Keeping a closer eye…

The Minister seeks to enhance supervision of the financial services sector to provide stability

After last year's budget touched only lightly on regulation of the financial services sector, this year's speech saw a raft of new proposals which sit within the Minister's overall project to ensure financial stability in the Kenyan economy

Tightening the regulatory net

The Minister proposed a number of measures to enhance supervision of the financial services sector. These include the Central Bank of Kenya (CBK) implementing coordinated supervision of banks with cross border operations. This will entail information sharing and coordination with other regulators in the region.

Further, the Minister proposes to amend the *Banking Act* to introduce the concept of a "banking group" and "non-operating holding company". A non-operating holding company will be allowed to hold more than 25% of a bank's share capital, subject to CBK's written approval. Amendments have been made to introduce capital and liquidity requirements for such entities. This is a welcome change, especially to banks contemplating regional expansion as the current legislation was not structured to support banking groups.

Agency banking has seen increased growth in the last few years. The minister has moved in to tighten the regulation around their activities. Supervisory procedures will be extended to monitor activities of agents, while banks will now also become liable for the acts and omissions of their agents. The proposal seeks to protect customers and is likely to lead to increased costs of the agency banking model as banks will have to monitor their agents to ensure they perform to the respective bank's standards.

The Minister indicated a new Development Finance Institution (DFI) Bill is currently being developed which will facilitate supervision of DFIs such as the Agricultural Finance Corporation which were previously not subject to supervision.

The Minister proposes to amend the *Proceeds of Crime and Anti Money Laundering Act* to include transactions under other financial sector players, including the insurance and capital market sectors.

Amendments through the *Capital Market (Amendment) Bill 2012* propose taking away significant powers from the CMA and vesting them in the Minister. These powers include formulation of regulations, rules and guidelines required for regulation in such areas as listing and de-listing of securities, disclosures about securities transactions and reporting obligations. The amendments further envisage enhanced collaboration between regulatory authorities both within and outside Kenya to investigate of persons who contravene regulatory or legal requirements.

The Minister proposes to amend the Retirement Benefits regulations to bar individual Retirement Benefit Schemes from appointing a corporate trustee related to their sponsors. This is intended to eliminate conflict of interest but might not be fully effective as individuals related to the sponsors e.g. management could still act as trustees.

Towards a one stop shop

The Minister recognised the global trend towards convergence of financial services with banking, insurance and stock brokerage being offered under one roof. In this regard he recommended an amendment to the Banking Act to expand the scope of banking business to include incidental financial services that can be offered by banks subject to review and approval by the Central Bank.

The Minister also noted that in order to "strengthen the supervisory capacity, safeguard stability and enhance efficiency of the financial sector regulators" the government proposes to establish a consolidated financial sector regulatory framework bringing together the CMA, IRA and RBA. In addition, the Banking Supervision Department will be re-established as an entity under a reviewed CBK Act.

Time for the small players?

The Minister intends to further deepen the capital markets and has proposed the following:

To encourage capital raising through the NSE for the SME segment, the Minister will develop a framework for a Growth Market Enterprise Segment on the NSE. SMEs will now have more options other than the traditional debt markets. However, learning from the low level of recent listings and liquidity on the Alternative Investment Market, the NSE together with other enabling institutions such as the CMA would need to carry out significant market education to ensure that this becomes a success.

The Minister has gone a step further to increase subscription for Government paper by proposing to amend the Central Depositories Act to consolidate the settlement of both fixed income and equity securities under the Central Depositories and Settlement Corporation. This will encourage uptake of its debt securities by individuals, in a year where it intends to significantly finance the 250 billion KES budget deficit through public borrowing.

In the Insurance Sector, the Minister proposes to amend the insurance regulations to include a new class of business, micro insurance business, which will provide protection targeting the low income population. The new class is likely to continue increasing the current low insurance penetration in the market.

Winners and losers

New regulation is welcome...

Regulation of the Kenyan financial services industry has lagged behind recent developments in the sector; such as the growth of agency banking and the regional expansion of banks. With this budget, the supervisory regime appears to have caught up with several of the new trends – and the greater stability this new regulation should bring is to be welcomed by businesses and the public as a whole.

... but who picks up the bill?

Regulation always comes at a cost – more onerous processes and reporting, the possible need for corporate restructuring and extra capital – and the lesson from the introduction of financial services regulation around the world is that these costs usually end up with customers. This cost to consumers is perhaps a necessary evil in ensuring a safer financial services sector as a whole.

...and where is the detail?

The budget may have proposed significant new regulatory reform but some amendments the industry has called for were conspicuous in their absence. Tax treatment of derivative transactions and withholding taxes on transactions with correspondent banks services remain grey areas. This confusion may hold back growth in certain segments of the sector and in the products which financial institutions can offer. In a volatile environment where derivatives could be of help to businesses to hedge market risks, this is a disappointment. The only tax-related relief for the industry comes in the form of the new VAT Bill, where the amended definition of supply suggests that the issue of self-supply of commercial rental services may no longer be a concern for banks.