



# CMA *Forum*

A Publication of the Capital Markets Authority

Issue 09 | October - December 2011



**Capital Markets Authority**  
3rd Floor, Embankment Plaza  
Longonot Road, Upperhill  
P.O. Box 74800 - 00200, Nairobi.  
Tel: 2221910/2264900/2221869/2226225  
Cell: 254 722 207767/ 254 734 651550  
E-mail: [corporate@cma.or.ke](mailto:corporate@cma.or.ke)  
Website: [www.cma.or.ke](http://www.cma.or.ke)



# Contents

Chief Executive's Message ..... 1

CMA joins key regional and international financial sector bodies ..... 2

CMA implements a new Organization Structure ..... 3

Authority Facilitates the Establishment of the Growth Enterprise Market Segment ..... 4

Towards the Development of Islamic Capital Markets in Kenya ..... 6 - 8

## Pictorial



The Capital Markets Authority Chairman, Mr Kung'u Gatabaki (right), welcomes the Lord Mayor of the City of London, Rt Hon Michael Alderman Bear to the Capital Markets Authority offices.



The Chief Executive, Capital Markets Authority Mrs Stella Kilonzo MBS (left), makes a speech as the Lord Mayor of the City of London, Rt Hon Michael Alderman Bear, looks on during a cocktail hosted by the Ministry of Finance when the Lord Mayor visited Kenya.



Capital Markets Authority Board Members, Mr Mahmood Manji (left), Dr Gituro Wainaina (centre), and Dr Geoffrey Mwau (right) in a discussion during the conference co-hosted by the Capital Markets Authority and the British High Commission during the Lord Mayor's visit to Kenya.



The Chief Executive, Capital Markets Authority Mrs Stella Kilonzo MBS (left), in a discussion with the Lord Mayor of the City of London, Rt Hon Michael Alderman Bear, during the conference co-hosted by the Capital Markets Authority and the British High Commission during the Lord Mayor's visit to Kenya.



The Chief Executive, Capital Markets Authority, Mrs Stella Kilonzo MBS (left), presents a token of appreciation to the Lord Mayor of the City of London, Rt Hon Michael Alderman Bear, during the Lord Mayor's visit to the Capital Markets Authority offices.

# Chief Executive's Message

As part of its mandate of creating a facilitative legal, institutional, regulatory framework, the Capital Markets Authority continues to spearhead initiatives geared towards positioning the capital markets to play their pivotal role towards the achievement of Vision 2030 objectives.

The Authority has been focusing on bond market reforms, putting in place an enabling legal and regulatory framework, demutualisation of the Nairobi Securities Exchange, introduction of Real Estate Investment Trusts (REITS), a Futures Exchange, and the rollout of the Growth Enterprise Market Segment (GEMS) amongst other initiatives to benchmark Kenya with global best practise and position the country as the pre-eminent destination of capital in the region.

The bond market is particularly important as it is expected to facilitate raising of funds to support Vision 2030 flagship projects and other productive economic activities. The introduction of reforms through the Bond Markets Steering Committee such as adoption of the proposal to introduce a hybrid bond market model, and a lengthened maturity profile among other measures designed to make the bond market more vibrant.

The demutualisation of the NSE, designed to separate the management from the ownership of the exchange, is part of broader legal, institutional, and regulatory reforms aimed at broadening and deepening capital markets in Kenya by increasing competitiveness, encouraging development of new financial products, enhancing the governance structures, and ultimately bolstering investor confidence.

The setting up of the Growth and Enterprise Market Segment (GEMS), the listing platform for Small and Medium Sized Enterprises, is expected to give them an opportunity to raise capital, provide an exit mechanism for investors, and facilitate price discovery. We anticipate this will also help investors diversify their



**Mrs. Stella Kilonzo**  
Chief Executive

portfolios. This is in line with the Vision 2030 objectives by catalyzing additional economic activities through the SME sector, which contributes about 40 percent of Kenya's GDP.

We expect to start approving Real Estate Investment Trusts (REITS), once the framework is in place.

Introduction of REITS will pool funds for investment in stable income generating rental properties and would be open to investment by the general public given that the income streams will be predictable much like fixed income securities such as bonds.

# CMA joins key regional and international financial sector bodies

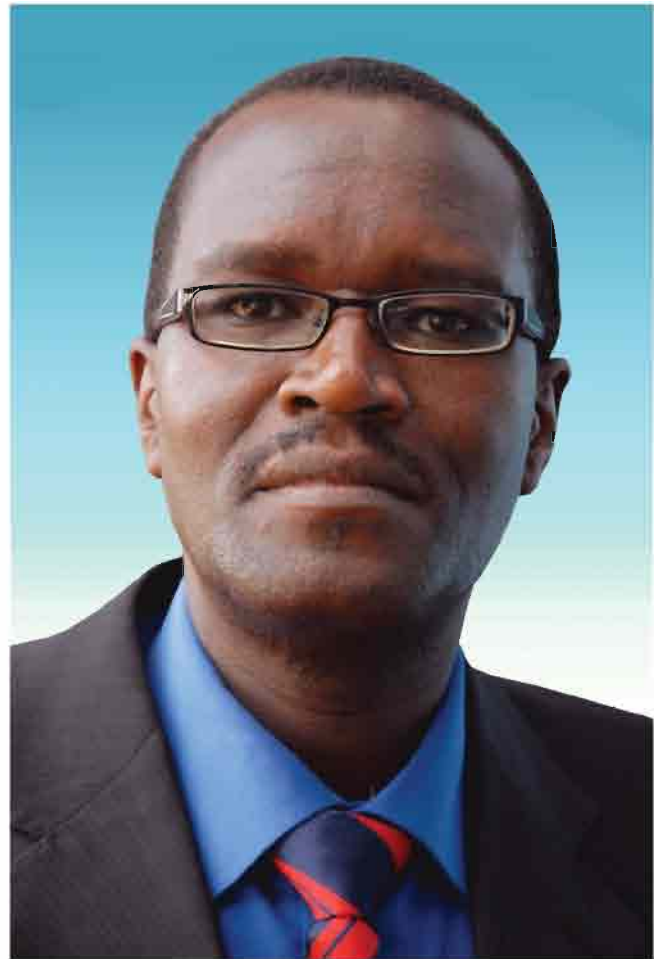
The Capital Markets Authority (CMA) has accepted an invitation to sit on the Financial Stability Board Regional Consultative Group for Sub-Saharan Africa as one of the jurisdictions chosen.

This gives CMA an opportunity to contribute in key decision making and policy formulation from a regional and global perspective for the benefit of our capital markets and financial sector as a whole. This is an important step for CMA and Kenya as a country as it creates an avenue to contribute in shaping the development and implementation of financial sector policies at a regional level aimed at ensuring there is financial stability.

The membership of the Financial Stability Board Regional Consultative Group for Sub-Sahara Africa provides an important platform for collaboration with other financial sector players to influence regulatory, supervisory, and other financial sector policies in Africa and beyond.

Other members of the Sub-Sahara Africa consultative group include; Angola, Botswana, Cameroon, Côte d'Ivoire, Ghana, Mauritius, Namibia, Nigeria, and Tanzania.

The Capital Markets Authority Chief Executive, Mrs Stella Kilonzo, has also been appointed a Council Member of the prestigious World Economic Forum's Global Agenda Council on Banking and Capital Markets. The Global Agenda Council on Banking and Capital Markets convenes 15 of the world's most relevant thought leaders to provide insights and develop recommendations to address key global challenges.



**Mr. Antony Mwang**  
Head of Corporate Communications

The Global Agenda Council on Banking and Capital Markets provides an important platform for engagement with other global financial sector business leaders and is an opportunity to impact global agenda policy while at the same time ensuring the voice of the capital markets industry in Kenya and East Africa is heard.

# CMA implements a new Organization Structure

As part of efforts to achieve its strategic objectives, the Capital Markets Authority (CMA) appointed four staff members in November 2011 to take up key responsibilities in line with the new organizational structure approved by the Board in 2010. The new organization structure is geared towards increasing organizational efficiency and effectiveness through acquisition of the right skills to help the organization meet its core mandate.

The Authority has recently appointed Mr. Wycliffe Shamiah as Director, Market Operations; Mr. Paul Muthaura as Director, Regulatory Policy and Strategy; and Mrs. Rose Lumumba as Director, Corporation Secretary and Communications.

Mr. Luke Ombara was also appointed as Manager, Policy and Market Development for the Futures Oversight Unit; and Ms. Esther Maiyo as Manager, Internal Audit. They all held various positions in the Authority previously. CMA Chief Executive, Mrs. Stella Kilonzo, while announcing the new appointments, said the Authority was keen to ensure continuous capacity building to meet its objectives under the Strategic Plan, 2009-2012, and play its critical role of facilitating resource mobilization towards the attainment of the Vision 2030 objectives.

Mrs. Kilonzo added that the reorganization of the Authority into directorates is geared towards enhancing organizational efficiency. The Market Operations Directorate is responsible for Market Supervision, Investigations & Enforcement, and Corporate Approvals; while the Regulatory Policy and Strategy Directorate looks after Investor Education and Public Awareness, Strategy Policy & Regulatory Framework, Research, Market Infrastructure and Product Development.

Mrs. Lumumba, an MBA holder, is an Advocate of the High Court of Kenya and a Certified Public Secretary. She has close to 20 years' experience in capital markets.

Ms. Esther Maiyo holds an MBA (Finance), CPA(K) and has 16 years experience in various capacities within CMA.

Wycliffe Shamiah, an MBA (Finance) holder, CPA(K) has worked in the Authority for 16 years.

Paul Muthaura, who has a Masters Degree in Banking and Finance Law and currently studying for a Doctorate in Business Administration and has over 6 years' experience in capital markets and over 4 years' experience in law.

Luke Ombara, an Economist with 16 years' experience.



# Authority Facilitates the Establishment of the Growth Enterprise Market Segment

The Authority is keen to ensure that the capital market industry plays its rightful role in economic development and this necessary reforms are being undertaken to deepen and broaden the market. It is for this reason that the Authority in collaboration with the Nairobi Securities Exchange (NSE), the Central Depository and Settlement Corporation (CDSC), and other stakeholders, has developed the policy and regulatory framework for the establishment of a market segment for SMEs to be referred to as Growth Enterprise Market Segment (GEMS).

Small and Medium Enterprises (SMEs) contribute greatly to economic growth of both developed and developing countries. In Kenya for instance, according to the Economic Survey 2010, SMEs employ about 80 per cent of the country's total employment outside small-scale agriculture and contribute about 40 percent to GDP. In the US, the SMEs provide 67% employment and 61% of manufacturing sector output. In Korea, there are over 30 million SMEs constituting about 99.9% of the enterprises and employing over 88.1% of the labour force.

Notwithstanding the contribution to economic growth, SMEs continue to face a variety of constraints, which include: inadequate infrastructural facilities, shortage of skilled manpower; high rate of enterprise mortality; low level of entrepreneurial skills; lack of a conducive operating environment; restricted market access; and cumbersome regulatory requirements. One of the major difficulties SMEs come across, however, is the issue of access to finance. Indeed access to finance has been mentioned variously as the second most important constraint to doing business after inadequate supply of infrastructure.

At the same time a common lament heard throughout the Stock Exchanges of Africa's developing countries is that there are too few investment products and very little investor demand.



**Kamunyu Njoroge,**  
Manager, Investor Education & Public Awareness

It is the objective of addressing the above twin issue that makes the case for an SME market in Kenya ever more plausible. Besides, the growth of small businesses will generate increased employment, wages, goods and services, and tax revenues. Not only is the growth of SMEs a vital element to a nation's economy, but also that today's SMEs will become tomorrow's main market listings. The establishment of a market for GEMS is therefore not only intended to unlock capital for SMEs but also raise the level of savings and investments within the capital markets.

The introduction of GEMS is in line with the Government focus on the Small and Medium Sized Enterprises sector as one of the key drivers of Vision 2030. It is expected to augment various initiatives by both the Government and the private sector to deal with the challenges facing SMEs, like the

establishment of the MSE revolving fund of Kshs. 3.8 billion, by the Deputy Prime Minister and Minister for Finance during the 2010/2011 budget speech and the proposed MSE Bill.

The Authority's proposition is a GEMS that seeks to respond to the problems SMEs face when attempting to tap into the capital markets. In modeling this market, various markets including: the JSE Ltd. AltX; TSX Venture Exchange – Canada; Novo Mercado; a special segment of the São Paulo Stock Exchange [BOVESPA]; Bursa Malaysia ACE Market; Stock Exchange of Mauritius Development & Enterprise Market; Egyptian Exchange Nilex Market TSX Venture Market Canada, and the AIMS of the London Stock Exchange have been examined.

The main salient features of GEMS include the following;

**First;** amendments have been proposed to provide more flexible listing rules compared to the main market with respect to: the minimum capital; number of shareholders; number of shares to be offered to the public; the minimum free float; as well as the company's financial track record. For a firm to participate in GEMS it will need to: be a public company limited by shares, registered under the Companies Act; have minimum share capital of Kshs. 10 million; have at least one year, track record; have at least 100,000 issued shares with at least 25 shareholders and a free float of at least 15% immediately after listing; have all its shares deposited with a CDSC to facilitate settlement; and ensure all securities are free from restrictions on transferability; (except contractually imposed restrictions on dealing such as "lock-ins").

**Secondly;** a Nominated Advisor (Nomad), approved by the Exchange, will be required at all times to assist the applicant company in getting, and staying, listed on the SMEs Market and in the Initial Public Offering of its shares and in particular be responsible to the Exchange for assessing the appropriateness of an applicant for GEMS, or an existing GEMS company and for advising and guiding a GEMS company on its responsibilities. The Nomad will also act as a coordinator between the issuer and the Exchange at all times and issue research coverage on the companies that it sponsors.

**Third;** there will be easy graduation of SMEs market listed firms to the main Exchange through: a streamlined process where Issuer's information that is on file with GEMS market can be provided directly to the main Boards of the Securities Exchange; waiver of some fees for GEMS firms that are graduating; and Exchange support through meetings with Exchange staff to review process and timing of graduation whenever it is sought to compress the timeline for a graduation.

**Fourth:** with regard to Corporate Governance; the level of adherence will be required even at a higher level than the already existing market to mitigate risk inherent in most SMEs; however the following will apply, as well, for GEMS:

- a) No prior shareholder approval for most transactions (unless the transaction is of a fundamental nature like a reverse takeover or a disposal resulting in a fundamental change of business);
- b) The Articles and Memorandum of Association must provide for, among other things public issuance of securities, immobilization of securities, as well as protection of minority shareholders, and transferability of shares;
- c) A minimum of 5 directors; with at least one third of the board being independent directors, and an independent audit Committee;
- d) Same conditions provided to majority shareholders in the disposal of the Company's Control to be extended to all shareholders (tag along);
- e) Quarterly reports to disclose any significant (3%) direct or indirect ownership interest, and report on Controlling Shareholder and Senior Managers holdings and evolution of the volume of securities held by them;
- f) Directors' induction course before and immediately after listing.

This policy and legal framework has been finalized by the Authority for submission to the office of the Minister for Finance for gazetting.

# Towards the Development of Islamic Capital Markets in Kenya

## 1.0 Introduction

The Islamic financial services industry, comprising Islamic banking, Islamic insurance (takaful) and the Islamic capital market, is an area that has grown to become an increasingly substantial segment within the global financial market and has gained considerable interest as a viable and efficient alternative model of financial intermediation. The Islamic financial system broadly refers to financial market transactions, operations and services that comply with Islamic rules, principles and codes of practices. The laws and rules of the religion require certain types of activities, risks or rewards to be either prohibited or promoted. These rules commonly referred to as the "Fundamental Principles of Islamic Finance" include:

- i. Prohibition of interest (riba'):**  
Literally "an excess" and interpreted as "any unjustifiable increase of capital whether in loans or sales";
- ii. Money as "potential" capital:**  
Money is not a commodity, but a medium of exchange, a store value and a unit of measurement. Money represents purchasing power and cannot be utilised to increase the purchasing power without any productive activity. Islamic finance advocates the creation of wealth through trade and commerce;
- iii. Risk sharing:**  
Because interest is prohibited, suppliers of funds become investors, rather than creditors;
- iv. Prohibition of speculative behaviour:**  
Islamic finance discourages hoarding and prohibits transactions featuring extreme uncertainties (gharar), and gambling (maysir);



**Joseph Mwenda:**

Regulatory, Policy and Strategy Directorate

- v. Sanctity of contracts:**  
Islamic finance upholds contractual obligations and the disclosure of information as a sacred duty. This feature is intended to reduce the risk of asymmetric information and moral hazard.
- vi. Shari'ah approved activities:**  
Only those business activities that do not violate the rules of the Shari'ah qualify for investment. For example, any investment in a business dealing with alcohol or gambling is prohibited; and
- vii. Social justice:**  
Any transaction leading to injustice and exploitation is prohibited.



## 2.0 The Global size of the Islamic Financial Industry

While the Islamic financial services industry currently represents approximately only 2% of global assets, Shariah-compliant financial assets have been growing at over 10% per annum over the past 10 years. Measured by Shariah-compliant assets of financial institutions, the global Islamic finance industry was estimated at US\$822 billion in 2009. Global Shariah-compliant assets were projected to reach US\$1 trillion in 2010 and US\$1.6 trillion by 2012. Further, Moody's estimates there are currently 350-450 Islamic Financial Institutions (IFIs) with assets value projected to reach US\$ 2.8 trillion by 2018. Islamic commercial banks account for the bulk of assets, with investment banks and Sukuk issues making up most of the remainder. Nevertheless, current estimates put global Shariah compliant assets to be at least US\$ 1.4 trillion as at 2010 and to grow to US\$ 2 trillion by 2012.

- i. It is estimated that the size of the Islamic banking industry at the global level was approximately US\$822 billion at the end of 2009 (IFSB et al, 2010) compared with \$639 billion in 2008, and are currently estimated to total about US\$ 1 trillion worldwide, according to publicly available information.
- ii. The Takaful industry growth has proved resilient and Takaful contributions have totaled US\$ 8.9 billion as at end 2010.
- iii. Sharia compliant stocks can be estimated to be totaling around US\$ 480 billion.
- iv. Funds under management were estimated to be US\$52.3 billion in 2009; a fraction of the \$22 trillion global asset management industry and a minor component of the estimated \$ 1 trillion Islamic finance industry.
- v. US\$ 330.5 billion worth of Sukuk had been issued since 1990 to 2009, consisting of sovereign, corporate and quasi-sovereign sukuk. From 2000-2010, Sukuk worth US\$ 149 billion has been issued, representing 45% of global issues during the past 10 years.

The Islamic finance market in Africa is potentially worth close to \$235 billion, conservatively

assuming that banking entrenchment represents an average 50% of total GDP produced by African Muslims, according to Moody's Investors Service. Today, 37 Islamic financial institutions operate in Africa, serving a Muslim population of 412 million inhabitants. Countries currently offering Islamic Finance include; South Africa, Botswana, Kenya, Algeria, Nigeria, Egypt, Sudan, Mauritius and Tunisia. Others contemplating development of the same include Tanzania, Malawi, Zambia, Uganda and Ethiopia.

## 3.0 Challenges facing the Islamic Finance Industry

The main challenges facing the Islamic Finance Industry are homogenous in nature and mainly include the following:

### i. Liquidity:

This is one of the most critical issues for Islamic Financial Institutions (IFIs) as only a small secondary market exists to enable them to manage their liquidity.

### ii. Lack of standardization:

A broad product range and relatively low transaction volumes mean that documents for Islamic financial products tend to be tailor-made for individual transactions.

### iii. Lack of awareness:

Consumers lack knowledge about Islamic financial products

### iv. Skills shortage:

The shortage of skilled human resources is becoming a concern for the industry and the strong growth in Islamic finance also means that having and maintaining qualified staff is challenging.

### v. Varying interpretations of Islamic law, often fuelled by different Shariah regulatory frameworks:

Islamic Financial Institutions (IFIs) have little latitude when implementing the opinions of their Shariah advisors, and the advice itself can vary between advisors.

#### vi. Reputation risk:

It is important for Islamic Financial Institutions (IFIs) to constantly ensure that their Islamic products are truly Shariah-compliant for a sustainable business model.

#### iv. Need for regulatory (including tax) reforms:

Successful introduction of Islamic finance to the market will require tax neutrality as compared to the tax treatment of conventional products.

#### v. Asset concentration exposure to real estate sector:

According to the Shariah, all transactions must be backed by a tangible asset and so exposure to the real estate sector is common for Islamic Financial Institutions (IFIs).

## 4.0 Snapshot of the Islamic Finance Industry in Kenya

Kenya has ambitions of becoming the Islamic finance hub of East Africa and has the first mover advantage. The Central Bank of Kenya (CBK) has already licensed two Islamic banks - Gulf African Bank (GAB) and First Community Bank (FCB) Islamic Windows. Since starting operations in June 2008, FCB has also recently been authorized by the CMA to launch FCB Capital, which will offer Islamic asset management business and capital markets products especially Sukuk. Similarly, FCB has been authorized to act as an Islamic insurance (Takaful) broker for general Takaful products the bank is structuring in conjunction with the local Cannon Insurance Company. In addition, Takaful Insurance of Africa, the first fully Shariah-compliant insurance company in Kenya, was licensed and launched in January and March 2011 respectively. The company is backed by the Corporative Insurance

Company of Kenya. It would suffice to note that the two banks have already contributed in the development agenda of the country by participating in Shariah-compliant (Sukuks) components of the last two infrastructure bonds issued by the Central Bank of Kenya on behalf of the Government of Kenya. In addition, various commercial banks are now offering Shariah compliant products through operating Islamic Windows. This is a solid testimony of the vast potential of Islamic finance in Kenya.

## 5.0 Engagement with Islamic Finance Stakeholders

The Authority has kicked off a series of consultative meetings with all stakeholders in the Islamic Finance Industry and Muslim scholars to seek their input in drawing up a policy, institutional, and legal framework for the capital market and chart a way forward in developing a vibrant Islamic capital market in Kenya. In this regard, the first ever round-table consultative meeting on Islamic Capital Markets Development consultative meeting was held on 19th October 2011. The meeting's aim was to share the findings of a Research Study conducted by CMA on Islamic Capital Markets with key stakeholders in this field and get their input in the development of a roadmap towards Kenya's Islamic Capital Markets policy and a subsequent regulatory framework. The Authority is now in the process of actively engaging leading Islamic Finance jurisdictions as well as experts to facilitate capacity building within the Kenyan market. In addition, consultation with stakeholders and public sensitization activities will continue to be progressed with the overall aim of facilitating the Kenyan Islamic Capital Market towards the achievement of Vision 2030 goals.

