Regulating Kenya's Securities Markets: An Assessment of the Capital Markets Authority's Enforcement Jurisprudence

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Abstract

The importance of an optimal regulatory and enforcement matrix in enhancing securities markets cannot be overemphasized. Countries with deep and vibrant securities markets generally have effective regulatory and enforcement philosophies. This paper seeks to characterize the regulatory and enforcement paradigms of Kenya's securities markets in the context of the global regulatory and enforcement philosophies. From the analysis, it is evident that the regulatory paradigm is indissolubly government or national with nominal self-regulation. Although the statutory framework enshrines self-regulation, the relevant provisions are ambiguous and remain ineffectual. The notion of self-regulation remains an illusion. The regulator enjoys plenary legislative and supervisory powers over market intermediaries and listed companies without being subject to meaningful accountability mechanisms. Amendments to the Capital Markets Act and its Regulations have consolidated the Capital Markets Authority's position as a paramount regulator. Finally, the enforcement history of the Capital Markets Authority discloses no decipherable philosophy. Enforcement actions have been intermittent and reflect no imperatives.

This paper examines Kenya's securities markets regulatory and enforcement paradigms and their impact on market development. Using the statutory mandate, influence of the executive, the Capital Markets Authority (CMA) and the Nairobi Securities Exchange (NSE) over the securities markets, it assesses whether the regulatory model is Government, self or a configuration of the two. Drawing from the tenures of different chief executives of the CMA, the paper illuminates how the agency has deployed its enforcement arsenal from 1990 to the present. In a nutshell, this paper answers the following questions. First, what is Kenya's securities markets regulatory model? Second, what is the Capital Markers Authority's enforcement philosophy and finally, how have the regulatory model and enforcement philosophy impacted on the development securities markets?

Part One examines Kenya's securities markets regulatory paradigm in the context of global regulatory approaches. From the discussion it is evident that regulatory structure is indissolubly Government-led. Although the statutory framework appears of propagate self regulation, the operative provisions lack clarity. Arguably, self regulation remains illusory. Part Two illuminates the Capital Markets Authority's enforcement toolkit. The analysis demonstrates that the CMA enjoys a panorama of enforcement actions. Disconcertingly, most of them have never been invoked suspected infractions notwithstanding. Part Three attempts to characterize Kenya's securities markets enforcement jurisprudence. Using enforcement actions taken by the Authority from 1990 to the present, the paper demonstrates that there has largely been no underlying philosophy. Enforcement intensity and diversity appears to vary with the chief executive. Most importantly, it has been intermittent, unmethodical, unstructured and unenthusiastic. The paper concludes that the enforcement jurisprudence is undecipherable.

A. Securities markets regulatory strategies

According to the International Organization for Securities Commissions (IOSCO), the three interrelated and sometimes overlapping goals of securities regulation are:

- Protecting investors,
- Reducing systemic risk and

- Ensuring that markets are fair, efficient and transparent.[1]

However, the fundamental question remains unanswered: "how should financial markets be regulated?"[2]This overriding question implicates the tension between investor protection and capital formation which are elemental in securities regulation. Whereas advocates of investor protection champion the imposition of intense regulatory burdens on market participants, the industry is invariably in favor of deregulation or light regulation. The need to reconcile the tension in a manner conducive to investor protection and promotion of business cannot be exaggerated. Concededly, a sound and effective regulatory framework plays a critical role in the development of securities markets. Effective regulation is the foundation of confidence in the market which attracts investors.[3]Undoubtedly, the allocation of regulatory power and its exercise is critically important to the development of securities markets.[4]

Regulatory approaches to securities markets have traditionally been characterized as Government or Government-led and Self regulation.[5] However, a third categorization which is a configuration of the two variously described as "Self regulation with Oversight"[6] or "Cooperative regulation"[7] or "Government Supervised Self regulation"[8] has developed. This regulatory model combines the attributes of government and self regulation. Because of its flexibility it is emerging as the most appropriate regulatory model.[9] However, the exact configuration of regulatory responsibilities between the market and the government varies from jurisdiction to jurisdiction.

In an authentic Government or Government-led system, the central government is responsible for all regulatory aspects of the securities markets. Market participants have no role to play in the regulatory matrix. Governmental powers over the markets are ordinarily exercised by a government minister or an administrative agency or both. The government maintains power to intervene in the day-today affairs of the markets. This regulatory system is common in the recently established markets where the entire securities markets infrastructure including the securities exchange was established by the government. Government regulation of securities markets which commentators justify on market failure is sometimes criticized as being paternalistic.

The standard definition describes self regulation as a regulatory regime under which an organization or industry sector establishes its own rules and regulates itself accordingly.[10] It is a system of private governance carried out by the market typically through the securities exchange which promulgates rules that govern member's activities and provides mechanisms for admission of new members, monitors and investigates compliance and disciplines members for violations. Pure or voluntary self-regulation is characterized by no direct governmental oversight.[11]

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[1]IOSCO, Objectives and Principles of Securities Regulation, available at www.iosco.org/librarypubdocs/pdf/IOSCOD323.pdf. (visited on Oct. 20, 2010).

[2] Cally Jordan & Pamela Hughes, *Which way for Market Institutions: The Fundamental Question of Self-regulation,* 4 BERKELEY BUS L.J. 205, 207 (2007).

[3] See Stavros Gadinis & Howell E. Jackson, *Markets as Regulators: A Survey,* 80 S. CAL. L. REV. 1239, 1242 (2007).

[4] James J. Fishman, *Enforcement of Securities laws Violations in the United Kingdom*, 9 INT'L TAX & BUS LAW 131 (1991).

[5] However, a recent global survey by Howell Jackson & Stavros Gadinis, on regulatory approaches concluded that there are three models of securities regulation namely: "Government led Model" exemplified by the France, Germany and Japan, "Flexibility Model" typified by the United Kingdom, Australia and Hong Kong and the "Cooperation Model", as practiced in the United States and Canada.

[6] See Andreas M. Fleckner, *Stock Exchanges at the Crossroads,* 74 FORDHAM L. REV. 2541, 2553 (2006); Douglas C. Michael, *Federal Agency use of Audited Self-regulation as a Regulatory Technique,* 47 ADMIN.L. REV. 171 (1995).

[7] Sam S. Miller, *Self-Regulation of the Securities Markets,* 42 WASH. & LEE L. REV. 853, 861(1985).

[8] Joel Seligman, *Cautious Evolution or Perennial Irresolution: Stock Market Self-regulation during the First Seventy years of the Securities and Exchange Commission*, 59 BUS LAW 1347 (2004). See generally Marianne K. Smythe, *Government Supervised Self-regulation in the Securities Industry and the Antitrust Laws: Suggestions for an Accommodation,* 62 N.C.L.REV.475

[9] See Ernest E. Badway & Jonathan M. Busch, *Ending Securities Industry Self-regulation as we know it,* 57 RUTGERS L. REV. 1351, 1372, (2005).

[10] See also BLACK'S LAW DICTIONARY 1391 (8th ed. 2004) (defining self regulation as an organization or industry's control, oversight or direction of itself according to the rules and standards that it establishes.")

[11] See Neil Gunningham & Joseph Rees, *Industry Self-regulation: An Institutional Perspective,* 19 LAW & POL'Y 363, 366 (1997).

According to William Cary, a former Chairman of the Securities and Exchange Commission of the United States of America, self regulation denotes autonomy in a relative sense.[12] Self regulation is premised on the reasoning that individuals and firms strive to uphold positive norms, practices and standards set by the industry.[13] It is underpinned on the need to benefit from the superior knowledge and expertise of the industry.[14] Scholars justify the self- regulatory authority of securities exchanges on the ground that they have capacity to exercise dominant market power acquired through their monopoly in securities' dealing.[15]Commentators agree that self regulation has a long tradition in the financial services.[16] However, it is becoming exceedingly clear that the scope of self regulation is decreasing inversely proportional to the development of securities markets. This is attributable to its inability to respond to investor demands and market dynamics.

In developed jurisdictions government participation in the regulation of securities markets is a late nineteenth and twentieth century phenomenon.[17] "[S]tock exchanges predate government agencies as regulators of equity trading markets. In fact regulating the trading process was the primary goal behind the establishment of organized stock markets."[18] They relied on the committee system to exercise their regulatory powers.[19] The historical convention of self regulation dates back to the middle ages when economic activities were regulated through merchants, professionals and craftsmen.[20] For many years, it was the principal form of regulation in the City of London. "[T]he London Stock Exchange has been a hermetic example of self regulation throughout its history."[21]The City of London played a central role and the regulatory structures reflected the national realities. Similarly, before the 1930s, regulation of securities markets in the United States was essentially self regulation.[22] A similar argument may be made in relation to Kenya's markets before the enactment of the Capital Markets Authority Act in 1989. From 1954 to 1971, the Nairobi Securities Exchange was responsible for all regulatory aspects of the securities markets. The precursor of government regulation was the Capital Issues Committee established in 1971. Interestingly, the Committee did not fundamentally change the regulatory architecture except in relation to approval of new issues. Substantive government regulation was institutionalized by the Capital Markets Authority Act, 1989.

Stock exchanges are conspicuous features of market economies and have traditionally been organized as not-for-profit organizations established and owned by brokers who managed them as exclusive clubs with high entry barriers and some monopoly.[23] Regulating the market was an integral part of the multifarious functions stock exchanges have discharged over the years.

[12] William L. Cary, *Self-Regulation in the Securities Industry,* 49 A. B. A. J. 244, 244 (1963).
[13] See James J. Fishman, *Enforcement of Securities laws Violations in the United Kingdom*, 9 INT'L TAX & BUS LAW 131 (1991).
[14] Andreas M. Fleckner, *Stock Exchanges at Crossroads,* 74 FORDHAM L. REV.2541, 2553 (2006).
[15] Jonathan Macey & David Haddock, *Shirking at the SEC: The Failure of the National Market System*, U. II. L. REV.315 (1985); Jonathan Macey & Hideki Kanda, *The Stock Exchange as a Firm: The Emergence of Close Substitutes for the New York and Tokyo Stock Exchanges*, 75 CORNELL L.REV. 1007 (1990).
[16] See Onnig H. Dombalagian, *Self and Self-Regulation: Resolving the SRO Identity Crisis,* 1 BROOK J. CORP FIN. & COM. L. 317 (2007). (On the strengths and weaknesses of self regulation).
[17] In the United Kingdom, the Directors Liability Act 1890 liberalized the law on deceit. See generally LOUIS LOSS et al., SECURITIES REGULATION, (4th ed. 2006).
[18] Gadinis & Jackson, supra note 3 at 1246.
[19] Most exchanges had the Business conduct, Admission, Publicity, Listing and Disciplinary Committees.
[20] George P. Gilligan, *The Origins of the UK Financial Services Regulation,* 18 (6) COMP. L. 167 (1997); George P. Gilligan, *The Michael Lawrence Sacking: A Confirmation of the Regulatory Traditions of the Stock Exchange and the City of London?* 4(3) J.F.C. 207, 212 (1997); Mitnick B.M., THE POLITICAL ECONOMY OF REGULATION, 27-31(1980).
[21] Gilligan, *Id.* at 210.
[22] See Walter Werner, *The SEC as a Market Regulator,* 70 VA. L. REV. 755 (1984) (explaining the role SEC played in promoting self-regulation in early years of its existence).
[23]Fleckner, supra note 14 at 2545-2551.

Stock exchanges are trading markets,[24] information distributors,[25] business enterprises[26] and corporate governance standard setters.[27] But unlike other forms of businesses associations, they are market regulators.
Protagonists of self regulation highlight its salient advantages as succinctly encapsulated by Taylor:

> "The expertness and immediacy of self-regulation often provide the most expedient and practical means of regulation. By making those regulated actual participants in the regulatory process, they become more aware of the goals of regulation and their own stake in it. In some areas, the self-regulatory bodies can promote adherence to ethical standards beyond which could be established as a matter of law."[28]

Self-regulation is admittedly cost effective because it promotes efficient rules which impose a lower regulatory burden on the market. Relatedly, the cost of regulation is underwritten by the market. Moreover, it is in the self-interest of market intermediaries and other participants to ensure that the markets are transparent and fair in order to attract investors.[29] Another advantage is that unlike parliamentary law making which is susceptible to filibuster and other limitations, self-regulation is flexible and thus suitable when dealing with rapidly changing and dynamic sectors.[30] Finally, because self-regulation is defined by contract as opposed to jurisdictional limits of national legislation, it can extend across national borders.[31]

The most formidable short comings of self-regulation are captured by the following words.

> "The natural lack of enthusiasm for regulation on the part of the group to be regulated, the temptation to use a façade of industry regulation as a shield to ward off more meaningful regulation, the tendency for businessmen to use collective action to advance their interest through the imposition of poorly anti-competitive restraints as opposed to those justified by regulatory needs, and a resistance to changes in the regulatory pattern because of vested economic interests in its preservation."[32]

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[24] See Charles Cox & Douglas C. Michael, *The Market for Markets: Development of International Securities and Commodities Trading*, 36 CATH. U. L. REV. 833, 834(1987) (emphasizing the importance of liquidity to the survival of securities exchanges) Therese H. Maynard, *What in an 'Exchange"? Proprietary Electronic Security Trading Systems and the Statutory Definition of an Exchange*, 49 WASH &LEE L. REV.833(1992); JOHN C. COFFEE, JR. & JOEL SELIGMAN, SECURITIES REGULATION, 8-9 (9th ed.2003); Daniel R. Fischel, *Organized Exchanges and the Regulation of Dual Class Common Stock,* 54 U. CHI. L. REV. 119, 121 (1987).

[25] In addition to the freely accessible information, most securities exchanges are data vendors. See Harold J. Mulherin, *Prices are Property: The Organization of Financial Exchanges from a Transaction Cost Perspective*, 34 J.L. & ECON. 591(1991).

[26] See Heidi Mandanis & Michael Taylor, *United Kingdom and United States Responses to the Regulatory Challenges of Modern Financial Markets* 38 TEX. INT'L L. J. 317, 328 (2003).

[27] *Id*.

[28] Cecilia R. Taylor, Capital Market Development in Emerging Markets: Time to teach an old Gog some nwew tricks, 45 Am. J. Comp. L. 71, 73 (1997). For an over view of the main advantages of self-regulation, see Onnig H. Dombalagian, *Demythologizing the Stock Exchange: Reconciling Self-regulation and the National Market System,* 39 U. RICH. L. REV.1069, 1093-1100 (2005); Paul G. Mahoney, *The Exchange as Regulator*, 83 VA. L. REV. 1453; SRO Consultative Comm., Int'l Org. of Sec. Commissions, Model for Effective Regulation 4 (2000), available at http://www.iosco.org/librarypubdocs/pdf/IOSCOPD110.pdf (visited on Oct.10th, 2010).

[29] Stavros & Howell, supra note 3 at 1254.

[30] See generally Eva Hupkes, *Regulation, Self-regulation or Co-regulation*? 5 J.B.L. 427 (2009).

[31] See Norman S. Posner, *The Stock Exchanges of the United States and Europe: Automation, Globalization and Consolidation*, 22 U. PA. J. INT'L ECON. L. 497, 537 (2001) (Making a strong case for the role of self-regulation in cross-border electronic stock exchanges of the future). See also Gilles Thieffry, *Towards a European Securities Commission*, INT'L FIN L. REV 14 (1999).

[32] See Report of Special Study of Securities Markets and Exchange Commission, H.R. Doc. No. 95, 88th Cong., 1st Sess., pt.4 at 722 in Taylor, Supra note 14 at 74. But see Pritchard A.C., *Markets as Monitors: A Proposal to replace class Actions with Exchange as Securities and Fraud Enforcers*, 84 VA. L. REV.925; *Robert A. Prentice, The Inevitability of a Strong SEC*, 91 CORNELL L. REV. 775 (2006); Lori Richards, *Self-Regulation in the New Era,* available at http://www.sec.gov/news/speech/spch398.htm (last visited Nov. 18,2010).

Concededly, "all too often, self-regulation becomes self-preservation."[33]Conceivably, the genesis of self-regulation and self interest are entwined.[34] Another important drawback of self-regulation is that self regulatory bodies have limited authority to sanction violations of their rules and regulations. "The enforcement apparatus of self-regulation has many imperfections."[35] They have no power to impose criminal sanctions.[36]Similarly, because self regulatory organizations are private organizations, the rules and regulations they promulgate are unenforceable by private action.[37] Finally, although self regulatory bodies perform public functions, they have no governmental accountability to the public. Opponents of self regulation rely on practical experiences to illuminate its shortcomings. In the United Kingdom, failure of the self-regulation motivated the U.K. Parliament to delegate regulatory powers to the Financial Services Authority (FSA) through the provisions of the Financial Services and Markets Act, 2000. Importantly, the Financial Services Authority is a private sector agency.[38]

The argument for securities markets regulation without governmental oversight is becoming increasingly strenuous to sustain particularly with the advent of demutualization. Demutualization refers to changes in the ownership structure of stock exchanges whereby exchanges organized as not-for-profit entities owned by members convert to publicly-owned organizations, usually for profit corporations.[39] This has been precipitated by several factors including competition.[40]The securities exchange acquires another constituency, namely, investor stockholders.[41] Demutualization necessitates the segregation of regulation from business operations and a re-allocation of regulatory responsibilities because, "the potential for conflict between the exchanges business goals and regulatory mission is apparent."[42] Relatedly, "there are some new conflicts that could call into question its regulatory role."[43] The danger of under or over-regulation cannot be underestimated.[44]

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[33] See Kenneth Durr & Robert Colby, The Institution of Experience: Self-Regulation Organizations in the Securities Industry 17892-2010, available at www.sechistorical.org (visited on Dec. 21, 2010); James J. Fishman, *A Comparison of Enforcement of Securities law Violations in the UK and US,* 14(9) COMP L.163, 164(1993).

[34] See George P. Gilligan, *The Origins of UK Financial Services Regulation,* 18(6) COMP L. 167 (1997).

[35] See Gadinis & Jackson, supra note 3 at 1254; Dale A. Oesterle, *Comments on the SEC's Market 2000 Report: On Among Other Things, Deference to SROs, the Mirage of Price Improvement, the Arrogation of Property Rights in Order Flow, and SEC Incrementalism*, 19 J. CORP. L. 483,488 (1993); Dombalagian, supra note 1365 at 1121.

[36] Marcel Kahan, *Some Problems with Stock Exchange-based Securities Regulation*, 83 VA. L. REV. 1509, 1517(1997); Steven Shavell, *Criminal Law and the Optimal use of Nonmonetary Sanctions as a Deterrent,* 85 COLUM L.REV. 1232 (1985) (discussing when criminal sanctions may be desirable); Douglas Michael, supra note1343 at 189.

[37] Dombalagian, Supra note 1363 at 1122.

[38] See Howard Davis, Director, London School of Economics, Address at Hong Kong Theatre, Mar. 26, 2004, What's Left for Self-regulation?, available at http://www.Lse.ac.uk/collections/meetthedirector.pdf/whatsbLeftForSelfRegulation04Feb27.pdf.(visited onOct.10, 2010); Alistair Darling, *The Regulation of the UK Insurance Industry*, 4(6) INT. I.L. R. 171(1996).

[39] See Sara M. Saylor, *Are Securities Regulators prepared for a truly Transnational Exchange?* 33 BROOK J. INT'L L. 685, 693 (2008); Roberta S. Karmel, *The Once and Future New York Stock Exchange: The Regulation of Global Exchanges,* 1 BROOK J. CORP. FIN. & COM. L. 355 (2007); Roberta S. Karmel, *Turning Seat into Shares: Causes and Implications of Demutualization of Stock and Futures Exchanges,* 53 HASTINGS L. J. 367 (2002). (Discussing how demutualization affects the power structure within a stock or futures exchange); Amir N. Licht, *Stock Exchange Mobility, Unilateral Recognition, and the Privatization of Securities Regulation,* 41 VA. J. INT'L L.584 (2001); Frank Donnan, *Self-regulation and the Demutualization of the Australian Stock Exchange,* 10 AUSTL. CORP. L. I 1999).

[40] See Caroline Bradley, *Demutualization of Financial Exchanges: Business as Usual?* 21 NW. J. INT'L. L. & BUS. 657 (2001); Reena Aggarwal, *Demutualization and Corporate Governance of Stock Exchanges*, 15 J. APPLIED CORP. FIN. 105, 113 (2002); Oliver Hart & John Moore, *The Governance of Exchanges: Members' Cooperatives versus Outside Ownership,* 12 OXFORD REV. ECON. POL'Y, 53 (1996); See also John C. Coffee Jr., *Racing Towards the top? The impact of Cross-listing and Stock Market Competition on International Corporate Governance*, 102 COLUM. L. REV. 1757 (2002). See also Stephen F. Diamond & Jennifer W. Kuan, *Ringing the Bell on the NYSE: Might a Nonprofit Stock Exchange have been Efficient?* 9 DUQ. BUS L.J. 1 (2007).

[41] Caroline Bradley, *Demutualization of Financial Exchanges: Business as Usual?* NW. J. INT'L L. & BUS 657 (2007).

[42] See Gadinis & Howell, supra note 3 at 1258. See generally Frank Donnan and Roberta S. Karmel supra note 39.

[43] See Karmel, supra note 39 at 423.

[44]See Joel Seligman, *Cautious Evolution or perennial Irresolution: Stock Market Self Regulation during the first Seventy years of the Securities and Exchange Commission,* 59 BUS. LAW 1347 (2004).Sara M. Saylor, *Are Securities Regulators prepared for a truly Transnational Exchange*? 33 BROOK J. INT'L L. 685 (2008).

These and other weaknesses of self-regulation have emboldened the cooperative or oversight system under which a Government Ministry or agency exercises oversight functions over the market.[45] The purpose of oversight is to alleviate the shortcomings of self-regulation.[46] Cooperative regulation best describes the common task of protecting investors and the public interest.[47]

Although the concept of self-regulation retains some utility, it is sub-optimal and its scope is severely circumscribed.[48] As IOSCO eloquently acknowledges, "Effective self-regulation must be defined within the context of government oversight. Government oversight is an essential element in the self-regulatory structure"[49] Consequently, market and government regulation are not alternatives but complementary.[50] There are certain aspects that are handled more effectively by the government while others are more competently dealt with by market intermediaries.[51]The two systems augment each other. Arguably, an optimal regulatory system should be an integration of the strengths of government and self regulation. Self-regulation with oversight ensures *inter alia* that the market benefits from its accumulated wisdom and superior knowledge. Its object is to strike a balance between "the limitations and dangers of permitting the securities industry to regulate itself" and "the sheer ineffectiveness of attempting to assure regulation directly through the government on a wide scale."[52]

The challenge has inevitably shifted from whether the regulatory system should be self or government to how regulatory power should be allocated.[53] This regulatory model demands a jurisdictions specific allocation of regulatory power between the government and the market.[54] The ultimate challenge is how to establish a system with the right oversight and incentives so as to maximize the benefits of the interface and minimize conflicts. In the United States for example, self-regulatory organizations operate under the oversight of the Securities and Exchange Commission (SEC).[55]Critics of the cooperative regulatory model hypothesize that the government could operate more effectively as the sole regulator. Although government regulation has particular strengths such as expertise, involving the industry enhances the regulatory framework by imbuing the advantages of self regulation.[56]

Although the Capital Markets Act and the Licensing Regulations recognize the securities exchange and expressly provide for the promotion of self regulation, the NSE operates under the heavy oversight of the CMA. Arguably, the regulatory mode is Government-led with insignificant attributes of self regulation.

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[45]*Id.* at 1377-87. (Discussing different regulatory methodologies for securities markets governance).

[46] Gadinis & Jackson, supra note 3 at 1256.

[47] See Subcomm. On Commerce and Finance of the House Committee on Interstate and Foreign Commerce, 92 d. Cong., 2d Sess., Report of the Securities Industry study 85(Subcomm. Print 1972).

[48] See Jordan &Hughes supra note 2 at 226.

[49]See generally, Roberta S. Karmel, *Should Securities Industry Self-Regulatory Organizations be Considered Government Agencies?* 14 STAN. J. L. BUS. & FIN. 151 (2008) (Arguing that self-regulation should be retained and strengthened its shortcomings notwithstanding).

[50] See Jake Keaveny, *In Defense of market Self Regulation,* 70 BROOK L. REV. 1419, 1450-51 (2005).

[51] See Marcel Kahan, *Some problems with Stock Exchange based Securities Regulation,* 83 VA. L. REV. 1517, 1518 (1997). See generally Alistair Alcock, *Are Financial Services Over-regulated?* 24)5) COMP. L. 132(2003) Marianne Smythe, *Government Supervised Self Regulation in the Securities Industry and the Anti-Trust Laws,* 62 N. C. L. REV. b475, 487 (2006).

[52] See generally Yuwa Wel, *Speculation and Regulation: A Story of China's Capital Market,* 16 WTR CURRENTS INT'L L. J. 14, 25 (2007).

[53] Jonathan Macey & Maureen O'Hara, *From Securities Markets to Venues: Securities Regulation in an Evolving World,* 58 STAN. L.REV. 563, 582. (Arguing that neither pure self-regulation nor pure government regulation is effectively equipped to meet the challenges of demutualized stock exchanges).

[54] See Richard G. Wallace & Benjamin R. Dryden, *Self-regulation: Background and recent Developments*, SPO 54 ALI-ABA 33

[55] Richard L. Stone & Michael A. Perino, *Not just a Private Club: Self Regulatory Organizations as State Actors when Enforcing Federal Law,* 1955 COLUM. BUS L. REV. 453 (1995).

[56] See Harold Demsetz, *Information and Efficiency: Another Viewpoint*, 12 J.L. & ECON. 1, 1-2 (1969).; Macey & O'Hara, supra note 1387 at 582-83; Jonathan R. Macey, *Administrative Agency Obsolescence and Interest Group Formation: A Case Study of the SEC at Sixty,* 15 CARDOZO L. REV. 909, 913-14 (1994). See also Fair Administration and Governance of Self-Regulatory Organizations, Exchange Act Release No.50, 699, 69 FED. REG. 71, 126 (Dec. 8, 2004); George J. Stigler, *Public Regulation of Securities Markets,* 37 J. BUS. 124, 126 (1964).

Although one of the principal statutory objectives of the CMA is to implement a system of self-regulation "to the maximum practicable extent," it is becoming increasingly difficult to implement this objective primarily because of the lack of accountability by market intermediaries.

Powers of the Nairobi Securities Exchange

The basic powers of the NSE are embodied in its constitutive documents, the CMA Regulations, Membership and Trading Rules and the Listing Manual. The Capital Markets Act makes no direct reference to the powers. Although the constitutive documents accord the stock exchange an extensive mandate[57]the objects and powers conferred are exercisable subject to the provisions of the Capital Markets Act and Regulations made under the Act which render them largely ineffectual.[58] For instance, although the exchange is empowered to promote any other company to facilitate acquisition of property or acquire or hold shares in other companies, the CMA has restricted its shareholding to the Central Depository and Settlement Corporation Ltd (CDSC).

The mandate of the NSE contained in the Management and Membership Rules, Trading Rules and the Listing Manual is equally subordinated to the Capital Markets Act and its Regulations. A few examples sufficiently contextualize this argument. First, the exchange is required to admit all firms licensed by the CMA as full or associate members. Second, although the stock exchange is empowered to approve securities for listing, securities approved by the Authority must be admitted to listing "without any other conditions."[59] Third, rules made by the exchange cannot be amended, varied or rescinded without prior approval of the Authority. Relatedly, the Authority is empowered to make additions to the rules and has discretion to abrogate them. Fourth, a member of the exchange cannot be suspended without approval of the Authority. Moreover, a member can only be expelled by non-renewal or revocation of license by the Authority. Fifth, the Authority must be notified of any disciplinary action taken by the NSE against members or listed companies within seven days. The Authority is empowered to review the decision either on its own motion or on application by the affected party and has jurisdiction to set the decision aside after hearing the securities exchange on the matter. Sixth, the Authority approves the annual budget of the exchange. Finally, the exchange can only suspend or delist securities with sanction of the CMA.[60] Except in one instance where a listed company was reported as having petitioned the NSE to waive a financial penalty it had imposed for late submission of financial reports in 2008, there is no evidence that NSE has been enforcing its membership and continuing disclosure obligations aggressively.[61]Additionally, it has neither investigative nor prosecutorial power and cannot enforce the provisions of the Capital Markets Act in its domain.

The oversight jurisdiction of the CMA over Kenya's securities markets extends to its relationship with the Central Depository and Settlement Corporation, its affiliate.

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[57] The objects clause of the memorandum of association of the NSE empower it to: To formulate rules for the conditions under which the listing of a particular security may be effected, for the conditions under which applications for delisting may be made, for the carrying out of the business of the stick exchange with due regard to the interests of the investing public, suspension of trading of any given security, segregation of members and clients funds, ensuring fair representation of members in the elections of its board of directors, for the proper keeping of securities in its custody and for the responsibility of stock brokers and dealers for the actions of their employees or representatives in their dealings with the public. It is empowered to carry on the business as advisers on the administration and organization of industry and business and the training and utilization of personnel for industry to acquire, build maintain alter and enlarge buildings factories offices roads, railways etc. It is also empowered to take or otherwise acquire and hold shares in any other company having objects altogether or in part similar to those of the exchange. Can lend, borrow or raise or secure the payment of money and can invest its money in any manner. Finally, it is empowered to do all such other things as may be conducive or incidental to the attainment of the other object.

[58] The Nairobi Stock Exchange is empowered to admit new members, approve listing of securities, promulgate and enforce Membership and Listing Rules, undertake real time market surveillance, publish stock prices and index, approve prospectuses and charge for services rendered.

[59] Reg. 13(2); James Anyanzwa, *NSE okays listing of Kenol, Equity Bank Shares*, THE STANDARD, Dec. 11, 2007 at 15.

[60] Reg. 22. See also Reg.3 of the Listing Manual of the Nairobi Stock Exchange.

[61] See Isabella . & Emmanuel W., *NSE Petitioned following move to penalize Sasini Co. Ltd.,* Feb. 12, 2008 at 20; Nixon Kareithi, *Tim sales Takeover*, DAILY NATION, Apr. 5, 1990; Isabella Mukumu & Emmanuel Were, supra note 729 at 20; Nixon Kareithi,& Seneiya Waiganjo, ICDC Shares Puzzle, KENYA TIMES Oct. 11, 1990 at 1; Nixon Kareithi, *Stock Exchange turn down Timsales plea* KENYA TIMES Mar. 29, 1990 at 15

Powers conferred on the corporation are exercisable subject to those of or in consultation with the CMA.[62] Although the CDSC is empowered to appoint Central Depository Agents, it can only suspend or revoke their appointment in "consultation" with the Authority.[63] The character of the consultation contemplated by the Rules remains unclear. This was the issue at hand when the CDSC suspend ded the custodial license (central depository agent license) of Equity Bank Company Ltd. The CMA ordered the CDSC to reinstate the license immediately and undertook to arbitrate the dispute between the two entities.[64] The CMA argued that it had not "approved" the suspension as required by the provisions of the Central Depositories Act, 2000. Surprisingly, the Central Depositories Act does not address the issue of suspension or revocation of custodial licenses and the applicable Rules require "consultation."

These instances demonstrate that although the NSE and the CDSC appear to enjoy certain powers, ostensibly exercised by self-regulatory organizations in other jurisdictions, the powers are deeply circumscribed by the Capital Markets Act and its regulations. Concededly, the dynamism of the securities markets coupled with, globalization, advancement in technology and the unreliability of market intermediaries have rendered self-regulation impracticable in many respects. The utility of self-regulation has progressively been undermined by the insatiable greed of market intermediaries which has necessitated substantial government intervention. Consequently, the CMA exercises plenary legislative and supervisory powers over the NSE and market intermediaries. Its powers are ubiquitous and its primacy over all aspects of the securities markets is incontestable. The enveloping powers are justified on the need to protect investors and bolster investor confidence.

Significantly, the CMA has acknowledged its overarching oversight and has conceded that regulatory reforms should provide for the recognition of self-regulatory organizations and confer significant powers and responsibilities to them.[65] This is exceedingly important particularly in the context of the impending demutualization of the NSE which constitutes the separation of business and regulatory functions of the exchange. Although Kenya Association of Stock brokers and Investment Banks (KASIB) has been positioning itself to be recognized as a major stakeholder in the securities markets, this is likely to happen over the short term. Noteworthy, although the Central Bank of Kenya (CBK) / International Finance Corporation (IFC) Report on "The Development of Money and Capital Markets in Kenya" 1984, on which the Capital Markets Authority Act, 1989 was founded advocated for self-regulation with oversight but with more emphasis on self-regulation, the swing of the pendulum towards the Government-led model has been necessitated by the inflexibility of market intermediaries.

Concededly, market intermediaries play a crucial role in securities markets governance. The corporate affairs department of the CMA could enormously benefit by partnering with the more skilled and experienced NSE and KASIB in promoting investor awareness. In sum, the CMA is responsible for prudential, supervision and conduct of business of the securities exchange and other market intermediaries.

Executive Oversight

Administratively, the securities markets in Kenya fall under the powerful Ministry of Finance (Treasury) which is in turn accountable to the Parliament. Notably, the ministry exercises overwhelming influence over the CMA which could adversely affect its capacity to discharge its statutory mandate. A panoramic view of the powers of the minister reveals that they are encompassing and are manifested in the appointment, removal and fixing remuneration of members of the Authority and the Capital Markets Tribunal, law making, sources of finance and fees payable to the Authority, prescription of penalties for breach of provisions of the Act and accountability.

[62] See generally The Central Depositories (Regulation of Central Depositories) Rules, 2004

[63] *Proviso* to Reg. 13 (1) of the Central Depositories (Operational) Rules 2003.

[64] The letter sent to the chief executive of the CDSC by the CMA read in part: "In accordance with the Central Depository Act, 2000, the CMA is required to approve the suspension procedures. This was not done. Furthermore, any suspension by CDSC should only be effected after consultation with CMA. This was not done."

[65] See Wachira Kang'aru, *New Rules to give NSE teeth*, DAILY NATION, Feb. 4, 2010 at 24; James Anyanzwa, *Listing of Companies set for major review,* THE STANDARD, Dec. 1. 2009 at 27.

Apart from the standing members of the Authority namely: the Attorney General of the Republic of Kenya, Permanent Secretary to the Treasury and Governor of the Central Bank of Kenya, the minister either directly appoints or recommends others for appointment by president, including the chief executive and the chairman.[66]Typically, the president appoints the ministers' nominees. Similarly, the minister appoints all members of the Capital Markets Tribunal.[67] The minister is empowered to demand, at any time, returns, accounts and any other information relating to the activities of CMA and the Authority is obligated to comply with the order.[68] While this power may have been intended to enhance accountability, it legitimizes political interference in the affairs of the CMA. Arguably, executive influence over the securities markets is astounding.

Cumulatively, these powers enable the executive arm of government not only to influence the day-to-day operations of the CMA, but its long-term policies and other activities.[69] Political influence has in many instances corroded the public interest basis for securities regulation.[70] A vividly illustration of this influence was the Barclays Bank of Kenya Ltd Kshs. 3 billion ($ 37,500,000) bond.[71] Although the principal regulatory authorities approved the issue, Treasury withheld approval at the instigation of influential stock brokers who feared that the issue would negatively impact on their business.[72] The bond was approved three years later.[73] To embellish this argument, in early 2009, the minister threatened to disband the board of directors of the CMA and surprisingly, the NSE and the CDSC.[74] With regard to the CMA, the minister appointed two new directors but had no power over the boards of the NSE and CDSC which are private companies and appointment to their boards of directors is regulated by their constitutive documents.[75] Finally, the CMA's ambivalence on the licensing of new stock brokers or liberalizing the stock broking market is traceable to powerful interested parties who appear to have tacit support of the executive.[76]

Historically, the CMA has operated at the behest of the executive.[77]The "iron triangle" between the executive, stock brokers and the CMA has shaped many regulatory aspects of Kenya's securities markets.[78] The findings of Transparency International reinforce this view. In its 2009 Global Corruption Report for Kenya, Transparency International was emphatic that:

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[66] § 8

[67] § 35A (1) This is a specialized tribunal with jurisdiction to hear appeals by persons aggrieved by decisions of the Capital Markets Authority.

[68] § 36 (2)

[69] James Anyanzwa, *Dismantle CMA Board, probe scam,* THE STANDARD, Feb. 10, 2009 at 23; Joseph Bonyo, *New CMA Board set to be named*, DAILY NATION, Mr. 18, 2009 at 30.

[70] See generally Steven A. Ramirez, *Depoliticizing Financial Regulation,* 41 WM. & MARY L. REV. 503 (2000).

[71] See Washington Akumu, *Barclays ready for first quarter launch of Kshs. 3 Billion bond*, DAILY NATION, Jan. 6, 2004 at 17; Jaindi Kisero, *Why Barclays is yet to list Corporate bond,* DAILY NATION Feb. 10, 2004 at 5.

[72] Kisero *Id*; See Steven P. Croley, *Public Interested Regulation,* 28 FLA. ST. U. L. REV. 7(2000) (On how interest groups influence decision making by governmental regulatory agencies). See also Jaindi Kisero, *Why Barclays is yet to list Corporate Bond*, DAILY NATION, Jan. 10, 2004 at 19.

[73] See Benson Kathuri, *Barclay Bank Bond to be listed, on NSE,* THE STANDARD, Oct. 30, 2007 at 9; James Anyanzwa, *Barclays Corporate Bond excites the Investors,* THE STANDARD, Nov. 20, 2007 at 4; Kariuki Ndung'u, *Barclays Bond opens on NSE*, KENYA TIMES, Nov. 27, 2007 at 19.

[74] See Joseph Bonyo, *Cheserem is new CMA Chair,* THE STANDARD, Feb. 21, 2009 at 23. See also, James Anyanzwa, *NSE chief and 4 directors bow out ahead of AGM*, THE STANDARD, Apr. 30, 2009 at 30; Wachira Kang'aru, *New faces set for NSE Board,* DAILY NATION, Apr. 30, 2009 at 28; Joseph Bonyo, *New CMA board set to be named,* DAILY NATION, Mar. 19, 2009 at 16.

[75] See Muna Wahome, *Why Uhuru order has not been effected*, DAILY NATION, Apr. 11, 2009 at 25 ; Wachira Kang'aru, *How Treasury forced NSE to do its bidding,* DAILY NATION, May 2, 2009 at 24. The ministry applied pressure on the NSE and a non broker was appointed chairman of the board of NSE.

[76] See Muna Wahome, *Capital Markets Authority mulls over lifting of broker licensing freeze,* DAILY NATION Feb. 28, 2010 at 27.

[77] See James Anyanzwa, *Nyaga: Treasury gets cold feet as investigation begins,* THE STANDARD, Feb. 12, 2009 at 24. See also John Oyuke, *Report on Nyaga's fall not accurate, says NSE chairman,* THE STANDARD, Feb. 12, 2009 at 27.

[78] See Allan B. Morrison, *How Independent are Independent Regulatory Agencies?* DUKE L. J. 252 (1988); Joseph P. Kalt & Mark A. Zupan, *Capture Ideology in the Economic Theory of Politics,* 74 A. ECON. REV. 279, 279 (1984); Richard B. Stewart, *The Reformation of American Administrative Law,* 88 HARV. L. REV. 1667, 1684-87 (1975).

> "[T]he fundamental problem that mostly causes poor governance in Kenya is singular: excessive power within the presidency. If power were devolved from the presidency, oversight institutions such as the CMA would be effective in ensuring good corporate governance without undue influence from an overbearing executive. The executive powers greatly compromise the effectiveness of the oversight institutions."[79]

Both the executive and the CMA exercise overwhelming oversight over Kenya's securities markets. The allocation of regulatory authority is skewed in favor of the government.[80] Consequently, the regulatory continuum is more government-led than self-regulatory with oversight. This has been justified on the need to protect investors. On the downside, the overpowering influence of the executive has undermined the Authority's autonomy and compromised its capacity to discharge its statutory mandate efficiently and effectively.

B. Enforcement

The enforcement regime is an important ingredient of any effective legal and regulatory framework.[81]Enforcement determines the efficaciousness of regulation. "The effectiveness of the regulatory scheme rests upon the nature and scope of enforcement tools"[82] because they give the framework effect, enhance confidence and protect investors. Effective enforcement is the bedrock of investor protection.[83] The interface between regulation and enforcement manifests itself through supervision which broadly encompasses: licensing or authorization, inspection, investigation and sanctioning.[84] Being the principal government institution responsible for regulating securities markets, the CMA has primacy in enforcing the provisions of the Capital Markets Act and other Rules and Regulations germane to securities markets.

Significantly, the CMA enjoys the full complement of powers which a typical regulator should have in order to discharge its mandate effectively.[85] Securities enforcement in Kenya is trifurcated as:

- prevention,
- monitoring and information gathering and,
- power of intervention, sanctions, penalties and judicial proceedings.

Whereas prevention commences the enforcement continuum, imposition of appropriate sanctions on those found responsible signifies its conclusion.[86]

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[79] See Global Corruption Report 2009: Country Reports for Africa and Middle East, 188 (2009), available at http://www.transparency.org/publications/grc_2009#6.1 (last visited Nov. 6th, 2010).

[80] See Washington Gikunju, *Central Bank of Kenya seeks bigger role in Capital Markets*, BUSINESS DAILY, Dec. 8, 2008 at 20; Editorial, *Finance Minister should just name CMA chief*, BUSINESS DAILY, Aug. 17, 2012 at 14; John Gachiri, *CMA seeks power to monitor brokers with lavish lifestyles,* BUSINESS DAILY, Aug. 17, 2012 at 19; Jaindi Kisero, *This Country sorely needs a Capital Markets Authority chief with clout*, DAILY NATION, July 4, 2012 at 12 (underscoring the need for the Government to appoint an empowered and independent chief executive of the Capital Markets Authority); Jaindi Kisero, *A fiercely independent and passionate chief executive urgently needed*, DAILY NATION, July 25, 2012 at 12.

[81] See Stuart Bazley, *Market Cleanliness Systems and Controls and Future Regulatory Enforcement*, 28(11) COMP.L. 341 (2007); Jill E. Fisch, *Top Cop or top Flop? The SEC at 75*, 95 VA. L. REV.785 (2009) (Expressing the view that regulatory reforms in U.S. Securities markets should focus on enforcement and transparency).

[82] See Fishman, supra note 4 at 138; Norman. Poser, *Why SEC Failed: Regulators Against Regulation,* 3 BROOK J. CORP FIN. & COM L. 289 (2009); Akiko Karaki, *Regulation and Compliance in Japanese Financial Institutions*, 14 COLUM J. ASIAN L. 327 (2001).

[83] See William R. McLucas, *Protection from International Fraud: Legal and Enforcement Developments Part 1,* 13(11) COMP. L. 203 (1992).

[84] See Ioannis Kokoris & Rodrigo Olivares-Caminal, *Some Issues on cross-border Stock Exchange Mergers*, 29 U. PA. J. INT'L L. 455, 465 (2007-2008).

[85] See Ingrid Pusey, *The role of the Regulator in Combating Financial Crimes: A Caribbean Perspective,* 14(3) J.F.C. 299, 311-12 (2007).

[86] See Fishman, supra note 4 at 165.

Prevention

For preventative purposes, the CMA has statutory power to undertake activities aimed at keeping off the securities markets persons with questionable business history, practices or conduct. Prevention is pursued primarily through traditional mechanisms such as registration, authorization, approval and licensing.[87] These are prophylactic approaches intended to sieve or filter companies and market intermediaries of unquestionable financial, business and professional integrity (bad apples) and disallow irregular and transactions likely to have deleterious effects on the market. If successful, it is acclaimed as the most cost effective approach to enforcement. Although no listed company has been found liable for defrauding investors as was the case in Nepal and India,[88] stockbrokers have.[89] The licensing process for instance, is a fundamental part of the CMA's regulatory matrix. Its purpose is to assess the risks particular firms pose to customers and the securities markets in general. The CMA registers collective investment schemes,[90] approves credit rating agencies, registered Venture capital companies, central depositories and stock exchanges.[91] It licenses stock brokers, investment banks fund managers, investment advisers, authorized securities dealers and authorized depositories.[92] Transactions that require authorization include, transfer of listed securities outside the stock exchange,[93] public offers, rights, script, capitalization and open offers.[94] These mechanisms afford the CMA an opportunity to appraise the market periodically.

The Capital Markets Act, Central Depositories Act and the CMA Regulations prescribe numerous requirements for registration, licensing, approval[95] and authorizations. This is intended to ensure that the standards are sufficiently high to protect the unsuspecting public.[96] To ensure that the securities markets are continually improving, licensing of intermediaries is done on an annual basis and the Authority has discretion to decline the renewal. Additionally, it is empowered to extend a license for up to three months to enable the applicant comply with licensing requirements. The CMA has exercised this power regularly.[97] In addition to licensing, stock brokers, investment banks, dealers and fund managers are required to have compliance officers to embolden their compliance capabilities.[98] Typically, licensing, approvals and registration are less effective in weeding out sophisticated fraudsters and tricksters. As the Tables in the succeeding sections demonstrate, the number of complaints by investors and fraudulent activities has grown exponentially.

Monitoring and information gathering

An exceedingly important weapon in the CMA's toolkit is monitoring and information gathering. This twin procedural device bolsters preventive mechanisms by *inter alia* reinforcing compliance.

[87] See Hiren B. *Mistry, Battle of Regulators: Is the U.S. System of Securities Regulation better provided than that which operates in the United Kingdom?*4(4) J.I.F.M. 137(2002) Caroline Currie, *Civil Enforcement as a Regulatory Device: The use of Civil law as a means of Enforcing Securities law Violation,* 17(5) COMP. L. 139,146 (1996).

[88] See Bishwambhar Pyakuryal & Kishor Uprety, *Nepal: The Emerging Securities Markets (Legal and Policy* Aspects) 9 TRANSNAT'L. 421, (1996)(explaining how companies with unknown backgrounds would list securities and then collapse within a short time leaving securities holders with no recourse); Umakanth Varottil, *Evolution and Effectiveness of Independent Directors in Indian Corporate Governance*, 6 HASTINGS L. J. 281 (2010) (explaining similar cases in India).

[89] See Wachira Kang'aru, *Collapse of three stock firms leaves bad taste in the mouth of those staking their money in shares: When the bearish stocks market scared away potential players,* DAILY NATION, Jan. 5, 2010 at 8; Jackson Okoth, *Why Nyaga Stock Brokers Co. Ltd resorted to Price Manipulation*, THE STANDARD, Feb 10, 2009 at 30; Washington Gikunju, *Stockbrokers in tight spot as CMA acts on rogue trading,* BUSINESS DAILY Apr. 22, 2009 at 12; Benson Kathuri, *The task ahead for market fraud unit,* THE STANDARD May 19, 2990 at 14; Jackson Okoth, *Stockbrokers' plan to redeem tattered image*, THE STANDARD Feb. 21, 2009 at 11.

[90] § 30

[91] § 11(3) (f)

[92] §§23, 24 &25

[93] §§ 31

[94] Fifth Schedule to the Capital Markets (Securities) (Public Offers, Listings and Disclosure) Regulations, 2002, supra note 468.

[95] §5

[96] See Fishman, supra note 4 at 165.

[97] James Anyanzwa, *Three broker firms fail CMA test,* THE STANDARD, Apr. 29, 2009, at 31; Joseph Bonyo, *Six brokers put on notice by CMA,* DAILY NATION, Apr. 29, 2008 at 28.

[98] Reg. 53A.

They provide early identification of problems to regulators, incriminating information and documents, facilitate gathering of evidence and act as deterrent to wrong doing.[99] Disclosure by market intermediaries and listed companies is an indispensable component of monitoring and information gathering.[100]

The CMA enjoys substantial monitoring and information gathering powers. This enables the Authority to keep abreast with developments in the market and more fundamentally, keep pace with its dynamism. The CMA conducts its monitoring and information gathering functions through demanding information from market participants,[101] on-site and off-site inspections and investigations. Section 13A of the Capital Markets Act empowers the chief executive officer of the Authority to authorize any senior officer or manager of the Authority to inquire into the affairs of any person under the Act. The inquiry is intended to establish reasonable cause to justify an application to the court for a search warrant to facilitate more elaborate investigations.

Attempts to bolster the CMA's information gathering capacity were revamped in March 2009 when the Authority, Central Bank of Kenya, Retirement Benefits Authority and the Insurance Regulatory Authority signed a memorandum of understanding on information sharing.[102] This was intended to facilitate investigation of cross-sector regulated entities and challenges. Additionally, provisions of the Capital Markets Act were amended to enable the Authority share information with other regulatory agencies.[103]

Inspection

While off-site inspections are facilitated by disclosure requirements and examination of information furnished on demand, on-site inspections and investigations are facilitated by the right to full and free access to premises of licensees which the CMA enjoys.[104] Inspections enable the Authority assess the level of compliance with the provisions of the Capital Markets Act and relevant Regulations. Records reveal that the CMA has been conducting on-site inspections as part of its market surveillance. As the Table below reveals, before 2004, the CMA's annual reports were not reporting the number of on-site inspections the Authority had undertaken during the preceding year. Off-site inspections have not been reported.

Year	Number of on-site inspections	Licensees affected
2004	80	50
2005	92	50
2006	112	52
2007	122	72
2008	149	75
2009	149	75

[99] *Id.* at 164.
[100] Regulation 12 of the Licensing Regulations for instance, require the stock exchange to make daily reports to the Authority on the securities transacted, price movements on each security, including the high, low and average price and the volume of transactions in respect of each security. Additionally, within 30 days after the end of each quarter, the stock exchange must furnish the Authority with a report of all securities transactions for each day inclusive of private transactions, names of the parties to each transaction and the holders of notifiable interest notified to the exchange in accordance with the Regulations on disclosure. The Trading Rules require the stock exchange to notify the Authority any extra ordinary occurrences on the exchange.
[101] For example, under section 13(1) of the Capital Markets Act, the Authority or its agent may by written notice require any person to furnish the Authority or agent within a specified duration returns or information as the notice may specify. Under section 9(4) of the Central Depositories Act, Central Depository Agents are required to furnish the CMA with such information or documents as it may require relating to a securities account. Other disclosure requirement on the Central Depository and Central Depository Agents in relation to the acquisition or disposal of book-entry securities are imposed by section 58(1).
[102] See Steve Mbogo, *Financial sector regulators in bid to work jointly*, BUSINESS DAILY, May 13, 2009 at 12.
[103] See James Anyanzwa, *Capital Markets Authority moves to protect Investors,* THE STANDARD, June 29, 2010 at 18, See Finance Act, 2010 introducing § 13(3).
[104] §§ 12(2) & 56 of the Central Depositories Act, 2000**.**

Evidently, the inspections did not involve all licensees of the Authority. It is difficult to assess the effectiveness or otherwise of these inspections because four stock brokerage firms were put under statutory management by the CMA between 2007 and 2010 allegedly for mismanagement and fraud. Evidence suggested that the CMA was aware of the circumstances but failed to institute remedial measures. Significantly, the number of intermediaries operating without licenses has reduced significantly. However, investor complaints have been incessant.

Records reveal that the CMA has been receiving a wide spectrum of complaints about listed companies and market intermediaries.[105] Complaints are an important source of information on potential trouble spots and violations. Some on-site inspections are precipitated by investor complaints. More importantly, complaints can also occasion surprise investigations by the Authority.

The Table below illustrates the number and character of complaints and infractions handled by CMA during the period 2003-2009.

Year	2003	2004	2005	2006	2007	2008	2009
Investor complaints	7	33	65	57	199	495	415
Violation of Regulations	2	1	2	1	1	2	0
Fraudulent activities	2	5	3	0	1	0	36
Mismanagement of companies	4	1	3	1	1	2	0
Operating without a license	12	2	0	0	1	2	0
TOTAL	27	42	75	59	204	501	551
Number resolved	unreported	37	55	47	184	216	308

Evidently, the number of investor complaints grew astronomically between 2006 and 2008, although there was a slight reduction in 2009. There are several possible explanations for the dramatic increase in investor complaints and fraud. The unprecedented heavy over-subscription for IPOs between 2006 and 2008 particularly during the privatization of Kenya Electricity Generating Co Ltd (Kengen) and Safaricom Ltd increased the number and orientation of investors in the securities markets. Relatedly, the collapse of three prominent stock brokerage firms between 2007 and 2009 lead to massive financial losses by investors. Third, this may be indicative of increasing awareness of investor rights or responsiveness by the CMA. Due to paucity of information, it is difficult to account for the dramatic increase in the number of fraudulent activities in 2009. This is against the backdrop of noticeable improvements in other areas.[106] Noteworthy, the CMA discloses neither the nature nor character of the fraud or whether it related to market intermediaries or listed companies.

Although the Table reveals that the CMA has been resolving investor complaints and other forms of infractions, it is incontestable that a sizable number of complaints have been carried forward over the years. Because the unresolved complaints or infractions may possibly have been the more complicated ones, it is difficult to hypothesize how they were addressed because their status remains undisclosed in subsequent annual reports. Elucidation on whether they became irresolvable, were overtaken by events, necessitated further investigation, elicited penalties or proceedings have been pending in court would have been more enlightening.

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[105] **Capital Markets Authority ANN. REP. 39 (2010).**

[106] See Paul Wafula, *Surge in fraud threatens business,* BUSINESS DAILY, Dec. 28, 2010 at 16; Mwaura Kimani, *Financial Services Sector in Africa hit hard by fraud,* BUSINESS DAILY, Dec. 10, 2010 at 8; Victor Juma, *Employee theft raises demand for fraud experts,* BUSINESS DAILY, Dec. 13, 2010 at 12; Jackson Okoth, *CMA recovers lost monies as it intensifies the fight against fraud*, THE STANDARD, Nov. 26, 2010 at 18; Paul Wafula, *Banks step up fight against theft,* BUSINESS DAILY, Jan. 11, 2011 at 9 (explaining that due to the general increase in fraudulent activities in the financial sector in the last two years, some banks had hired security and fraud experts).

Investigation

As a critical component of the enforcement process, the purpose of investigation is to ascertain whether alleged or suspected violations actually took place and who was responsible. It entails the gathering of specific information on a particular matter. Surprisingly, the IFC/CBK Report had not envisioned an administrative agency with overarching regulatory powers. Consequently, the CMA had no robust investigative or prosecutorial powers for many years.[107] The legislature appears to have reasoned that the Kenya Police Service had the requisite capacity to investigate offenses created by the Act. Investigative powers are now embodied in section 13A of the Act. However, only the chief executive of the Authority is mandated to invoke the powers. The provision ordains that if a senior officer or manager authorized by the chief executive of the Authority to inquire into the affairs of a person is satisfied that an offence has been committed, he may apply to a Magistrates Court for a warrant to search the premises of the person.[108] This provision was introduced by the Finance Act, 2008. Provisions of the Central Depositories Act on the investigative powers of the Authority are more emphatic. Section 56 empowers the CMA to enter and search any premises if it has reasonable ground to suspect that an offence under the Act has been or is being committed.

To energize its investigative capacity, the CMA established a Fraud Investigation Unit in May 2009. The unit was mandated to investigate suspected violations and fraud, including theft, conversion of funds and employee pilferage, identify perpetrators and gather evidence for their prosecution. It was contemplated that the unit would manage the risk of fraud through prevention, detection and deterrence.[109] Noteworthy and worrisome, investigations by the CMA have not previously generated enforcement actions. It is arguably necessary for the CMA to disclose the actual action taken against licensees or listed companies even if the identity of the culprit is not disclosed. The current practice of aggregating complaints and infractions in terms of numbers received and resolved without any further explanation glosses over material information. A reasonably detailed explanation would promote transparency and bolster the CMA's reputation as a consumer focused organization. Similarly, it would benefit stakeholders and scholars in understanding and characterizing the Authority's enforcement philosophy and intensity.

Apart from investigations undertaken by its officers, the CMA has previously engaged professional firms principally, accountants and lawyers to investigate specific incidences of infractions. When Uchumi Supermarkets Co. Ltd (a publicly held company) ceased to carry on business on May 31st 2006, the Authority engaged a constellation of advocates, auditors, receivers and capital market specialists to investigate the circumstances leading to the closure and in particular transactions involving the company's securities.[110] The investigation uncovered *inter alia* instances of securities trading by persons who may have been in possession of material non-public information. In 2009, the CMA engaged Price Waterhouse Coopers (PwC) to perform a forensic audit on Francis Thuo and Partners Co. Ltd.[111] Investigations were also been undertaken at the instigation of the Treasury. After Nyaga Stock brokers Co. Ltd was placed under statutory management by the CMA, Treasury engaged Price Waterhouse Coopers to conduct a forensic audit on the firm. The report implicated the CMA, NSE and the CDSC in duplicity.[112] Recommendations of the reports were neither made public nor implemented.

Significantly, the Capital Markets Fraud Investigation Unit investigated the circumstances leading to the collapse of the four stock brokerage firms and recommended the prosecution of six persons.[113]

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[107] § 13

[108] The Magistrate has jurisdiction to issue a warrant authorizing the officer to (1) enter any premises to search for money, documents or assets and seize the same (2) direct the person in possession of the assets to act in accordance with the directions of the Authority with a view to preserving the assets or (3) make copies of documents or extracts held by a bank.

[109] The unit is made up of police officers from criminal investigation department with experience in investigating fraud, cyber and other white collar crimes. See Benson Kathuri, *The task ahead for market fraud unit*, THE STANDARD, May 13, 2009 at 18.

[110] The firms engaged were: Mohammed & Muigai Advocates, DCDM Consulting, Begbies Traynor and Indian Institute of Capital Markets respectively under a project code named *Project "Tafuta"* (*Tafuta* is the Swahili word for search).

[111] James Anyanzwa, *CMA to Investigate troubled Broker*, THE STANDARD, June 2, 2009, at 26.

[112] See Standard Team, *Report reveals depth of lot at Stock Market,* THE STANDARD, Feb 10, 2009 at 17; Wahome Thuku, *State to Prosecute former Brokerage firm manager,* THE STANDARD, Apr. 1, 2010 at 19.

[113] See Washington Gikunju, *Police turn the heat on Stock mart fraudsters*, BUSINESS DAILY, Oct. 26, 2010 at 31; Washington Gikunju, *Crackdown on Fraudsters*, BUSINESS DAILY, Oct. 27, 2010 at 19.

It will be enlightening to see how many criminal cases will be instituted, for what offenses and the outcomes.[114] The CMA appeared to have the gumption to take enforcement action against market miscreants.

Power of intervention, sanctions and penalties

To deter breaches of the provisions of the Capital Markets Act, regulations and other forms of securities markets improprieties, the CMA has a panorama of enforcement actions at its disposal. Principal among them are, power of intervention, sanctions, penalties, and judicial proceedings.

Power of intervention

The Capital Markets Authority is empowered to intervene in the business of its licensees in certain defined instances[115] and in any other circumstances in the interest of investors. These powers are intended to widen the scope of enforcement actions which the Authority could take to safeguard the interests of investors and the securities markets. Under section 33A of the Capital Markets Act, the Authority may exercise its powers of intervention in four principal ways.

First, the Authority is empowered to appoint a competent person or persons as "statutory manager" to assume the management, control and conduct of the affairs and business of a licensed person. The manager is required to exercise all powers of the licensed person to the exclusion of its board of directors. The appointment is initially for a period not exceeding six months but may be extended by the High Court on application by the Authority.[116] The CMA invoked this power at least four times between 2007 and 2011. Whereas the power was arguably not intended to constitute the commencement of winding up of licensees, the CMA appears to have interpreted it as *carte blanche* to put miscreant stock brokerage firms out of business. Except in the case of Ngenye Kariuki Stockbrokers Ltd, statutory management and winding up appeared synonymous.[117]

Because statutory managers are appointed "to assume the management, control and conduct of the affairs and business of a licensed person to exercise all the powers of a licensed person" to the exclusion of its board of directors, it is open to question whether they are required to carry on the business of the licensee in the ordinary manner as opposed to closing it which has been the standard practice. The Act is categorical that the statutory manager can only petition the High Court for winding up if "it is just and equitable to do so in the interest of all interested parties."This phrase implicates the interests of a wide spectrum of stakeholders which the closure of business does not appear to contemplate.

With regard to Francis Thuo & Partners Ltd, the amount paid by Renaissance Capital Ltd was more than the liabilities of the firm. The firm is yet to resume trading on the NSE. It is unclear whether the NSE was auctioning the seat of Francis Thuo & Partners Ltd on the NSE or another seat or whether the firm received any surplus.[118] If it contemplated the former case, the transaction would have been unlawful because it would have been tantamount to the transfer of one firm's license to another entity. The matter remains outstanding.[119]

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[114] See Zadock Angira, 16 sought over theft of Kshs 4m ($50,000) investor funds from brokers, DAILY NATION, Jan. 19, 2011 at 25; CMA, *Public Notice*, DAILY NATION, Jan. 18, 2011 at 35. Disconcertingly, Kenya's criminal law does not impose extraordinarily harsh penalties on persons convicted of fraud. The maximum imprisonment term under the Penal Act is seven years while the maximum fine under section 34 of the Capital Markets Act is only Kshs. 15 million ($187,500). Offences such as conspiracy to defraud, fraudulent appropriation or accounting by officers of the company and fraudulent accounting by clerks or servant attract a custodial sentence of only three and seven years respectively. Supra note 1252, §§ 317, 328 and 330.

[115] These include: if a person's license or approval is suspended under the provisions of section 25, a winding up petition is filed, a resolution to wind up licensed person has been proposed, a receiver or receiver manager has been appointed in respect of a licensed person or in respect of all or any of its assets.

[116] See Benson Wambugu, *High Court extends Brokers' Statutory Managers term,* BUSINESS DAILY, May 14, 2010 at 18.

[117] See Francis Thuo & Partners Stock brokers Ltd, Nyaga Stock brokers Ltd and Discount Securities Ltd.

[118] See John Gachiri, *Francis Thuo plans return to NSE after five years in the cold,* BUSINESS DAILY, April 3, 1 2012.(reporting that the stoke broking firm was busy searching for a partner to reactivate its stock brokerage license);

[119] See James Anyanzwa, *Collapsed broker clings to license*, THE STANDARD, May 6, 2008 at 16. More recently in 2011 the issue arose in the demutualization of the Nairobi Securities Exchange. Members of the securities exchange argued that the firm is still a member of the exchange. It will be interesting to see how the regulator grapples with this challenge; David

An fascinating aspect about the Francis Thuo & Partners Ltd conundrum was that the CMA appointed the NSE the statutory manager and with the former's acquiescence, the latter bailed out the stock brokerage firm by publicly auctioning a seat on the securities exchange which Renaissance Capital Ltd clinched for Kshs. 251 million ($313,750).[120] Noteworthy and worrisome, the lack of accountability on the part of the regulator continued and in the Nyaga Stockbrokers Ltd debacle, the CMA appointed itself and the NSE as joint statutory managers. In the Ngenye Kariuki Stockbrokers Co. Ltd quagmire, the CMA appointed itself the statutory manager. Needless to emphasize, the appointment of statutory managers and exercise of their statutory powers is critically important because it implicates the CMA's accountability to the securities markets generally.

Second, the Authority has jurisdiction to remove officers or employees of licensees who in its opinion have occasioned or contributed to the contravention of the provisions of the Capital Markets Act or Regulations or deterioration of financial stability of the licensee or are guilty of conduct detrimental to the interests of investors. This is one of the draconian powers conferred upon the CMA which it has not invoked in the past.

Third, the Authority is empowered to appoint a competent person who is familiar with the business of a licensee to its board of directors to serve as its director. The appointee can only be removed from office with prior approval of the CMA or by an order of the High Court. The Authority is yet to activate this power.

Finally, the Authority is empowered to revoke or cancel any existing power of attorney, mandate or appointment or other authority by a licensee in favor of any officer, employee or any other person. The Authority has not reported having invoked this power in relation to a licensed person.

The rough logic behind these powers was to ensure that the CMA had the full complement of protective mechanisms to safe guard the interests of investors and the securities markets. Regrettably, the CMA has replicated the practice of company receivership under Corporate Law where the appointment of a receiver irreversibly leads to winding up.[121]Virtually all companies placed under receivership in Kenya are wound up. But the two systems are largely dissimilar. Receivers are typically appointed by creditors or the court at the instigation of creditors to facilitate recovery of the amount outstanding. Their sole responsibility is to safeguard the interests of the particular creditor(s). Conversely, statutory managers appointed by the CMA are required to safeguard the interests of a wider constituency.

On balance, the CMA's invocation of the power of intervention, particularly in relation to the appointment of statutory managers has been antithetical to the enhancement of securities markets. Ngenye Kariuki Stockbrokers Co. Ltd is the *locus classicus* exemplification. The CMA placed the firm under statutory management in early 2010 notwithstanding sustained protestation by KASIB and assurances by the proprietor that the amount outstanding would be secured. The impudence with which the CMA acted signified the regulators unwillingness to explore competing enforcement mechanisms in grappling with unparalleled circumstances. Although statutory management has since been lifted, the CMA is yet to license firm to commence trading on the NSE. The Authority appears to have reevaluated its handling of miscreant stockbrokers. This case is a dramatic exemplification of the regulator's propensity to satisfice as opposed to optimizing regulatory enforcement[122]

Mugwe, *Broker Francis Thuo wins battle for NSE share*, BUSINESS DAILY, 9 2012 at 19; John Gachiri, *Francis Thuo plans return to NSE after five years in the cold*, BUSINESS DAILY, Apr. 3, 2012 at 1;

120 See Washington Gikunju, NSE places Kshs. 251 million *($* 313,750) price tag as Stock broker's seat, BUSINESS DAILY, Apr. 8, 2009 at 18. See also, James Anyanzwa, NSE advanced Discount Securities Ltd, Kshs. 31m ($ 387,500), THE STANDARD, June 16, 2009 at 33**.**

121 Kenneth Kwama, *The Dark History of Receiverships in Kenya,* THE STANDARD, Mar. 23, 2010 at 4; Benson Wambugu, *Court blocks bid to place firm under receivership*, Business Daily, Dec. 20, 2010 AT 15 (in Commercial Bank of Africa Ltd. v. Kajulu Holdings Ltd, Muga Apondi J. is reported to have refused to grant receivership on the ground that it would invariably have led to the winding up of the respondent company).

122 See Washington Gikunju, *Billions at risk as CMA slams hammer on Broker*, BUSINESS DAILY, Mar. 17, 2009 at 14; Washington Gikunju, *CMA explains why action was taken against Broker*, BUSINESS DAILY, Feb. 15, 2010; Editorial, *Capital markets regulator must learn to play by rules*, BUSINESS DAILY, Apr. 3, 2012 at 10; Editorial, *Regulator must ensure market accountability*, BUSINESS DAILY, June 29, 2012 at 7.

Sanctions and penalties

Before 2008, neither the Minister of Finance nor the Capital Markets Authority had statutory power to prescribe or impose sanctions or penalties on market intermediaries and listed companies for breach of provisions of the Capital Markets Act. However, the CMA's licensing regulations empowered it to impose a variety of sanctions on licensees, their directors and employees as well as listed companies and their directors. Following the unprecedented collapse of Francis Thuo & Partners Ltd, the CMA instigated amendments to the Capital Markets Act to confer upon itself and the Minister statutory power to prescribe and impose sanctions and financial penalties on licensed persons, the securities exchange, approved persons, listed companies, directors and employees of licensed persons, approved persons and directors of listed companies. The changes were effected by a hodgepodge of amendments through the Finance Act. The Act now has a wealth of provisions empowering the Minister and the CMA to prescribe penalties for breach of provisions of the Act, Regulations and Rules of procedure of a securities exchange, including the levying of financial penalties of such amounts as may be prescribed depending on the gravity or severity of the breach. In sum, the Authority enjoys an enviable spectrum of statutory sanctions.[123]

Disqualification from employment or appointment as directors was intended to prevent untrustworthy persons from being part of the securities markets for the specified duration. The CMA invoked this sanction in Capital Markets Authority v. Shah, Munge & Partners Ltd in 2002. Unfortunately, neither the Act nor the regulations require the Authority or any other person to maintain a register of disqualified persons which is essential for institutional memory. Publishing findings of malfeasance is undoubtedly a drastic penalty because of its wide implications on the person's reputation. Although the CMA has publicly declared its willingness to name and shame market intermediaries, it has not actualized the threat.[124]

An interesting sanction is the power to recover amounts equal to double the benefit accruing to the person from the breach. This power converts CMA to an assessor or court of law and raises pertinent questions of due process and even-handedness. It presupposes that the CMA has the infrastructure to assemble and assess the veracity of facts and determine the benefit likely to accrue from a particular breach. This is an exceedingly complex undertaking even for courts in developed jurisdictions.

Restitution orders

Section 34 (3) of the Capital Markets Act, provides that a person convicted for contravening any provision of the Act may be ordered by the court to pay compensation to any person who suffers loss by reason of the contravention. The compensation may be either in addition to or in substitution for any other penalty. The amount of restitution or compensation for which the person is liable is the profit accruing to the person or the loss sustained or the adverse impact of the breach on the aggrieved party or parties or where the harm is borne by the market, the illegal gains or the loss averted.

This provision lacks clarity in certain respects. First, it is elusive whether the aggrieved person has the right to sue for restitution or compensation. The provision uses the word "may" which implies the absence of an obligation. Second, the reference to "court" is ambiguous because the provision is based on criminal offenses. Whether the word is used to designate the criminal court or the court in subsequent civil proceedings is unclear. Third, it is uncertain whether conviction is a condition precedent to restitution or compensation. What if the person is not convicted but the third parties suffer loss? Fourth, the provision uses the term "penalty" rather imprecisely.

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[123] These include: disqualification of persons from employment or appointment as directors of listed companies, stock exchange, licensed or approved persons for a specified period, recovery from the employee or person an amount equivalent to double the benefit accruing by virtue of the breach, requiring licensed or approved persons to take action against employees who are in breach of the provisions of the Act, revocation or restriction on the use of licenses, suspension o a licensed person from trading for a specified period, suspension in the trading of a listed company's securities for a specified period, reprimand, ordering a person to remedy or mitigate the effect of the breach and, publishing findings of malfeasance by any person.

[124] See Justus Ondari, *We will shame rogue brokers, says Capital Markets Authority,* BUSINESS DAILY, May 26, 2010 at 19. (The report quotes an anonymous stock broker intimating that the CMA responsibility was to facilitate the smooth operations of the securities markets not to publish information that was injurious to the markets. The broker argued that such a move would be too drastic and counterproductive).

In criminal proceedings once the accused is convicted, sentence follows and typically takes the form of a fine, imprisonment or both. The ambiguity of the term is compounded by the substitutability of the penalty and compensation which is impracticable in law. Finally this provision appears to suggest that a person convicted and sentenced for contravening the provisions of the Act may be required to pay compensation or restitution in addition to other penalties imposed by CMA which would implicate the principles of equity in the administration of justice.

Closely allied to the foregoing argument, the Authority is also empowered to make orders for restitution. Under section 25A (2) the Authority may in addition to any other sanction or penalty imposed on any person for contravening the provisions of the Act, regulations, rules or procedures of a securities exchange, make orders for restitution. However under section 25A (3), the Authority is required to make an order for restitution if the breach occasions loss to one or more parties, provided:

- the amount of loss is quantified and proved to the Authority by the claimant, and
- a notice setting out the amount claimed and the right of the party to be heard has been sent by the Authority to the person expected to make restitution.

Analogous to section 34, the power to make orders for restitution under section 25A (2) is discretional. Secondly, the provision is unclear on how and when aggrieved parties are required to file their claims, procedural safeguards, rules of evidence and the standard of proof. Analogous to section 25A (1), this sub-section constitutes the CMA into a juridical agency. Evidently, there is need for more elaborate provisions on restitution or disgorgement.

Other orders

Surprisingly, the Authority is empowered compound criminal offences and impose fines on suspects without prosecution. Section 62 of the Central Depositories Act provides that where the Authority is satisfied that a person has committed an offence under the Act, it may order the person to pay a sum of money not exceeding fifty percent of the amount of the minimum fine to which the person would have been liable if he had been prosecuted and convicted. If the fine is not paid within fourteen days of the order, the Authority may cause criminal proceedings to be instituted against the person. This provision is reticent on how the Authority satisfies itself that the person would have been convicted, the procedural safeguards and more importantly the principles applicable in determining the amount of fine.

In sum, these powers implicate the CMA's organizational capacity and commitment to due process. Since the Authority does not conduct administrative proceedings, it is bothersome to hypothesize on what principles it imposes financial penalties. This is because assessing the amount to be paid is an arduous task in practice.
Concededly, these provisions accord the CMA flexibility and promptness necessary in dealing with a dynamic sector such as the securities markets. However, because the securities markets are still nascent, it behooves the Authority to exercise its discretion judiciously. The CMA has invoked this power to impose sanctions by meting out substantial financial penalties on market intermediaries. Imposition of financial penalties for administrative breaches remains the most treasured enforcement tool.[125] Although the jury is still out on the effectiveness of this strategy, the CMA was sending an unequivocal message that it would not countenance nefarious conduct in the securities markets. As securities markets recover from the confidence crisis occasioned by the catastrophic collapse of four stock brokerage firms, a sustained firm approach on market intermediaries and publicly held companies remains instrumental in the restoration of investor confidence.

Winding Up

Typically, when fraud is discovered, there are insufficient assets to pay accumulated debts and other obligations[126]and winding up the corporation may be the only remedy in the circumstances. This is a terminal remedy which is seldom resorted to.

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[125] See Joseph Bonyo, *CMA tightens the noose on brokers,* DAILY NATION, May 4, 2009, at 13(reporting that CMA had imposed fines ranging from Kshs. 100,000($1,250) to 6 million ($7,500). In the words of one stock broker, "We were fined some Kshs. 250,000($3,125) for two small issues that we have rectified and even defended before the board."

[126]See James Fishman, Supra note 1370 at 158.

Section 33A (9) provides that winding up of a licensed or approved person should only be resorted to where it appears to the statutory manager that it is just and equitable to do so in the interest of all interested parties. The statutory manager is required to consult the Authority before petitioning the High Court for the winding up order. This provision makes it imperative for the statutory manager to determine whether the winding up a licensee or authorized person is beneficial to all interested parties. Unsurprisingly no petition has been made against any of the stock broking firms placed under statutory management.

Other proceedings

Section 34A (2) of the Capital Markets Act provides that the discretion conferred upon the Authority to levy financial penalties or impose other sanctions does not prejudice the right to pursue other legal proceedings vested in the Authority. Although no specific statutory provision confers on the Authority the right to enforce the provisions of the Act through civil proceedings, it has previously sought the court's jurisdiction under its expansive statutory mandate of "protection of investor interests."[127] The position is more explicit where criminal offences are involved. Constitutionally, the power to prosecute offenders in Kenya is vested in the office of the Director of Public Prosecutions.[128] However, the Authority is empowered to prosecute offences under the Capital Markets[129] and the Central Depositories Acts.[130]The CMA should have unrestricted statutory authority to institute civil proceedings against market intermediaries and directors of publicly held companies as part of its enforcement arsenal.

Finally, since securities law does not confer a private cause of action to enforce the provisions of the Capital Markets Act or the Central Depositories Act, and the law on investor remedies at common law is exceedingly investor unfriendly, private actions have not contributed to deterrence in any significant way. Providing for a statutory private right of action would complement public enforcement of securities laws and improve securities markets governance. Importantly, it is unlikely to lead to an avalanche of suits.

The most striking consequence of the 2007/2012 amendments to the Capital Markets Act and its Regulations was that they constituted the CMA the prosecutor, judge and jury over malfeasances committed by market intermediaries, listed companies and their directors. The amendments manifested a predictable reaction by the CMA to the dramatic collapse of stock broking firms which challenged its capacity and commitment to regulate the securities markets effectively.[131] These amendments were intended to bolster the Authority's enforcement toolkit. The imposition of exceedingly punitive financial penalties on market intermediaries immediately thereafter was not uncontemplated. This is not atypical for regulators. Generally, "after the decision to regulate is made, regulators move immediately toward heavy-handed mandatory requirement and prohibitions."[132] Although a comprehensive diagnosis of the problem had not been made, it was imperative for the CMA to stamp its authority and express its detestation of the egregious conduct of market intermediaries. The unlimited mandate to impose financial penalties coupled with the power to exercise its discretion under the different provisions cumulatively was intended to accord the Authority the requisite flexibility in enforcement.

Numerous challenges confront the CMA in its endeavors to operationalize the new provisions. For instance, how is a violation such as overdrawing clients account or not engaging a compliance officer quantified? What about, non-compliance with the CMA's directives? Without clear guidelines on how to attach monetary values on infractions and the circumstances which the CMA must consider when imposing the actual penalty, it is difficult to hypothesize how the penalties may be perceived as procedurally fair by market intermediaries.

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[127] See Sam Kiplagat, CMA, Consolidated Bank Co. Ltd. seek to recover Kshs. 12 million ($150, 000) from Nyaga Stock brokers Co. *Ltd*, DAILY NATION, July 6, 2010 at 18.

[128] Art. 157(6) of the Constitution of Kenya, 2010.

[129] § 38 empower the Attorney General of the Republic of Kenya, on request by the Authority to appoint any officer of the Authority or an Advocate of the High Court to be a public prosecutor for the purposes of offences under the provisions of the Act.

[130]§ 63 empower the Authority to conduct prosecution against offences under the Act in person or by any officer authorized by the Authority in writing.

[131] See Simon Orton, *Proposals for Enforcement and Discipline under the United Kingdom's new Financial Services and Markets Regime*, 1(3) J.I.F.M. 128, 132 (1999); James Anyanzwa, *CMA credibility hurt as Brokers fight back,* THE STANDARD, Jan. 19, 2009 at 22; Geoffrey Irungu, *Stock brokers want deadline for new Rules extended*, BUSINESS DAILY, Dec. 23, 2009 at 12.

[132] Stephen J. Choi, *The Framework for the Regulation of Market Intermediaries*, 1BERKELEY BUS L. J. 45, 81(2004).

These are teething problems the Authority must surmount. As the CMA attracts and develops more expertise, the rough edges of the law will smoothen out. Although some commentators question the effectiveness of financial penalties on the premise that they seldom address fundamental organizational challenges such as behavioral change, they acknowledge that they are an indispensable enforcement tool in the regulation of securities markets.[133] Analogous to the US and UK, the power to impose financial represented a dramatic shift in regulatory style from the traditional criminal law to "civil penalties."

Market intermediaries contended that the CMA should have labored to appreciate the challenges the industry was facing and should have been more sympathetic and proactive in identifying solutions.[134] Undeniably, stock brokers were facing serious challenges of corporate governance, internal controls and compliance capacity but appear to have taken advantage of the challenges and a passive regulator to defraud the market.[135] The fact that the Authority had power to impose financial penalties on market intermediaries under the licensing regulations but did not invoke it demonstrated regulatory inertia at the time. The tough enforcement stance adopted by the CMA in the recent past was perceived positively by investors who for a long time had to endure the serpentine character of market intermediaries. Although the heightened enforcement posture of the CMA has antagonized its previous complaisant relationship with market intermediaries, its long term benefits to investors and the securities markets cannot be overemphasized.

Another important mechanism that the CMA should pursue to augment its enforcement efforts is compliance competence which demands its involvement in training, communication and nurturing the values and culture of compliance by market intermediaries and listed companies.[136] "Regulation cannot by itself prevent the failure of banks and other of financial institutions."[137] It is imperative for the Authority to ensure that proper business practices and standards are maintained. This is important because although investigations instituted by the CMA and the Treasury on collapsed stock broking firms disclosed instances of market impropriety, no enforcement action was taken. This underscores the need to promote the culture of compliance. The CMA's overall approach to enforcement against securities markets intermediaries' particularly stock brokers has been reactionary and confrontational.[138]

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[133] See generally, John T. Scholz, *Enforcement Policy and Corporate Misconduct: The Changing Perspectives of Deterrence Theory,* 60 SUM LAW & CONTEMP. PROBS. 253; John S. Baker Jr., *Reforming Corporations Through Threats of Federal Prosecution*, 89 CORNELL L. REV.310, 337 (2004); Barry W. Rashkover, *Reforming Corporations Through Prosecution: Perspectives from an SEC Enforcement Lawyer*, 89 CORNELL L. REV.535 (2004). For a comparative analysis of the enforcement approaches between the United States and the United Kingdom, see Joseph Silvia, *Efficiency and Effectiveness in Securities Regulation: Comparative Analysis of the United State's Competitive Regulatory Structure and the United Kingdom's Single Regulatory Model,* 6 DEPAUL BUS. & COM. L. J. 247; Cass Sunstein, *On the Expressive Function of Law,* 144U.PA. L.REV. 2021 (1996); Dan M. Kahan, *Social Influence, Social Meaning, and Deterrence*, 83 VA. L. REV. 349, 362-65 (1997); Melvin A. Eisenberg, *Corporate Law and Social Norms,* 99 COLUM. L. REV. 1253 (1999); Cass Sunstein, *Social Norms and Social Roles,* 96 COLUM. L.REV. 903(1996); Julia Black, *Tension in the Regulatory State*, P.L. 58, 70-2 (2007); Choi, Supra note 1442 at 81. For an inspiring discussion on the ineffectiveness of harsh financial penalties as a deterrent mechanism, see Cristie Ford, *Toward a new model for securities law Enforcement*, 57 ADMIN. L. REV.757.

[134] See CHRISTOPHER STONE, WHERE THE LAW ENDS, 121 (1971); Donald C. Langevoort, *Monitoring: The Behavioral Economics of Corporate Compliance,* 2002 COLUM. BUS L. REV. 71.

[135] See Geoffrey Irungu, *Stock broker's System 'Vulnerable.'* DAILY NATION, Sept. 15, 2010 at 23; Jackson Okoth, *NSE seeks reliable Broker System to stop Fraud*, THE STANDARD, Oct. 20, 2009 at 19; Wachira Kang'aru, *New System to curb Share fraud,* DAILY NATION, July 17, 2009 at 18; James Anyanzwa, *NSE in fresh attempt to install Broker trading system,* THE STANDARD, Sept. 21, 2010 at 14. (This was a back office computer system intended to facilitate monitoring of trade in securities by brokers and investment banks to reduce fraud and other malpractices by their employees); Editorial, *Upgrade Security Systems to Safeguard Capital Markets,* BUSINESS DAILY, Jan. 22, 2009 at 17; Wachira Kang'aru, *Second Generation Managers on the spot,* DAILY NATION, Jan. 26, 2009 at 14 (pointing out that that in the case of Francis Thuo & Partners, Nyaga Stock brokers and Discount Securities, the founding proprietors had relinquished the day-to-day affairs of the firms to their sons).

[136] See generally Jonathan Edwards & Simon Wolfe, *Compliance: A Review,* 13(1) J.F.R. 48(2005).

[137] William Blair, *The Reform of Financial Regulation in the U.K.*, 13(2) J.I.B.L. 43, 449 (1998).

[138] One of the most contentious issues has been the shareholding of the demutualized Nairobi Securities Exchange. While the Government argues that it should have a share, stock brokers and Investment banks have vehemently opposed the move insisting that the Government has not invested anything to warrant a share. After acrimonious discussions, it was proposed that the Government would hold 20% of the demutualized exchange. But the stand off has persisted and delayed the process

To create the desired impact, the Authority has abandoned other enforcement tools in favor of statutory management and financial penalties. This has fuelled animosity and suspicion between the regulator and market intermediaries. Although the CMA should have deployed a wider selection of enforcement tools, financial penalties appear to be an appropriate weapon in the circumstances. The enforcement posture adopted by the CMA appears consistent with its strategic objective of facilitating the development of orderly, fair and efficient securities markets in Kenya. This is necessary to galvanize the markets to the next level.

C. Enforcement Jurisprudence

Attempt to characterize a particular jurisdiction's securities markets enforcement jurisprudence is complicated because there is no analogous jurisdiction for a comparative inquiry. Enforcement jurisprudence is dependent on many cross-country variables and is largely country specific. Budget levels, staffing, role of the stock exchange and other market intermediaries, presence of complementary bodies, private enforcement, regulators predilection, nature of penalty and other factors inform the enforcement philosophy. Moreover, there is no optimal enforcement intensity.[139] As pertinently observed:

> "Some regulators may advice, request, and admonish, but are slow to punish. Others may believe that punitive fines generate a desirable general deterrent effect, and that the greater danger lies in using overly mild penalties that can be easily absorbed as a cost of doing business."[140]

The Financial Services Authority of the United Kingdom is reputed for using the collaborative approach to regulation. In some jurisdictions stock exchanges are part of the regulatory equation while in others they play a passive role.[141] Furthermore, some jurisdictions are ill-prepared to pursue enforcement actions vigorously. Ultimately, the challenge is whether "a particular jurisdiction's intensity ensures an adequate level of compliance or sufficient oversight to foster robust capital markets."[142]This is because in most jurisdictions, the regulatory structure is predicated on the notion that securities' trading is socially beneficial. Although commentators on securities markets concede that enforcement intensity, market development and competitiveness are correlated, it is difficult to measure the public benefits of enforcement.[143] Thus, enforcers of securities markets law should pay particular attention to the markets when formulating and implementing their enforcement strategies. Indisputably, securities markets are a tool for development.[144]

Assessing the CMA's enforcement jurisprudence is arduous because the Authority has neither an enforcement pyramid nor an elaborate reporting system.[145] It is unclear whether the Authority engages in collaboration, problem solving, or employs lower level sanctions such as reprimanding or warning letters before drastic regulatory action is taken. Section 25A which requires the Authority to publish in its annual report the names of persons against whom action has been taken under the provision makes no reference to the enforcement action itself. It is submitted that on-site inspections are an important enforcement tool to address most of the concerns the Authority may have with a particular market intermediary.

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of demutualizing the exchange which is part of the reforms the Capital Markets Authority has been implementing. See Geoffrey Irungu, *Brokers oppose OTC market plan for bond trading,* BUSINESS DAILY, Aug. 15, 2012 at 31; Geoffrey Irungu, *Treasury rejects brokers' bid to dilute its stake in Nairobi bourse*, BUSINESS DAILY, Aug. 23, 2012 at 1..

[139] See generally Howell E Jackson, *Variation in the Intensity of Financial Regulation: Preliminary Evidence and Potential Implications*, 24 YALE J. ON REG. 253 (2007) (On the challenges of comparing and measuring the benefits of regulatory intensity); Howell E. Jackson, *Regulation in a Multi-sectored Financial Services Industry*, 77WASH U. L. Q. 319.

[140] See John C. Coffee Jr., *Law and the Market: The Impact of Enforcement,* 156 U.PA. L. REV. 230, 276 (2007/8).

[141] The Hong Kong Stock Exchange for example has oversight over new listings.

[142] See Howell E. Jackson, *The Impact of Enforcement: A Reflection,* 156 PA. L. REV. PENNUMBRA 400, 406 (2008).

[143] *Id* at 406. See generally Coffee JR., supra note 1391; Rafael La Porta et al., *What works in Securities Laws*? 61 J. FIN.1 (2006); James R. Barth et al., *Bank Regulation and Supervision: What works Best?* 13 J. FIN. INTERMEDIATION, 205 (2004); James D. Cox & Edward F. Greene, *Financial Regulation in a Global Market Place: Report of the Duke Global Capital Markets Round Table,* 18 DUKE J. COMP. & INT'L L. 239 (2007); Cyrus Afshar & Paul Rose, *Capital Markets Competitiveness: A Survey of Recent Reports*, 2 ENTREPRENEURIAL BUS L. J. 439 (2007).

[144] See John C. Coffee Jr., *Two tale of Enforcement*, 77 EURO LAW 3(2008).

[145] See generally, David P. Doherty et al, *The Enforcement Role of the New York Stock Exchange,* 85 NW. U. L. REV. 637 (1991).

Regulatory enforcement in the securities markets has assumed increasing importance over recent years, particularly following the dramatic closure of Uchumi Supermarkets Co. Ltd and the spectacular collapse of four stock broking firms in succession. Intriguingly, a historical review of the Authority's enforcement regime from 1990 to 2009 discloses no clear philosophy.

Analysis

The Tables below illustrate the number and character of enforcement actions taken during the tenures of different chief executive of the CMA from 1990 to the present. The intensity of enforcement varied with the occupier of the office of chief executive and generally vacillated between both ends of the continuum. Comparatively, it was either exceedingly low or reasonably intense.

1990-1994

Organization	Delisted	Suspended	Denied License	Licensed
Listed Companies	-	-	-	-
Stock brokers	-	-	-	13
Investment Advisers	-	-	-	-
Fund Managers	-	-	-	-
TOTAL	-	-	-	13

Evidently, no enforcement action was taken during this period. This is primarily because the Authority was in its formative stages and the NSE's influence on the market had not dissipated. The Authority was largely acting in concordance with the wishes of the NSE. For instance, the thirteen stock broking firms the Authority licensed were owned by individuals who were known to the directors of the stock exchange. Some of the proprietors were former employees of the original six firms. Another reason why no major enforcement decisions were made may have been because the Authority was a small outfit lacking the necessary expertise and experience to assert its authority as regulator. More importantly, this period was the apogee of corruption, ethnicity and patrimonialism.[146]

1995-2002

Organization	Delisted	Suspended	Denied License	Denied Listing
Listed Companies	10	5	-	2
Stock brokers	-	2	-	-
Investment Advisers	-	-	1	-
TOTAL	10	7	1	2

From an enforcement perspective this may be characterized as one of the most active periods for the securities markets. The CMA assumed the role of a regulator and listed companies were the most affected by the enforcement actions. The Authority appears to have adopted a non-compromising approach in enforcing the provisions of the Act and its regulations. The number of listed companies dropped significantly because there were more delistings than listings. Because of its passivity during the preceding years, commentators on the Authority's enforcement methodology characterized it as "the traditional fault-finding, heavy-handed type." They advocated for a more "pro-active, creative, supportive and progressive" approach if CMA was to become a partner in the growth and development of the securities markets. *Prima facie,* these enforcement actions appear rather harsh because the securities markets had very few listed companies and market intermediaries. More importantly, the delistings and suspensions took place within a short period of time. Due to the dearth of information on the circumstances that led to the delistings, it is not implausible to surmise that the CMA was discharging its statutory mandate. This hypothesis is buttressed by the fact that the denial of listing to the two companies was legally justified.[147]

[146] See Furnivall, supra note 88; supra notes 83- 89.
[147] See Michael Power, *Stock Market participants require professional training*, DAILY NATION, July 13, 1993 at 4 (Alluding to the fact that the CMA had acted professionally by refusing to approve the listing of securities by Trade Bank Co. Ltd although the NSE had approved the issue and was pestering the Authority to do the same. The Authority adamantly refused

2003-2007

Organization	Delisted	suspended	Denied license	Denied Listing	Suspension lifted
Listed Companies	2	-	-	-	-
Stock brokers	-	1	-	-	2
Investment Advisers	-	-	-	-	-
Fund Managers	-	-	-	-	-
TOTAL	2	1	-	-	2

From the statistics, it is unambiguous that the number of enforcement actions taken during the period under review was negligible.[148] The Authority appears to have adopted a non interventionist approach leaving the NSE to guide the securities markets. The absence of the CMA's leadership during this period was palpable. This argument is fortified by the discourteous commentaries and editorials in local newspapers castigating the Authority's inactivity[149]and the exaggerated profile of the NSE. The latter was illuminated by the regular briefings and market updates by the chairman of the NSE.[150]

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citing non-disclosure. The company collapsed shortly thereafter and its proprietors escaped to Canada to avoid prosecution for fraud). In the second case, the company failed to raise the minimum subscription as required by the section 49 of the Companies Act and the IPO aborted.

[148] See Washington Gikunju, *Stock broker suspended from Trading at the Nairobi Stock Exchange*, THE STANDARD, Feb. 17, 2007 at 21(the broker was first suspended for only two weeks); Washington Gikunju, *Broker suspended for six months,* THE STANDARD, Mar. 6, 2007 at 16; Mwaniki Wahome, *Stock broker suspended,* DAILY NATION, Mar. 6, 2007 at 27; Washington Gikunju, *Stock broker warned by Market Regulator over Money troubles,* THE STANDARD, Apr. 17, 2007 at 6 (absence of effective supervision by the CMA culminated in the firm being placed under statutory management in less than one year).

[149] See Editorial, *CMA must put its act in together or close shop*, THE STANDARD, Apr. 17, 2007 at 12; *The Public Watchdog, Capital Markets in need of competent Regulator*, THE STANDARD, Nov.27, 2007 at 13; Robert Bunyi, *CMA Stance poses major risks by giving brokers freehand to run the Market*, BUSINESS DAILY, Mar. 12, 2007 at 16; Editorial, *CMA must crack whip on errant Stock brokers,* THE STANDARD, Feb. 27, 2007 at 12; Washington Akumu, *Chief Executive Officer CMA: We are doing our best*, DAILY NATION, Mar. 27, 2007 at 13; Washington Gikunju, *CMA silent as deadline for troubled Stock broker now expires,* THE STANDARD, Feb. 27, 2007 at 8; Washington Gikunju**,** *Loopholes expose Brokers greed,* THE STANDARD, Feb. 27, 2007 at 12-13; Odhiambo Orlale & Owino Opondo, *Minister denies cartel controls Stock Market,* DAILY NATION, May 24, 2007 at 8; Robert Bunyi, *Regulator must act to protect market's integrity,* BUSINESS DAILY, Apr. 22, 2007 at 14; Michael Omondi, supra note 648; *Washington Gikunju, Radical change prescribed for bourse*, THE STANDARD, June 12, 2007 at 8-9; Washington Gikunju, *Agents defend role in Capital Markets,* THE STANDARD, Apr. 3, 2007 at 10; Wachira Kang'aru, *Even with failures, CMA has some key scores*, DAILY NATION, Dec. 4, 2007 at 11; Kimathi Njoka, *Investor at war with bank over Share deal,* THE STANDARD, Mar. 6, 2007 at 3(Family Finance Building Society was offering its share to the over 250,000 account holders in a private placement promising to list on the NSE after converting to a commercial bank but did not); Washington Akumu, *The best laid plans of Family Finance*, THE STANDARD, Nov. 28, 2006 at 18-19; Wachira Kang'aru, *New Bank puts off NSE Listing*, DAILY NATION, Apr. 25, 2007 at 29. Muroki Gititu, *School of Professional Studies floats Shares,* FINANCIAL POST, Sept. 23, 2007 at 7; Tom Mogusu, *Firms take solace in Private Placements,* THE STANDARD, Oct. 16, 2007 at 5; Peter Munaita, *Trans Century boss caught up in battle for Brokerage*, BUSINESS DAILY, Apr. 23, 2007 at 1; John Oyuke, Zero *Bidding flouts Procurement law,* THE STANDARD, Oct. 30, 2007 at 4; Mwangi Kainga, *Stock Market Regulator need to enforce Order*, FINANCIAL POST, May 6, 2007 at 9.Joseph Kinga, *Something going wrong at the NSE*, DAILY NATION, Nov. 20, 2007 at 12. Maurice Otieno, *CMA: A toothless bulldog held hostage by Stock brokers,* FINANCIAL POST, Dec. 23, 2007 at 5-7.(Asserting that the CEO of the CMA was one of the worst performers); Benson Oluka, *Crisis at Nairobi bourse loom amid charges of unethical trading,* THE EAST AFRICAN, Mar. 5, 2007 at 5;

[150] Geoffrey Kamali, *NSE intervenes in dishonest broker's saga,* EAST AFRICAN BUSINESS WEEK, Mar. 11, 2007 at 1; Joseph Bonyo, *NSE Explains poor trends at stock markets,* DAILY NATION, Nov. 3, 2008; Jimnah Mbaru, *NSE's Share Index could hit 7,500 mark next year*, THE STANDARD, Apr. 3, 2007 at 13; Wachira Kang'aru, *Stock brokers push for change of Rule at NSE*, DAILY NATION, Mar. 25, 2007 at 25; Washington Gikunju, *Gored by Agents,* THE STANDARD, Mar.23, 2007 at 12 (reporting that the NSE was proposing tough rules to deal with stock agents whom it considered a threat to their business);Washington Gikunju, *Bourse cautions public on unauthorized Agents*, THE STANDARD, May 12, 2007 at 3; *NSE, Press Release: Francis Thuo & Partners Co. Ltd,* THE STANDARD, Mar. 2, 2007 at 30 (assuring investors that NSE was formulating a rescue package for the firm); Geoffrey Irungu, *CDSC boss quits amid Stock broker pressure*, BUSINESS DAILY, June 22, 2007 at 5; Geoffrey Irungu, *Stock Market explains frenzy over Share trade, Daily Nation*, Nov. 23. 2006 at 29; Tom Mogusu, *More Deal, Please: CMA asked to run offers Simultaneously as Mumias Sugar Sale kicks off,* THE STANDARD, Dec. 6, 2006 at 6.Mwangi Kainga, *Investors Money safe,* say Mbaru, THE STANDARD, June 10, 2008 at 15; James Anyanzwa, *NSE Chief contract renewed*: *Mwebesa gets new lease of life after a six-month delay*, THE STANDARD, July 3, 2008; Kenneth Kwama, *Mwebesa exit: Did he jump or was he pushed out?* THE STANDARD, Nov. 24, 2008 at 14

The securities exchange became particularly conspicuous when the CMA appointed it the statutory manager of Francis Thuo & Partners Co. Ltd and Nyaga Stock Brokers Co. Ltd.[151]The CMA played a passive role in the delisting of the two companies. Members had resolved that the companies be delisted.[152]Notably, the lifting of suspension for the two stock broking firms was a magnanimous gesture.[153] But in a dramatic change in enforcement strategy the CMA appealed the decision of the Capital Markets Tribunal ordering it to approve the take-over of Carbacid Investments Co. Ltd by BOC Gases Co. Ltd. The Authority contended that the takeover had infringed the Takeovers and Mergers Regulations.[154]The appellate proceedings led to the suspension of trading in the shares of both companies for over three years to the detriment of investors.[155]The challenges facing Nyaga Stock Brokers Co. Ltd, Discount Securities Co. Ltd and Ngenye Kariuki Stock brokers Co. Ltd were traceable to the IPOs undertaken during the period under review. The IPOs were reminiscent of the United States 'back office' paradox of 1967-1970.[156] The CMA appeared unaware that brokers were facing serious back office challenges.[157]It is difficult to reconcile the Authority's enforcement approach during this epoch. It remained indifferent but purported to enforce its regulations when the Capital Markets Tribunal ordered it to approve the take-over bid.

This epoch was a classical exemplification of an instance where lax government oversight and strong but ineffectual self-regulation visited disastrous consequences on the securities markets. The experience bolsters the argument for greater government oversight.

2008- June 2012

Organization	Delisted	Suspended	Penalized	Statutory Management	Revocation of License	Restructuring Order
Listed Companies		1	-	-	-	-
Stock brokers	-	-	6	3	-	1
Investment Advisers	-	1	12	-	-	3
Fund Managers	-	-	-	-	1	-
TOTAL	1	1	18	3	1	4

(insinuating that the former CEO of the NSE was forced out by influential stock brokers); Washington Gikunju, *Transition at NSE as Mwebesa quits*, BUSINESS DAILY, Nov. 19, 2008 at 17.

151 See CMA Public Notice, *Appointment of NSE as Statutory Manager for Francis Thuo & Partners Co. Ltd.* DAILY NATION, Mar. 6, 2007 at 27; Advertiser's Announcement, *Notice: Nyaga Stock brokers Limited (Under joint Statutory Management of the CMA & NSE),* DAILY NATION, Mar. 26, 2008 at 17.

152 Supra note 271 at 14.

153 See James Anyanzwa, *Stock broker Re-opens after closure over financial distress*, THE STANDARD, Apr. 17, 2007 at 16. But see James Anyanzwa, *Doubts over legality of Bob Mathews director* , THE STANDARD, Mar. 24, 2009 at 24.(reporting that some of the directors of the firm were not fit for appointment)

154 See Michael Omondi, *CMA Appeals Oxygen Merger Ruling*, BUSINESS DAILY, Mar. 29, 2007 at 13; Wachira Kang'aru, *Fresh row hits BOC's Takeover of Carbacid Investments,* DAILY NATION, Dec. 9, 2008 at 18.

155 Kenneth Kwama, *Shareholders caught in Legal muddle*, DAILY NATION, Nov. 6, 2007 at 8-9; Mark Agutu, *CMA versus Tribunal in Takeover war*, DAILY NATION, Nov. 20, 2007 at 15; Evelyn Kwamboka, *Tribunal can't intervene in BOC Gases Suit, Court Rules,* THE STANDARD, Dec. 18, 2007 at 17; Justus Ondari, *BOC Gases Kenya still waiting to exhale*, DAILY NATION, Feb 26, 2008 at 8; Wachira Kang'aru, *Carbacid's Profit Growth lures Centum*, DAILY NATION May 19, 2009 at 9; Wachira Kang'aru, *Takeover locks up Wealth,* DAILY NATION, APR.3, 2007 AT 19; James Anyanzwa, *No deal in sight for BOC Gases, Carbacid Shareholders,* THE STANDARD, Mar. 4, 2009 at 20; Joseph Bonyo, *BOC Gases Co. Ltd, Carbacid Investment Co. Ltd Shares at the Bourse*, DAILY NATION, Nov. 11, 2009 at 21.

156 Some stock brokerage firms were overwhelmed by the business and could not cope. For a detailed discussion of the events, see JOEL SELIGMAN, THE TRANSFORMATION OF WALL STREET: A HISTORY OF THE SECURITIES AND EXCHANGE COMMISSION AND MODERN CORPORATE FINANCE, 450-51 (3rd ed.2003).

157 James Makau, *Inside fraud robs Brokers of millions*, BUSINESS DAILY, Jan. 22, 2009 at 14; Benson Wambugu, *Stock broker sued for "illegal" sale of shares,* BUSINESS DAILY, May. 6, 2009 at 18.

The chief executive during this period was a senior manager under the former chief executive and continued with the non-interventionist approach until a second stock broking firm was placed under statutory management.[158] Moreover, severe criticisms by local newspapers of the lackadaisical manner in which the Authority was discharging its mandate and the need for change were unrelenting.[159] To overcome the perception that it was apathetic to the securities markets, the enforcement philosophy of the CMA changed demonstrably and market intermediaries were the most affected.[160] The number and character of enforcement actions taken during the 2008/9 financial year increased astronomically from one in 2007 to twenty seven by 2009 rivaling the total number of enforcement actions taken between 1995 and 2002.

Incontrovertibly, this was an after-the-fact intervention and could not camouflage the reality that the CMA was guilty of dereliction of its statutory duty. Undeniably, the change in regulatory approach was a positive development for the securities markets. Typically, regulatory momentum increases after market scandals and is generally exemplified by the imposition of harsh penalties. Baldwin characterizes this regulatory methodology as a "new punitive regulation."[161] The placing of Ngenye Kariuki Stock brokers Co. Ltd under statutory management was contested by the firm's shareholders and market intermediaries. Whether the magnitude of improprieties in the securities markets increased or the CMA had resorted to the "black box" deterrence approach is difficult to ascertain.[162]

What appeared unmistakable was that the Authority had gravitated considerably towards an enforcement-led regulator.[163]The single company represented delisted voluntarily. Throughout 2010/11, the chief executive of the Authority labored to implement the United Kingdom's Financial Services Authority's risk based management system for market intermediaries in Kenya.[164] Stock brokers, investment banks and fund managers were for the first time subjected to stringent reporting, ownership and assurance requirements. Disconcertingly, although several positive steps were taken, no semblance of a coherent enforcement policy emerged.[165]

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[158] James Anyanzwa, *Regulator Licenses embattled brokers,* THE STANDARD, May 27, 2008 at 16; Philip Wahome, *CMA renews brokers' Licenses,* DAILY NATION, May 27, 2008 at 23; James Anyanzwa *Anxiety over Brokers' License renewal,* THE STANDARD, Mar. 10, 2009 at 16.

[159]The Public Watchdog, *Rethink Capital Markets Regulation and Operation,* THE STANDARD, Mar. 18, 2008 at 13; Washington Gikunju, *What it takes to tackle crises at Capital Markets*, BUSINESS DAILY, Mar. 28, 2008 at 26; Kevin Mwanza, *Rogue Stock brokers: A demise of Capital Markets Authority,* THE AFRICAN EXECUTIVE, Mar. 25, 2008 available at http://www.africa executive.com/modules/articles/php? Article=2933 (visited on Oct. 14, 2010); See also, Wachira Kang'aru, *Busy agenda, for NSE new board, Daily Nation,* July 17, 2008 at 14; Editorial, *CMA must move quickly to restore confidence*, BUSINESS DAILY, Feb 10, 2010 at 12.

[160] See Washington Gikunju, *CMA seeks powers to prosecute stock market Criminals*, DAILY NATION, Dec. 11, 2009 at 17; James Anyanzwa, *CMA hits out at Stock brokers,* THE STANDARD, Apr. 8, 2008 at 20; Washington Gikunju, *Stock brokers in tight spot as CMA acts on rogue trading*, BUSINESS DAILY, Apr. 22, 2009 at 20; Anyanzwa, *CMA to black list market fraudsters,* THE STANDARD, Mar. 11, 2010 at 28; James Anyanzwa, *CMA threatens to shut down Ngenye Kariuki Stock Brokers*, THE STANDARD, Mar. 10, 2010 at 32; Jackson Okoth & James Anyanzwa, *As market struggles, hope in Cheserem fades*, THE STANDARD, May. 26, 2010 at 4-5. James Anyanzwa, *Ngenye Kariuki Investors in the dark as CMA awaits brokers' revival,* THE STANDARD, Sept. 6, 2010 at 20; Washington Gikunju, *Weak Brokers face checks in new CMA Measures*, BUSINESS DAILY, Feb. 1, 2010 at 22; Washington Gikunju, *CMA plans new rules to protect investor funds*, BUSINESS DAILY, Jan. 7, 2009 at 10.

[161] See generally Baldwin R. *The new Punitive Regulation*, 67 M.L.R. 351 (2004).

[162] Moses Michira, *ICPAK to draft new Reporting Rules for Brokers,* BUSINESS DAILY, July 12, 2010 at 18 (reporting that the CMA had approached the Institute of Certified Public Accountants to make a template for financial reporting for stock brokers and investment banks. The template was scheduled to be ready by October 2010). See also Kevin Mwanza, *Stockbrokers and the CMA differ over Reporting format,* BUSINESS DAILY, July 21, 2010 at 6 (reporting that KASIB had rejected the idea of a financial reporting template being drafted by ICPAK on the ground that market intermediaries were companies incorporated in accordance with the provisions of the Companies Act and could not acquiesce regulation from ICPAK).

[163] See Geoffrey Irungu, *CMA plans stiffer penalties to reign on rogue brokers*, BUSINESS DAILY, Feb. 23, 2010 at 21.

[164] Georgosouli A. *The Revision of the FSA's Approach to Regulation: An Incomplete Agenda,* 7 J.B.L. 599 (2010) (arguing that the FSA was modifying the risk based management system to the management based Regulation); Gray J. *Is it time to highlight the limits of risk-based financial regulation?* CAP. MARKET L. J. 10 (2008); Black J. *The Emergence of Risk-based Regulation and the new Public Risk Management Regime in the United Kingdom*, P.L. 512, 545-46 (2005); David Mugwe, *CMA changes tack to ensure stability of stock brokers,* BUSINESS DAILY, Nov. 22, 2010 at 10; Joseph Bonyo, *Regulator to Profile Finances to prevent more collapses*, BUSINESS DAILY, Nov. 18, at 19.

[165] This is illuminated by the fact that in 2010, several closely held companies such as Deacons and Cooperative Insurance raised huge sums of money from the public on the pretext that the issues were private and the CMA did not intervene except in the case of

To consolidate its oversight over the securities markets, the CMA instigated the appointment of the Demutualization Steering Committee to spearhead demutualization of the Nairobi Stock Exchange.[166]Initial resistance by stock brokers and investment banks was predictable but dissipated for lack of support from other constituencies. The decoupling of membership from management and disentanglement of business from regulatory aspects was intended to *inter alia* expunge the perception that the NSE was a "private members club." This was necessary to enhance governance and boost investor confidence in the securities markets.[167] Although the legislative framework to formalize the process has been institutionalized, the process is yet to come to fruition.

Conclusion

Intriguingly, the CMA's enforcement approach over the period under review appears to have been largely informed by inclinations of the chief executive as opposed to institutional commitments, obligations, market exigencies and culture. The fact that the number and variety of enforcement actions oscillated between both ends of the continuum raises pertinent questions about the Authority's systems and departmental responsibilities and accountability. Commentators who characterized the 1995-2002 enforcement jurisprudence as 'the traditional, heavy-handed and fault-finding type' would be jubilant in typifying the 2008-2009 enforcement record in similar terms.[168]

There is considerable merit in surmising that the Authority has never had an elaborate enforcement philosophy. This has impacted negatively on securities markets confidence because investors are skeptical whether market improprieties by market intermediaries and publicly held companies will be penalized. Establishing a reputation of professionalism and consistency in enforcement plays an important role in augmenting investor confidence.

Muramati Sacco Society Ltd where the Authority discontinued the offer alleging that the provisions of the Capital Markets Act had not been complied with. Intriguingly, the sale was stopped on Dec. 28, two days before its closure on Dec. 31, 2010.The offer had been open since October and the company had been running advertisements inviting potential investors to subscribe for its shares. See David Mugwe, *Market Regulator halts sale of Sacco Shares,* BUSINESS DAILY, Dec. 29, 2010 at 6; Mwaniki Wahome, *Giant Sacco warned against selling shares to the public,* DAILY NATION, Dec. 29, 2010 at 12; David Mugwe, *Muramati ignores CMA Order*, BUSINESS DAILY, Dec. 30, 2010 at 12; Editorial, *CMA must protect the public,* BUSINESS DAILY, Dec. 30, 2010 at 6; Boniface Gikandi, *CMA moves causes panic in Murang'a,* THE STANDARD, Dec. 30, 2010 at 15; Mwaniki Wahome, *CMA moves to assure public over sale of Muramati shares,* DAILY NATION, Dec. 31, 2010 at 24; David Mugwe, *Muramati Sacco money safe in the bank, says CMA,* BUSINESS DAILY, Jan.5, 2011 at 11(reporting that the CMA was working together with the Sacco Society Regulatory Authority (SSRA) to ensure that the money raised by the Society from prospective investor was safe); David Mugwe, *How Muramati's shares sale ended in controversy,* BUSINESS DAILY, Jan. 7, 2011 at 6; Joseph Bonyo, *Players push to comply with new capital rules*, DAILY NATION, Jan. 11, 2011 at 24 (explaining that some stock brokers and investment banks are yet to comply with the minimum capital requirements. The firms had sought a three year implementation cycle but CMA refused); Washington Gikunju, *Stock brokers race to meet new capital rules,* BUSINESS DAILY, Jan.12, 2011 at 14.

[166] See Ann Ndung'u, *Demutualization of NSE set to Usher new era at the Bourse*, KENYA TIMES, Dec. 29, 2009 a9 17; Ann Ndung'u, *Demutualization of NSE Takes shape,* KENYA TIMES, Jan. 4, 2010 at 11; Washington Gikunju, *Government eyes NSE Ownership stake*, THE STANDARD, June 19, 2007 at 8-9; James Anyanzwa, *NSE Demutualization to kick off by January 2011*, THE STANDARD, Sept. 9, 1010 at 29; James Anyanzwa, *Stage set for change of NSE ownership structure,* THE STANDARD, June 16, 2009 at 19; Jackson Okoth, *NSE urged to speed up Demutualization*, THE STANDARD, July 21, 2009 at 15;Joseph Bonyo, *Meeting seeks to reform NSE,* DAILY NATION, Nov.24, 2009 at 18; Geoffrey Irungu, *Capital Markets Chiefs gear up for battle over NSE*, BUSINESS DAILY, Nov.24, 2009 at 20 (Reporting that a consultant had recommended that the shareholding of the demutualized exchange be divided as follows: Stock brokers & Investment banks 25%, Capital Markets Investor Compensation Fund 25%, Government of Kenya 25%, Current employees of NSE 5% and other investors 20%. Brokers contested the proposal arguing that the Government had done nothing to deserve a stake in the company. The proposal was subsequently modified so that Stock brokers and Investment banks would hold 80% share but reduce it to below 40% in three years while the Government and ICF would hold 10% each. See James Anyanzwa, *NSE kicks off reform process*, THE STANDARD, Nov. 25, 2009 at 12; Moses Michira, *CMA to control private share transfer fees*, BUSINESS DAILY, Dec. 8, 2010 at 11.

[167] See Betty M. Ho., *Demutualization of Organized Securities Exchanges in Hong Kong: The Great Leap Forward*, 33 LAW & POL'Y INT'L BUS. 283 (2002). See also The Public Watchdog, *Is NSE Demutualization a cure of Capital Markets Regulatory malaise or cosmetic change?* THE STANDARD, Mar. 9, 2010 at 15 (casting doubt on the strategies the CMA was employing to regulate the market); Washington Gikunju, *New law to broaden NSE ownership,* BUSINESS DAILY, Jan. 11, 2011 at 13 (explaining that the Capital Markets Act had been amended to enable the CMA to license companies limited by shares as securities exchanges. Previously, securities exchanges had to be companies limited by guarantee); John Njiraini, *Cheserem team has big task ahead,* THE STANDARD, Jan. 11, 2011 at 22 (arguing that the former chairman of the CMA had done little to bolster investor confidence).

[168] See Joseph H. Kimura & Yobesh Omoro, Impediment to the Growth of the Nairobi Stock Exchange, IPAR Discussion Papers, available at http//www.ipar.or.ke/html. (Last visited on August20th, 2012).

However, current efforts by the Authority to streamline the operations of the securities markets are commendable.[169]

The challenge of an enforcement philosophy is exacerbated by the absence of securities litigation. Whereas the Capital Markets Tribunal has heard and determined less than five appeals since its inauguration in 2002, the High Court has disposed of one substantial appeal. Neither the Court of Appeal nor the Supreme Court has determined any appeal on securities law. Conceivably, neither the Tribunal nor courts of law have contributed to the shaping of the Authority's enforcement jurisprudence.

The dearth of judicial decisions on securities is unsettling. Moreover, the few that have been adjudicated have been disposed of on preliminary or procedural issues.[170]

The preceding analysis shows that the Capital Markets Authority has not found firm ground in the treacherous path of evolving a clearly articulable or identifiable enforcement jurisprudence.

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[169] In August 2012, the Capital Market Authority disqualified certain persons from serving as directors of any company listed on the Nairobi Stock Exchange for impropriety committed while serving as directors of CMC Holdings) Ltd, a publicly held company. The move was unprecedented and audacious since some of the directors in question were respected retired senior Government employees with overwhelming political and economic persuasion who had served the company as directors for over 30 years. Although the CMA was only invoking a statutory power vested in it, the decision is notable. See Paul Wafula, *Market Regulator bans seven from boardroom in CMC row*, DAILY NATION, Aug. 6 2012 at 35; Paul Wafula, *Regulator spells out tough rules foe selecting* company directors, DAILY NATION, Aug. 6 2012 at 29; James Anyanzwa, *Regulator to screen executives of public firms,* THE STANDARD, July 19, 2012n at 30; Victor Juma, *Top CMC Directors found to have signed sham Accounts*, BUSINESS DAILY, Aug. 8 2012 at 1; Francis Mureithi, *Regulator may block Eveready boss' new term*, DAILY NATION, Aug. 10, 2012 at 26; *Moses Michira, End of era as regulator ejects directors*, BUSINESS DAILY, Aug. 6 2012 at 19; Benson Wambugu, *Tobiko takes on Kiereini and Njojp over loss of CMC Funds,* BUSINESS DAILY, Aug. 7, 2012 at 1;

[170] In Republic v. Minister of Finance & another ex parte Nyong'o & 2 others eKLR (2007) *available at* http//www.kenyalaw.org. The applicants sought an order to restrain the Minister of Finance from proceeding with the Safaricom Ltd IPO before operationalizing the Privatization Act which Parliament had already enacted. The case was decided on a procedural point. In the words of Justice J.G. Nyamu:

> "It follows that since the real owners of the shares are not before the court, the claim is hollow and grossly incompetent. The claim, even if it were found to have substance has in law been brought against the wrong parties. This is perhaps one of the clearest flaws touching on this claim."

The court avoided the regulatory aspects of the issue which were pertinent. For instance, could CMA have cancelled the issue? In the Kenya National Trading Corporation (KNTC) conundrum, the KNTC which owned 20% shareholding in Uchumi Supermarkets Co Ltd, invited offers from willing purchasers to take up its shareholding and the offer was to remain open for 30 days in accordance with the regulations. Puzzlingly, the CMA reduced the duration to two weeks. In an application challenging the CMA's action, the High court avoided the substantive issues holding that the applicants were mischievous and had instituted the action in bad faith. The salient issues were whether the Authority had power to reduce the duration of the offer and whether it had exercised its discretion reasonably and in good faith in the circumstances.

In Shah, Munge & Partners Ltd & others v. CMA eKLR (2009) *available at* http//www.krenyalaw.org. The appellants were challenging the decision of the Capital Markets Tribunal affirming the decision of the CMA to suspend the stock broker from business for 3 years and disqualifying its directors from being appointed directors of listed companies or licensees of the Authority for a period of 5years. The High Court relied exclusively on the findings of the Tribunal and upheld its decision without elucidating the policy justifications. An appeal is pending in the Court of Appeal. See Benson Wambugu, *High Court confirms Munge suspension*, BUSINESS DAILY, May 19, 2009 at 22.

In CMA v. BOC Gases Co. Ltd eKLR (2007) *available at* http//www.kenyalaw.org. The CMA was challenging the decision of the Capital Markets Tribunal requiring the Authority to approve the Take-over of Carbacid Investments Co Ltd by the respondent. The appellant's case was that the respondent had not complied with the Capital Markets (Take Overs and Mergers) Regulations, 2002. The appeal was withdrawn when Centum Investments acquired the shares of the dissentient members of Carbacid Investments Co. Ltd rendering the take-over in effectual.