibid.*
[53]Werner, *supra* note 40.
[54] *Ibid.*

2.4.2 Standardisation of Information and Quicker and Efficient Dissemination

Legislation helps to more quickly and efficiently disseminate information, and thus, through collectivisation economise the costs and time. A more efficient dissemination of truthful information at a lower cost can thus be justified as producing a beneficial effect on the accuracy of market prices.[55]Disclosure also enables comparability and timely dissemination of information. Through the possibility of standardisation, a higher level of predictability can be achieved while significantly reducing the costs. Companies can provide the information at the lowest cost, and investors can easily understand and compare this information, if it is provided in a standardised manner. Uniform statements can more easily be verified and certified, enhancing confidence in their reliability.

2.4.3 Enhanced Investor Confidence and Well-being of the Economy

Disclosure emboldens investor trust and confidence in the securities market by minimising fear of exploitation and expropriation.[56] It is a cardinal precept of securities regulation that adequate flow of information about issuers enhances investor confidence. By disclosing, issuers are presumed to be giving investors equal treatment which is typically perceived as fairness.[57] This is particularly important in jurisdictions characterised by concentrated ownership such as Kenya.

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[55] Gilson & Kraakman, The Mechanisms of Market Efficiency, 70 Va. L. Rev. 549, 593 (1984).
[56] David J. Schulte, The Debatable Case for Securities Disclosure Regulation, 13 J. CORP. L. 535,539 (1988); Raymond H. Brescia, Trust in the Shadows: Law, Behaviour and Financial Regulation, 57 BUFF. L. REV. 1361(2009).
[57] Susanna Kip Ripken, The Dangers and Drawbacks of the Disclosure Antidote: Towards a more Substantive Approach to Securities Regulation, 58 BAYLOR L. REV. 139, 152-56 (2006).

The public interest approach justifies disclosure requirements for the overall health of the economy.[58] If investors lose confidence in the markets, they will withdraw their money, and the economy will stagnate. Mandatory disclosure might lead to better informed decisions, reduce the risk of investing, prevent fraud, and thus lead to enhanced investor confidence.

In a model of limited resources, Fama and Laffer assumed that investors will compete for access to information in order to exploit it for their own benefit.[59] In that model, the gain of one investor is the cost of the other as the value of the information is exploited upon use creating no benefit for the overall economy.[60] The logical consequence would be, to make as much information publicly available as possible, in order to minimize the costs the individual would have to incur.

2.4.4 Evaluation of the Risk Underlying Prospective Investments

Disclosure of information about the issuer and the securities being offered enables prospective investors to evaluate the risks of possible investments.[61] Disclosure reduces information asymmetry in the market enabling investors to access information about corporations and their securities.[62] Improved decision making

[58]J. Seligman, The Transformation of Wall Street: A History of the Securities and Exchange Commission and Modern Corporate Finance (1982).
59Fama & Laffer, Information and Capital Markets, 44 J. Bus. 289, 298 (1971); Hirshleifer, The Private and Social Value of Information and the Reward to Inventive Activity, 61 Am. Econ. Rev. 561 (1971).
[60]*Ibid.*
61 Caroline Bradley, Information Society Challenges to Financial Regulation, 37 TOL. L. REV. 307, 315 (2006).
62 Marcel Kahan, Securities Law and the Social Costs of Inaccurate Stock Prices, DUKE L. J. 977 (1992); Joel Seligman, The Obsolescence of Wall Street: A Contextual Approach to the Evolving Structure of Federal Securities Regulation, 93 MICH. L. REV. 649, 649-50 (1969).

ultimately protects investors.[63] Disclosure of information thus constitutes a robust investor protection mechanism.[64]

2.4.5 Enhancement of Corporate Governance

There is a strong likelihood that stock prices, and thus the value of a firm itself, will be bolstered by improvements in corporate governance. The pure knowledge of being under the controlling eye of the public will probably prevent bad governance decisions, and lead to better and more efficient management.[65]

Mandatory disclosure rules greatly enhance corporate governance.[66] For instance, the requirement that listed companies supply annual reports to shareholders enables them to exercise their basic individual and corporate membership rights, such as participating in annual meetings.[67] Similarly, disclosure of information touching on the interests of an issuer's senior management in an acquisition of a business by an issuer or disposal of an issuer's assets is useful to shareholders in monitoring management. Disclosure influences corporate behaviour by encouraging 'diligence, honesty and forthrightness on the part of corporate managers while....act[ing] as a deterrence mechanism'.[68] It deters corporate insiders from engaging in fraudulent or corrupt behaviour or mismanagement. Thus, disclosure plays an important role in

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63 Iris H-Y Chiu, The Role of Disclosure Regulation in Investor Protection Relating to Corporate Insolvency: Some Observations on the US, EU and UK Regulatory Frameworks, 29(2) COMP. L. 35, 35-36 (2008).
64 Arthur R. Pinto, The Nature of the Capital Markets Allows a Greater Role for the Government, 55 BROOK L. REV. 77 (1989); Troy A. Paredes, Blinded by the Light: Information Overload and its Consequences for Securities Regulation, 81 WASH. U. L. Q. 417, 417 (2003); Donald Langevoort, Ego, Human Behavior and Law, 81 VA. L. REV 853 (1998).
65Langevoort, Organized Illusions: A behavioral Theory on why Corporations Misled Stock Market Prices (and Caused Other Social Harms), 146 U. Pa. L. Rev. 101 (1997); and Fox, Required Disclosure and Corp. Governance, 710, in: Corp. Governance, K. J. Hopt ed. (2005).
66 Hans Tjio, Enforcing Corporate Disclosure, SING. J. LEGAL STUD. 332 (2009); Allen Ferrell, Measuring the Effects of Mandated Disclosure 1 BERKELEY BUS L. J. 369, 383 (2004); Merritt B. Fox, Rethinking Disclosure Liability in the Modern Era, 75 WASH. U. L. Q. 903 (1997).
67Gakeri, *supra* note 29.
68 *Ibid.*

dealing with the agency problem. It has been shown that disclosure developed as a mechanism to control agency problems associated with promoters and company managers.[69]

2.4.6 Improvement of Transparency and Price Accuracy

Studies have shown that disclosure is fairly central in improving transparency and price accuracy. Improving the price-setting function of the market determines its resource allocative efficiency.[70] Increased share price accuracy improves the selection of new investment projects in the economy.[71] Additionally, price accuracy promotes fairness and reduces uncertainty because investors pay what the securities are worth.[72] This enhances investor confidence in the markets.[73] Apart from acting as an instrument of corporate control, it also, monitors and controls the management's agency problem.

2.4.7 Balancing between Positive and Negative Information

Since disclosure involves positive and negative information, listed corporations are typically inclined to disclose positive information while reluctant to disclose negative information. Mandatory disclosure handily compels them to also disclose negative information.

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[69]Paul G. Mahoney, Mandatory Disclosure as a Solution to Agency Problem, 62 U. CHI. L. REV. 1047, 1054-1065 (1995).

[70] See generally Edmund W. Kitch, The Theory and Practice of Securities Disclosure, 61 BROOK. L. REV. 763 (1995); Mitu Gulati, When Corporate Managers Fear that a Good Thing is Coming to an end: The Case for Interim Disclosure, 46 UCLA.L. REV. 675, 705 (1999); Ronald J. Gilson Id n. 18; Coffee, *supra* note 31.

[71] Ferrel, *supra* note 65.

[72] Merritt B. Fox et al., Law, Share Price Accuracy and Economic Performance: The New Evidence,102 MICH. L. REV. 331 335-6 (2003).

[73]Iris H-Y Chiu, Examining the Justifications for Mandatory ongoing Disclosure in Securities Regulation, 26(3) COMP. L. 67 (2005).

2.4.8 Enhancing Investor Awareness

Disclosure enhances investor knowledge and skill to access and optimise value from the securities market.[74] For example, it leads to investor awareness which improves decision making.[75] It also offers unsophisticated investors much needed protection.[76]

2.5 Theories against Mandatory Disclosure

There are theories stating that the mandatory corporate disclosure system is unnecessary because managers will have sufficient incentives to voluntarily disclose all information of interest to the market. In order to get access to the capital markets, issuers will have to satisfy the informational needs of investors, who will ask for certain information before investing their money.[77] As there are limited funds in the market, issuers will compete to gain access to these funds by voluntarily disclosing information to gain investor confidence.[78]

Easterbrook and Fischel illustrate this “principle of self-induced disclosure” by a simple benefits-cost analysis.[79] Generally, a company faces certain costs when disclosing information, the direct costs of dissemination, and the indirect costs, such as giving the information to competitors. On the other hand, an investor will be much more willing to give his money for a project that convinces him. He will expect that a company, in striving to distinguish itself from others, will disclose all available positive information. In the same way, it will disclose the negative information,

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[74] Lawrence A. Cunningham, Behavioral Finance and Investor Governance, 59 WAS. & LEE L. REV. 767, 790-92 (2002).
[75] See generally Sarah E. Bonner et al., Using Decision Aids to Improve Auditors’ Conditional Probability Judgments, 71 ACCT. REV. 221 (1996).
[76] Black, The Legal and Institutional Preconditions for Strong Securities Markets, 48 U.C.L.A. L. Rev.781 (2001).
[77] Kripke, The SEC and Corporate Disclosure: Regulation in Search for a Purpose 119 (1981).
[78] Beaver, Financial Reporting: An Accounting Revolution 13 (1981).
[79] Frank, *supra* note 18.

fearing that failing to disclose will cause shareholders to assume the worst and withdraw their money, resulting to a drop in stock value. This would even work towards continuous disclosure, as the company will have an interest in maintaining a market for their shares, in order to be able to issue more in the future. As long as the benefits of having access to capital will outweigh the costs, a company will naturally provide all information that the market asks for.

Investors require information to gain insights on an issuer for purposes of negotiations with the issuer. Specialists such as financial analysts evaluate as investment-worthy only the stock of companies disclosing information which in most times lead to higher prices in the securities and low costs of capital.[80] This incentive is often improved by aligning the interests of managers and shareholders contractually. Stock options or bonus arrangements are a common means of incentivizing management to act in the best interest of the firm. Often the pure existence of the arrangement itself signals reliability and trustworthiness of these companies to the markets.[81] Ultimately, incentives for managers cast issuers as having a reputation of honest and full disclosure, which will improve their value and ability to raise money in the capital markets.[82]

Jensen and Meckling argue that monitoring by shareholders promotes incentives for the managers.[83] The separation of ownership and control leads to conflicts of interest. A manager owning all of a company would receive all of the benefits. Having to share these direct benefits with shareholders, he will try through perquisites or other non-pecuniary benefits to maximize his own income. This misbehaviour is – in

[80] Kripke, *supra* note 77 at 121-123.
[81]Langevoort, *supra* note 37.
[82]Loss, Seligman & Paredes, Securities Regulation, Volume 1, 285 (4th ed. 2007).
[83]Jensen & Meckling, Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure, 3 J. Fin. Econ. 305 (1976).

a 'lemon like' model – discounted from the price an investor is willing to pay for the stock. However, there are incentives for both the managers and investors to incur certain costs to increase the value of the firm. They are willing to enter a control or monitoring contract that involves methods like auditing of independent firms, formal control systems, budget restrictions, and the establishment of incentive compensation systems.[84] They might guarantee the payment of dividends, forcing them to repeatedly return to the capital markets. This confidence as well signals quality of a firm.[85] As long as both sides profit in a cost-benefit analysis, they will be willing to incur these costs that necessarily will include the voluntary publication of material information. A similar argument employing signalling theory suggests that market-based incentives lead to a strong self-interest for managers to disclose relevant information in a competitive market, such as the fear of being removed, hostile takeovers, or the loss of their own value in the managerial market.[86]

The drawback of voluntary disclosure is that there is a strong incentive for management to withhold information where there is possibility for private gains by insider trading.[87] Another concern is agency costs. A 1992 analysis of fraud cases discovered that most misrepresentations occurred when managers tried to conceal bad news, such as declines in earnings, in order to secure their jobs.[88] These concealments might be especially feared in cases where management compensation is aligned with the company's success or otherwise where management contemplates

[84] *Ibid.*
[85]Easterbrook, Two Agency-Cost Explanations of Dividends, 74 Am. Econ. Rev. 650 (1984).
[86]Stephen A. Ross, Disclosure Regulation in Financial Markets: Implications of Modern Finance Theory and Signalling Theory, in: Issues in Financial Regulation 177, Franklin R. Edwards ed. (1979).
[87]Cox, Insider Trading Regulation and the Production of Information: Theory and Evidence, 64 Wash. U. L. Q. 475, 493 (1986).
[88]Arlen & Carney, Vicarious Liability for Fraud on Securities Markets: Theory and Evidence, 1992 U. Ill. L. Rev. 691, 701 (1992).

insider trading. So, even if they disclose information, there are doubts as to the completeness, quality and truthfulness of that information.

2.6 Conclusion

Mandatory disclosure is justified on various grounds including the need for elimination of information asymmetry and the need to inspire investor confidence in the stock exchange. Proponents of mandatory disclosure argue that a lack or delay of information can lead to overvaluation or undervaluation of stock prices. They therefore take the view that delivery to the investing public of as much quality information as possible facilitates the making of optimal investment choices. On the other hand, opponents of a mandatory corporate disclosure system argue that it is unnecessary because managers will have sufficient incentives to voluntarily disclose all information of interest to the market. They therefore submit that in order to get access to the capital markets, issuers will have to satisfy the informational needs of investors, who will ask for certain information before investing their money.

CHAPTER THREE

DISCLOSURE PHILOSOPHY IN KENYA

3.1 Introduction

This chapter critically analyses Kenya's law and policy framework on mandatory disclosure. The goal is to establish the strengths and weaknesses of the framework and to generate ideas for reform.

3.2 Kenya's Mandatory Legal Framework

In Kenya, mandatory disclosure is grounded in the Constitution;[89] the Capital Markets Act;[90] the Companies Act;[91] and the Capital Markets (Securities) (Public Offers, Listing and Disclosures) Regulations 2002.[92]

3.2.1 The Constitution of Kenya, 2010

This research reveals that mandatory disclosure is a public policy tool used in securities regulation to ensure provision of timely, accurate and complete information to the market. Mandating listed companies to disclose all appropriate information to the investors enhances integrity, transparency and accountability which are among the national values and principles of good governance in Article 10 of the Constitution of Kenya.

Article 35 of the Constitution provides for the right of access to information. Every citizen has the right of access to information held by another person, required for the protection of any right or fundamental freedom. Listed companies are mandated to

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[89] Constitution of Kenya 2010, Laws of Kenya.
[90] Capital Markets Act, Chapter 485A, Laws of Kenya.
[91] Companies Act, No. 17 of 2015, Laws of Kenya.
[92] Capital Markets (Securities) (Public Offers, Listing And Disclosures) Regulations, 3rd May 2002.

disclose all relevant information, whether bad or good, to enable investors assess risk thus enabling them to make prudent decisions.[93]

3.2.2 The Capital Markets Act

The disclosure principle was introduced into the Capital Market Act by the Capital Markets (Amendment) Act.[94] Prior to this amendment, the Capital Market Act only contained a provision mandating registered collective investment schemes to publish in writing an information memorandum signed by or on behalf of its officers and file a copy with the Authority before offering their securities to the public.[95] Under the amended Act, submission of a prospectus to the Capital Markets Authority for approval by an offeror or an issuer; and its publication are mandatory prior to a public offer of securities.[96] An offeror may submit a short-form prospectus to the Authority for approval where a public offer of securities is restricted to sophisticated investors; or directly communicated to a prescribed category and number of persons.[97]

The 2013 amendments were aimed at eradicating cartels that had dominated the market over the years and caused market distortion. The CMA championed the amendments to aid in realisation of transparency, fairness and equality while stockbrokers opposed these amendments arguing that they would create a barrier to the expansion of capital markets because of their far reaching prescriptions.[98] These

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[93]Fama, EF., & Laffer, AB, Information and Capital Markets, Journal of Business, 1971. 289-298.
[94]No. 48 of 2013, Laws of Kenya.
[95]Procedure for collective investment schemes (section 22 of the Capital Markets Authority (Amendment) Act, No 3 of 2000; section 5 A (1) the Statutory Law (Miscellaneous Amendments) Act, no 2 of 2002; and the Finance Act No 8 of 2008).
[96]The Capital Market Act, CAP 485A, Part IVA (Public Offers of Securities), Section 30A (4).
[97]*Id* at 30B.
[98] Stockbrokers and Regulator Tussle Over Proposed Law, September 27 2013, https://www.nation.co.ke/business/Kenya-Stockbrokers-and-regulator-tussle-over-proposed-law/996-2009098-xtbwuqz/index.html [Accessed August 1, 2018].

amendments are generally aimed at streamlining the opaque regulatory framework in Kenya that had been scaring away potential investors and financiers.[99]

3.2.3 Companies Act

Under the Companies Act of Kenya[100], all companies, listed and unlisted, are mandated to disclose their audited financial statements, list of directors and list of shareholders among others to the Registrar of Companies. For instance, section 709 of the Companies Act obligates the directors of a company to ensure that the company's annual financial statements for a financial year are audited in compliance with the applicable law. Then, the company is mandated under the law to submit the auditors' reports to the Registrar of Companies. These reports enable investors to assess the profits and losses of the company, hence enabling them to arrive at prudent and informed conclusions.

3.2.4 The Capital Markets (Securities) (Public Offers, Listing and Disclosures) Regulations, 2002

The Capital Markets (Securities) (Public Offers, Listing and Disclosures) Regulations were developed in 2002 by CMA in conjunction with the NSE in an attempt to ensure corporate disclosure by listed companies in conformity with the best international practices. Under regulation 20, securities issued by or for the Kenyan Government or state corporations are exempted from the application of these regulations. Equally, the regulations do not apply to private offers.

[99]Law to protect investors in Kenya capital market http://www.theeastafrican.co.ke/news/Law-to-protect-investors-in-Kenya-capital-market-/2558-1928684-x8l0w9/index.html [Accessed on August 1st 2018].
[100]Companies Act, No. 17 of 2015, laws of Kenya.

Regulation 10 imposes mandatory disclosure for public issues. It provides that the form and content of a prospectus shall comply with the Third Schedule.[101] The Third Schedule is divided into Part A for issuers seeking to list on the Main Investment Market Segment; Part B for issuers seeking to list on the Alternative Investment Market Segment; Part C for issuers seeking to list 0n the Fixed Income Securities Market Segment; Part CC for issuers seeking to list on the Growth Enterprises Market Segment; and Part D for issuers seeking to list on any of the market segments by way of Introduction.

The disclosures prescribed in the five parts of the Third Schedule are similar with a few variations. The issuers should disclose the identity of advisers, senior management and directors. The prospectus should provide the full name, age, nationality, business address, or home and functions of various categories of directors and senior management. This information is useful as it enables shareholders to hold these persons responsible for losses incurred as a result of their wrong actions or illegal omissions. The Third Schedule also prescribes disclosure of information regarding the issuer's major shareholders. The Schedule also mandates disclosure of the addresses and names of the vendors of any assets acquired by the issuer in the period preceding publication of the prospectus.

Information on the offers, statistics and expected timetable should also be disclosed. These statistics inform investors on the issue price, the number of securities expected to be issued, the methodology of price determination, and the time limits for paying up for securities and for delivery of securities to subscribers.

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[101] Regulation 10 (1), The Capital Markets (Securities) (Public Offers, Listing And Disclosures) Regulations, 3rd May 2002.

The Third Schedule also imposes disclosure of information on the issuer. This information gives investors a deep understanding of a given issue by stating the country and date of incorporation of the issuer, the legislation under which it operates, its legal form and its principal objects among other things.

Further, information on operating, financial review and prospectus should be disclosed. This is information on the risk factors that are specific to the issuer or its industry and make an offering speculative or on high risk in a section headed "Risk Factors".

Regulation 11 dictates disclosures to be made in respect of additional issues in form of capitalization, scrip dividend, right issue or additional shares.[102] For example, an issuer intending to make an additional issue should make an announcement within twenty-four hours from the board's resolution to recommend the additional issue to the shareholders.

Regulation 19 obligates issuers who offer their securities to the public to comply with the continuing obligations specified in the Fifth Schedule.[103] For example, information likely to have a reasonable material effect on market activity in the prices of securities should be immediately disclosed to the public.[104] This information shall be disclosed within twenty-four hours of the event simultaneously to the CMA, the securities exchange at which the securities are listed and to the public during non-trading hours of the relevant market segment.[105] Failure to adhere to any

[102] *Ibid*.
[103] *Id* at Regulation 19 (1).
[104] *Id* at Regulation 19 (2).
[105] *Id* at Regulation 19 (3).

continuing obligation within the prescribed time exposes an issuer to a financial penalty at a rate imposed by the CMA.[106]

3.3 Evaluation of Mandatory Disclosure in Kenya

Securities laws across the world have been seen by some authors as a misjudgement altogether, resulting from an overestimation of market failure.[107] These authors suggest that a market approach would lead to superior disclosure standards through regulatory competition and provide a better answer to the diverse needs of investors and issuers than mandated disclosure. [108] With globalization enabling investors and issuers access to world-wide markets, different regulatory regimes could compete for an optimal investment environment by offering diversified amounts of information. Similarly, jurisdictions and stock-exchanges across the world would compete for investors resulting in a wide range of investment opportunities for the investors. Optimal standards would thus be achieved through specialised markets offering issuers a more differentiated access to capital at a lower cost.

Disclosure of information seems to be a major impediment to listing at NSE. There is a perception among many companies that are eligible to issue securities to the public that the risks associated with additional disclosure are not adequately compensated by additional returns.[109] Some unlisted companies consider the cost of disclosure as incommensurate with the benefit derived from listing.[110]

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[106] *Id at* Regulation 19 (5).
[107] Romano, Empowering Investors: A Market Approach to Securities Regulations, 107 Yale L. J. 2359 (1998); Fox, Securities Disclosure in a Globalized Market: Who Should Regulate Whom, 95 Mich. L. Rev. 2498 (1997).
[108] *Ibid.*
[109]Mbui Wagacha, "Kenya's Capital Market: To List or not To List – A survey of Enterprise Attitudes" Institute of Policy Analysis and Research (IPAR) Discussion Paper 28 (2001).
[110]*Ibid.*

This study argues that since banks do not require public disclosure of a company's affairs in the same magnitude as the listing regulations, many firms may find it preferable to remain unlisted and obtain capital from banks. There are cases whereby disclosure and reporting requirements associated with a public listing may be seen as a loss of privacy and an exposure to the public domain, which can be seen as a loss of competitive advantage by listed entities to competing non-listed entities. Some authors advocate for compensation of listed companies for such a loss.[111]

Gakeri in his paper[112] interrogating the impact of disclosure in Kenya's securities markets argues that the effectiveness of the current system of disclosure in developing securities markets is severely circumscribed by prevailing market realities thereby undermining its role in share price accuracy enhancement, corporate governance and ultimately investor protection. He contends that most retail investors are incapable of accessing the potential benefits of disclosure due to multiple challenges such as low levels of financial literacy.

Gakeri asserts that the language and methodology of disclosure is predominantly non local and exceptionally sophisticated. He underscores the need to review and domesticate the various precepts of disclosure. His underlying argument is that as currently constituted, the mandatory disclosure in Kenya is incongruous with market realities and ill-equipped to champion investor interests thus incapable of galvanizing market confidence, integrity and growth. He concludes that on balance, it is arguable that the language and content of disclosure does not appeal to the ordinary investor in Kenya and that overreliance on disclosure is questionable.

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[111] *Ibid.*
[112] Gakeri, *supra* note 29.

Gakeri proposes a hybrid system incorporating merit-based and disclosure-based regulatory systems so that the mechanisms from both systems would complement each other in safeguarding investor interest. He identifies various advantages of periodic and episodic disclosures such as promoting market efficiency, curbing insider trading, keeping investors informed and keeping corporate managers in check. However, he states, disclosure may compromise confidentiality, precipitate premature disclosure, promote market volatility, has cost implications and could overwhelm shareholders with information. He proposes a cost and benefit analysis in addressing challenges associated with disclosure.

In an earlier paper[113], Gakeri delves into the function of juridical norms in emboldening securities markets in the Sub-Saharan Africa. His paper pays specific attention to Kenya and underscores the poignant role of a legal and institutional infrastructure in the governance of securities markets governance and investor protection. He posits that a deeper growth of securities markets is hinged on countries setting up appropriate legal and institutional regimes. He takes the view that disclosure in annual reports has no value to the ordinary investor who can hardly understand a statement of financial position. He proposes that innovative ways of communicating essential information about the company should be devised and disclosure in languages other than English should be provided for. He points out that mandatory disclosure is one of the factors that discourage listing and proposes that the public-private company dichotomy should be replaced by a classification of companies into listed and unlisted to expose more of them to the possibility of listing.

[113]Gakeri, *supra* note 28.

This study observes that Kenya's law on mandatory disclosure has adopted international practice dogmatically. For example, the law requires compliance with International Financial Reporting Standards (IFRS) and International Accounting Standards (IASs) which advocate for standard form financial statements. By so doing, Kenya has ignored local conditions thereby prejudicing small and unsophisticated investors. According to this paper, the dogmatic adherence to IFRS has led to a depressed quality of disclosure and encouraged reporting for the sake of reporting.

3.4 Conclusion

In pursuit of the policy and statutory justifications of disclosure, Kenya has entrenched mandatory disclosure in the regulation of securities. To maximize the benefits of mandatory disclosure and minimize its costs, Kenya should adopt a feasible approach to mandatory disclosure unique to the country's socio-economic realities.

CHAPTER FOUR

MANDATORY DISCLOSURE IN THE US

4.1 Introduction

This chapter evaluates the mandatory disclosure experiences of the US with a view to providing useful insights for Kenya. The US has entrenched the disclosure principle for almost nine decades since the enactment of the securities laws by the US Congress, that is the Securities Act of 1933 and the Securities Exchange Act of 1934. The Securities Act of 1933 requires disclosure in connection with public securities offerings while the Securities Exchange Act of 1934 imposes periodic disclosures by all companies listed on a stock exchange. Under the Securities Act of 1933, any firm that issues and sells securities to the public after July 27, 1933 has to file a disclosure document. On the other hand, the Securities Exchange Act of 1934 required every firm with a class of equity or debt listed on an exchange to file a similar disclosure document during the period beginning February 1935 and ending July 1, 1935.[114]

4.2 Objective of the Comparative Analysis

Just like the US, Kenya also applies mandatory disclosure. However, the US has a longer history of enforcing mandatory disclosure than Kenya. This chapter therefore seeks to evaluate the strengths and challenges of mandatory disclosure in the US with a view to generating guidelines for the design of a framework that is tailored to the unique demands of Kenya's securities markets.

[114] The Securities Act became law on May 27, 1933 and required registration with the Federal Trade Commission (FTC) of any securities sold to the public on or after July 27, 1933.The statute included a schedule of required disclosures but gave the FTC broad authority to determine their form and content.

4.3 Findings of the Comparative Analysis

4.3.1 Analysis of the Disclosure Principle in the US

Thirty years following enactment of the securities laws by the US Congress in 1933 and 1934, studies by economists and scholars began challenging the disclosure approach to investor protection and asserting that these laws do not provide any provable benefit to the investors. This assertion has been empirically tested to highlight deficiencies of mandatory disclosure.

George Stigler's approach evaluates the unexpected declines in stock prices before and after the enactment of the securities laws.[115] His research examined the unexpected declines in the stock markets despite protection of the investors by the securities laws. Stigler's hypothesis presumes that these significant declines were due to other reasons than the introduction of disclosure. In expounding his hypothesis, Stigler holds that enactment of the securities laws did not result in any significant influence on the quality of the stock.[116]

In his study of the economic effects of the 1933 Securities Act, George Stigler argues that the Securities Act of 1933, which requires registration of securities prior to distribution and the use of a prospectus with extensive and mandated contents, has really not reduced the level of fraud upon the public.[117] Stigler focused on whether the disclosure of financial information mandated by the Act increased the average returns of new- issues for investors. He made comparisons in market-adjusted returns of new issues during 1923-1928 and 1949-1955 and found that the two-year

[115]Stigler, Public Regulation of the Securities Markets, 37 J. Bus. (1964), p. 117
[116] Stigler, *supra* note 115 at 124.
[117]A. Sommer Jr, 'The U.S. Securities And Exchange Commission Disclosure Study' (1978) 1 Journal of Comparative Corporate Law and Securities Regulation.

compounded annual returns were approximately the same for both groups.[118] He found differences over long time periods which he attributed to a specification error arising from incorrectness of at least one of the key assumptions or features of the statistical model used.[119] Stigler did not find evidence of a significant increase in average returns following disclosure regulation, leading him to conclude that federal regulation of new-issues was ineffective, or at least superfluous given existing private market sources of financial information.[120]

Professor George Benston, in his evaluation of the welfare of the US securities laws in 1973, establishes a second approach that empirically tests the efficiency of the Securities and Exchange Act of 1934. His hypothesis is that disclosure leads to significantly higher costs for the companies that are not compensated by the benefits for the investors. He proves this by comparing companies that already disclosed information before the enactment of the securities laws, and those that only started disclosing in 1933. His conclusion is that adequate incentives for disclosure existed for companies before 1933, so that the public welfare effect of the laws was nil.[121] Benston also concluded that empirical analysis does not affirm that the Securities and Exchange Act of 1934 was necessary.[122]

In 1981, Jarrell modified Stigler's approach. He carried out a similar study using a market and risk-adjusted approach derived from the Capital Asset Pricing Model, with qualitatively similar results. However, he does not come to any significant insights. This is because despite seeing a better informational environment in 1935,

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[118]Stigler, *supra* note 115.
[119] *Ibid.*
[120]*Ibid.*
[121]Benston, The Value of the SEC's Accounting Disclosure Requirements, 44 Acct. Rev. 515 (1969).
[122] Irwin Friend and Randolph Westerfield, Required Disclosure and the Stock Market: Comment,65 Am Econ Rev 467 (Pt 1 1973).

he does not prove the same for the subsequent five years. However, he finds that the Securities Acts reduced the risks of investing significantly as riskier firms escaped to other market segments to avoid incurring costs of disclosure.[123]

Carol J Simon improves on Stigler's approach through the insights of the Arbitrage Pricing Theory and differentiating between different stock exchanges and market segments.[124] Simon finds that the unexpected returns for smaller stock exchanges were reduced significantly after 1934, although there were no changes at the NYSE. Like Stigler, Simon finds a reduced variance of the unexpected returns.[125] This finding buttresses the conclusion that the enactment of the Securities Acts did not significantly influence the informational efficiency of the securities markets and led, if anything, only to better transparency at smaller exchanges.

Paul Mahoney and Jianping Mei examine mandatory disclosure documents filed during the period 1933-1935 in response to the Securities Act of 1933. In their study, they note that empirical literature on the effects of mandatory disclosure is small and inconclusive and that only a few authors have examined whether the Securities Act affected the returns realized by investors in new issues of stock.[126] Also, they observe that securities laws around the world require publicly-traded companies to make financial and narrative disclosures to regulators and investors. In the event that such laws do not exist or do not apply, firms may make disclosures voluntarily or pursuant

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[123] Jarell, The Economic Effect of Federal Regulation of the Market for New Securities Issues, 24 J. Law. Econ.613 (1981).

[124]Simon CJ, The Effect of the 1933 Securities Act on Investor Information and the Performance of New Issues, 79 Am. Econ. Rev. 295-318 (1989).

[125]See also Merritt B Fox, 62 Law and Contemporary Problems 113 (1999) Required Disclosure and Corporate Governance; Fox, Required Disclosure and Corporate Governance, 710, in: Corporate Governance, K. J. Hopt ed. 2005; and Choi & Gulati, An Empirical Study of Securities Disclosure Practice, 80 Tul. L. Rev. 1023 (2006).

[126](Stigler 1964; Simon 1989).Benston (1973) also examines the effects of the periodic financial disclosures required by the Securities Exchange Act of 1934.Greenstone, Oyer and Vissing-Jorgensen (2004) and Ferrell (2004) examine the effects of the 1964 statute that extended the Exchange Act's periodic disclosure provisions to companies traded over the counter.

to an agreement. They argue that mandatory disclosure laws are motivated by a belief that these voluntary or contractual disclosures are sub-optimal.[127]

Ingram and Chewning centre their study on the timeliness of information, but they do not find any significant changes prior and after the enactments.[128] A similar finding is reached by Chow who concludes that the securities laws do not have any significant effect.[129]

According to Adam Pritchard, the costs of disclosure standards for listing corporations are borne by investors generally.[130] Investors bear these costs in the form of small reductions in their investment returns and disclosure documents that enfold important information with overwhelming trivial details.[131]

Posner and Scott suggest that it is almost impossible to empirically conclude anything about the effects on the restoration of public confidence in the capital markets because it is hard to quantify the costs of disclosure and all resulting benefits for the investor.[132] Some scholars have endorsed this position by asserting that empirical data cannot provide proof for the efficiency of mandatory disclosure rules at all.[133] Despite these criticisms, the US SEC has maintained that the disclosure system "is sound and does not need radical reform or renovation".[134]

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[127] Paul G. Mahoney & Jianping Mei, Mandatory Versus Contractual Disclosure in Securities Markets: Evidence from the 1930s, Preliminary Draft September 2005.
[128] Ingram & Chewning, The Effect of Financial Disclosure Regulation on Security Market Behavior, 58 Acc. Rev. 562-580 (1983).
[129] Chow, The Impacts of Accounting Regulation on Bondholder and Stockholder Wealth: The Case for the Securities Acts, 58 Acc. Rev. 485-520 (1983).
[130] Pritchard, AC, "Self-Regulation and Securities Markets," Regulation 26 (2003), p. 32.
[131] *Ibid.*
[132] Posner & Scott, Economics of Corporation Law and Securities Regulation, 379 sub 4 (1980).
[133] Langevoort, Theories, Assumptions, and Securities Regulation: Market Efficiency Revisited, 140 U. Pa. L. Rev. 851, 853 (1992); Ronald JG & Reinier H. Kraakman, The Mechanisms of Market Efficiency, 70 Va. L. Rev. 549, 641 (1984).
[134] Report of the Advisory Committee on Corporate Disclosure to the SEC, House Committee on Interstate and Foreign Commerce, 95th Congress, 1st Session, 2, Comm. Print 95-29 (1977), see also:

4.3.2 Challenges Related to Mandatory Disclosure Generally

There are challenges related to the disclosure principle which appear to undermine its objectives. The high compliance costs in a complex and hard-to-understand system are more likely to discourage listing. The issuers incur enormous direct and indirect costs of compliance.[135] Besides, creation, analysis, gathering and summarizing the data to generate the required information attaches a substantial cost. In addition, due to the high level of diligence required, external experts are generally contracted to enhance efficiency thus increasing compliance costs.[136] This information has high cost implications as it also needs to be disseminated to a wide spectrum of investors and potential investors.[137]

Complexity is the other key challenge facing the disclosure principle. The declining percentage of global IPOs that list on the US market is partly explained by complexity of the US disclosure system. Statistics indicate that in 2000 one of every two dollars was raised in the US, whereas by 2005 that number dropped to one in twenty.[138] Around this time, many companies opted for London listing viewing the British system as modernized and liberalized. The enactment of the Financial Services and Markets Act has greatly enhanced the clarity, efficiency and regulatory accountability of the LSE thus attracting various foreign companies.[139] The Financial Services and Markets of the UK give broad exemptions from prospectus registration requirements for Euro-securities and other offers thus reducing the level of

United States. Securities and Exchange Commission, Disclosure to investors: a reappraisal of Federal administrative policies under the '33 and'34 acts: The Wheat report (New York 1969).

[135] See Frank H. Easter brook & Daniel Fischel, Mandatory Disclosure and the Protection of Investors, 70 VA. L. REV. 669, 707-09 (1984); Jose M. Mendoza, Securities Regulation in Low-tier Venues: The Rise and fall of the Alternative Investment Market, 13 FORDHAM J. CORP. & FIN. L. 257 (2008).

[136]See Susan M. Phillips & Richard Zecher, The SEC And The Public Interest, 41 (1981).

[137] Note, Should the SEC Expand Non-Financial Disclosure Requirements? 115 HARV. L. REV. 1433, 1444(2002).

[138]Interim Report of the Committee on Capital Markets Regulation (December 2006).

[139]Cox, Hillman & Langevoort, Securities Regulation: Cases and Materials, 2007 Suppl. to the 5th ed. 2006, 4.

information disclosed.[140] Kenya should however be cautious in picking foreign approaches especially the UK ones which have dominated our legislation. Particular attention must be paid to the local socio-economic and cultural conditions obtaining in Kenya.

A mandatory disclosure system can only function if the law is clearly understood, simple, and easy to follow. For what are the benefits of a perfectly regulated system, if it is so complicated that non-experts are not able to follow the rules and specialized legal advice is so expensive that smaller companies simply see no benefit in going public? In the US, there have been calls for simplification of the complex body of law.[141] Clear and uniform safe-harbours, such as one single rule regulating integration, would reduce the risk of a violation of the Acts and thus enhance efficiency.

The prospectuses that contain mandatory information are detailed, technical and uninspiring to ordinary investors. Thus, ordinary investors especially those with little or no financial knowledge do not have capacity to properly understand and apply the information, hence undermining the utility of the information disclosed.[142] The bulk of the investing public is not enlightened for example on their capacity as shareholders of public companies.[143] A small portion of prospective investors read or

[140]Bates, United Kingdom Issues New Regulations on Public Offerings of Securities, 31 Sec. Reg. & L. Rep. 647 (1999).
[141]See Hazen, Treatise on the Law of Securities Regulation, 5th ed., Vol. I, § 1.2[3][d][2] (2005).
[142] See Lynn A. Stout, Are Stock Markets Costly Casinos: Disagreements, Markets Failure and Securities Regulation, 81 VA.L.REV. 611; Robert Prentice, Whither Securities Regulation: Some Behavioral Observations Regarding Proposals for its Future, 51 DUKE L. J. 1397, 1459-60 (2001); Christine Jolls et al., A Behavioral Approach to Law and Economics, 50 STAN. L. REV. 1471 (1995).
[143] Geoffrey A. Manne, The Hydraulic Theory of Disclosure and Other Costs of Disclosure, 58 ALA. L. REV. 473, 503-04 (2007); Henry G. Manne, Some Theoretical Aspects of Share Voting, 64 COLUM. L. REV. 1427, 1439-44 (1964); Stephen Bainbridge, The Politics of Corporate Governance, 18 HARV. J. L. & PUB. POL'Y 671, 696 (1995).

understand the contents of prospectuses. Hence continuing disclosure of material information often occurs unnoticed by the majority of the investing public.

The efficacy of regulatory disclosure is also affected by complexity.[144] Whereas the management of the corporation is presumed to understand the information disclosed, most investors do not.[145] Majority of the investors cannot decipher the meaning or implications of the detailed and technical data availed to them.[146] This is because disclosure documents are often drafted by experts who often use technical terms.

Most decision makers in the realm of securities markets are often described as irrational.[147] This phenomenon is pronounced in developing jurisdictions where investors are generally unsophisticated.[148] Thus, disclosure alone does not eliminate fraud. The substantive regulations introduced shortly after Enron and Worldcom underscore this point.[149]

4.3.3 Opportunities for Reforms

Various US stakeholders have levelled criticisms against the SEC administered disclosure system. Individual investors seek simplification of the process and substance of the disclosed information which they term as too complex to comprehend.[150] Professional and institutional investors are also critical of the

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[144] See generally Steven Schwarcz, Regulating Complexity in Financial Markets, 87WASH. U. L. REV. 211 (2009).
[145]*Ibid.*
[146] Homer Kripke, The SEC, The Accountants, Some Myths and some Realities,45 N.Y. U. L. REV 1151, 1153-54 (1970).
[147] See Donald Langevoort, Organized Illusions: A Behavioral Theory of why Corporations Mislead Stock Market Investors and cause social problems, 146 U.PA.L.REV. 101 (1997).
[148] Gakeri, *supra note* 29.
[149] See Paul M. Healy and Krishna G. Palepu, 'The Fall of Enron' Journal of Economic Perspectives—Volume 17, Number 2—Spring 2003—Pages 3–26 .
[150]Epstein, The Usefulness of Annual Reports to Corporate Shareholders, ch.III(1975).

complexity of the information that denies them forward-looking information such as projections and estimates.[151]

On February 2, 1976, SEC through its then chairman Roderick M Hills announced the appointment of an Advisory Committee on Corporate Disclosure to be chaired by then Commissioner, A. A Sommer, Jr. The obligations of this Advisory Committee included to identify the characteristics and functions of the present system of corporate disclosure and the role of the SEC within that system and to assess the costs of the present system of corporate disclosure and to weigh those costs against the benefits it produces.[152]

The Committee recognized importance of reliable, timely and sufficient information especially in making investment decisions. This is premised on the ideology that investors make prudent investment decisions when properly informed. The Committee advocated for efficient allocation of resources to establish and run a system through which sufficient and reliable information reaches investors.[153]

The Committee also addressed the need to simplify information provided in the prospectuses. It called upon the SEC to liaise with other stakeholders in designing mechanisms for disclosing information in a manner that serves the needs of the different investors. The Committee also proposed that the SEC should emphasize disclosure of information to reasonably knowledgeable investors leaving to disseminators the development of simplified formats and summaries usable by less

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[151] Stone, Information Needs of Security Analysts, in Financial Information Requirements for Security Analysis 59, Duke Second Accounting Symposium (Duke University Graduate School of Business Administration 1976).
[152] Securities Exchange Commission, 42nd Annual Report for the Fiscal Year Ended June 30, 1976 (Commissioners Roderick M Hills-Chairman; Philip A Loomis, Jr; John R Evans; Irving M Pollack; & George A Fitzsimmons-Secretary; Commissioner A A Sommer resigned from the Commission, effective April 2, 1976.), p 27-31.
[153] *Ibid.*

experienced and less knowledgeable investors. The committee based this proposal on its survey which found reliance by small investors on their brokers for information and help with investment decisions.[154]

The Committee concluded with an advice to the Commission to consider administering the system primarily for the purpose of providing useful information to investors and potential investors in companies. The system should therefore not be used to compel disclosure concerning, for instance, social or environmental matters and hiring practices unless it could be shown that such matters are material to investors.[155]

In January 31, 2017, the US Chamber of Commerce's Center for Capital Markets Competitiveness (CCMC) released Essential Information: Modernizing Our Corporate Disclosure System, a white paper exploring the future of corporate disclosures and why materiality is, and should remain, the guiding principle for public company disclosure.[156] The late David Hirschmann, then president and CEO of CCMC, took the position that disclosure of all material information critical for investors is the bedrock of capital markets hence the need for modernization of corporate disclosure.[157] Since its inception in 2007, the CMCC has led a bipartisan effort in modernizing and strengthening outmoded regulatory systems governing the capital markets to strengthen the economy, restore investor confidence, and ensure well-functioning capital markets.

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[154] Sullivan and Neilson, A Survey on Subjects of Concern to the Individual Investor, Public Relations Quarterly, Fall 1975, at 10.

[155] *Ibid.*

[156]Outlines Importance of Effective, Modern Corporate Disclosure System, Report Release, Event Focus on Future of Corporate Disclosure, How to Provide Value for Today's Investors,Tuesday, January 31, 2017 - 1:45pm https://www.uschamber.com/press-release/new-us-chamber-ccmc-report-outlines-importance-effective-modern-corporate-disclosure [Accessed August 1 2018].

[157] *Ibid.*

4.4 Lessons Kenya Can Draw from the US

Kenya can draw multiple lessons from the US particularly the need for:

i. Lessening requirements for mandatory disclosure in favour of voluntary disclosure.
ii. Establishing a framework for the quantification of the costs of disclosure and the resulting benefits;
iii. Strong enforcement of mandatory disclosure requirements by the relevant regulator(s) for example serious investigation of violations such as insider trading and prosecution of offenders;
iv. Simplification of the process and substance of the disclosed information;
v. Relevant disclosure; and
vi. Allocation of sufficient resources to the CMA to supervise and monitor the efficiency and reliability of the information provided by issuers to investors and the public in general.

4.5 Conclusion

The US has enforced mandatory disclosure for close to a century. Its experience reveals the existing imperfections of mandatory disclosure and the need for reform to maximize the benefits and minimize the costs of disclosure required by securities laws.

CHAPTER FIVE

CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This chapter contains the conclusions of the study and recommendations on how Kenya can improve the application and implementation of mandatory disclosure in the quest for growth and development of her securities markets. The recommendations are in form of a list of suggested changes to the applicable law.

5.2 Conclusion

This research proves its hypothesis that the current application of mandatory disclosure to securities regulation in Kenya hinders the growth of securities markets. It establishes that there is no comprehensive legal and policy framework with sufficient guidelines on mandatory disclosure principle in Kenya. The comparative study of the mandatory disclosure principle in the US justifies the need for appropriate modification of the disclosure legal framework to promote the development of the securities markets to meet Kenya's economic growth aspirations.

5.3 Recommendations

5.3.1 Short-Term Recommendations

CMA should explore the possibility of ensuring full disclosure and accessibility of essential information to the investing public via other languages other than English, such as Kiswahili. This will facilitate making of optimal investment choices and reduce uncertainties due to multiple conceptualisations in translations.

The enforcement of mandatory disclosure should be strong and strict. For example, CMA should scrutinize the content of prospectuses to ensure that issuers are not merely replicating previously disclosed information without necessary adjustments.

This will prevent meaningless disclosures or disclosure for the sake of disclosure. Moreover, when approving prospectuses, the CMA should advocate for less technical language to ensure that the general investing public can understand the information prior to making investment decisions.

5.3.2 Medium-Term Recommendations

CMA should critically review the regulation on mandatory disclosure with a view to fostering their clarity; simplicity; and comprehension especially to the stakeholders with minimum or no legal and financial expertise. This process should engage key stakeholders in the securities regulation such as the NSE and issuers. The process must ensure public participation. The resulting framework should abandon the complex and rigid standard formats of disclosure prescribed by the current framework in favour of simple and flexible formats of disclosure. The proposed framework should also target delivery of summarised and easily digestible information to the general public that is different, for instance, from the current prescribed formats of prospectuses and financial statements which unsophisticated investors are unable to comprehend.

The proposed legal framework should encourage voluntary disclosure by reducing the scope of mandatory disclosure; be mindful of the cost-benefit factor; provide for strong enforcement of mandatory disclosure requirements by the regulator(s) tasked with overseeing disclosure principle for example serious investigation of violations particularly insider trading and prosecution of offenders; simplify the process and substance of the disclosed information; require substantial allocation of resources by the exchequer to the regulator (the CMA) to supervise and monitor the efficiency and reliability of the information provided by issuers to investors and the public in general.

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