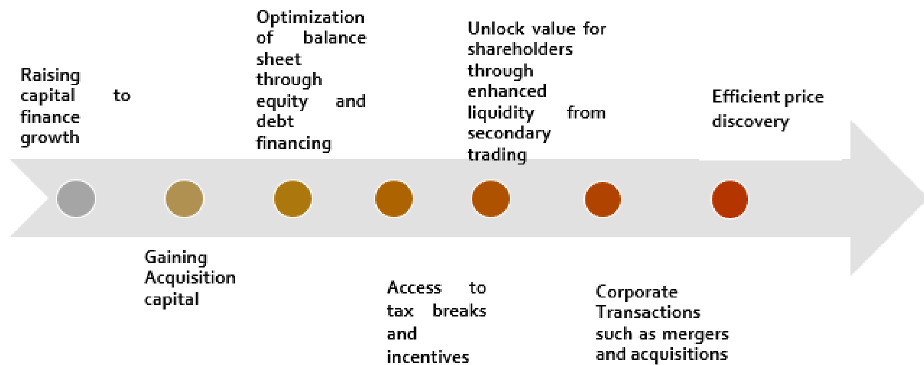
The Capital Markets Soundness Report

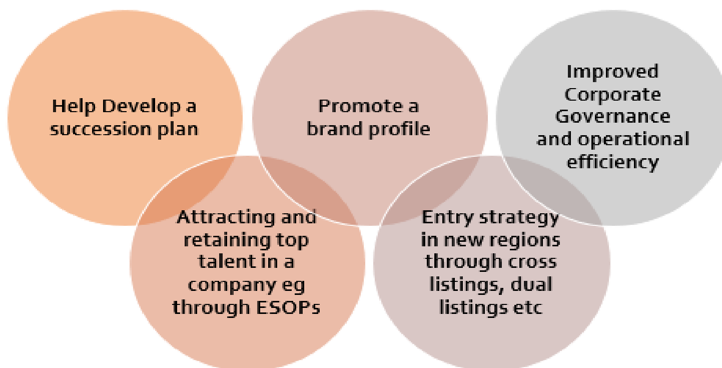
Volume VII

Quarter 2. 2018

"Improving capital market products' uptake and tackling identified obstacles to listings"

Financial Benefits to listing





Non-financial benefits to listing

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SPECIAL MESSAGE FROM THE CHIEF EXECUTIVE

Mr. Paul Murithi Muthaura, MBS
CEO, Capital Markets Authority, Kenya

It is with great pleasure that I present to you the second Capital Markets Soundness Authority Report (CMSR) for the year 2018. It marks the seventh edition since the Authority premiered this platform which seeks to inform policy and strategy within the Kenyan capital market space in Kenya. The publication also serves to put in context major economic and capital markets events globally, regionally and domestically and their impact on our industry and its players.

We appreciate the excellent feedback that we have been receiving on previous CMSR publications and remain committed to proactively engaging our stakeholders to make the soundness report as representative of current and projected circumstances. The constructive discussions triggered by the dissemination of this detailed analysis of soundness and performance indicators on the capital markets in Kenya serves to promote more informed decision making among private and public-sector players as well as domestic and international stakeholders.

On behalf of the Authority, and members of the CMA research team that have made possible publication of this edition, my appreciation goes to all of you for your consistent support and value-addition on the findings and recommendations in various fora. I welcome you to enjoy reading this quarter's issue and, as is the norm, look forward to your feedback.

Mr. Paul Murithi Muthaura, MBS
CHIEF EXECUTIVE

EDITORIAL

Mr. Luke Ombara
Director, Regulatory Policy and Strategy, CMA

Welcome to the seventh edition of the Capital Markets Soundness Report (CMSR), a publication covering the Second Quarter (April-June) of 2018.

This volume which is themed ***"Improving capital market products' uptake and tackling identified obstacles to listings"*** is inspired by the need to move forward stakeholders' recommendations aimed at addressing the low uptake of capital markets products, following a study conducted by the Authority and its subsequent extensive deliberations by stakeholders. A number of jurisdictions around the world have been able to effectively and consistently leverage capital markets to support growth and development and it is important to examine the measures behind their successes and determine what lessons Kenya can learn.

The June 2018 Budget Statement delivered by the Cabinet Secretary for the National Treasury and Planning on 14th June 2018 reiterated the Government's commitment towards achievement of the 'Big Four Agenda' and similarly, the Authority's new Strategic Plan 2018-2023 seeks to facilitate the channelling of capital markets financing to these sectors and provide solutions to enable achievement of the goals set forth in this national development goal. This edition therefore also provides a summary of the Outcome of the Budget Statement 2018/2019 and its potential impact on the capital markets space.

Globally, while there is a general expectation that interest rates in super economies are on an upward trajectory following the rise in the US Federal Reserve interest rates in the succeeding months, other developed economies such as China, Japan and the United Kingdom continue to take policy measures to ensure stable interest rate and inflation levels. The Authority will therefore continue monitoring closely the preferred monetary policies of developed economies and their possible impact on foreign debt and capital flows.

We further highlight measures being taken by countries across the globe to implement regulatory sandboxes both within and outside the financial sector to drive transformative innovation, with specific reference to the "Proof of Concept" Initiative by the Reserve Bank of South Africa in understanding the true workings of cryptocurrency and block chain technology as an important step towards determining its regulatory oversight model for FinTech.

In anticipation of major positive developments within the capital markets including the relaxation of interest rate caps, political stability, economic realignment with Big Four agenda, capital markets performance is expected to significantly improve driven by recovery in private sector investment, increased foreign investor activity and increased market activity within the domestic banking industry serving as a major contributor to overall market turnover. We will however continue to monitor key risk indicators in capital markets and where necessary, take mitigation measures.

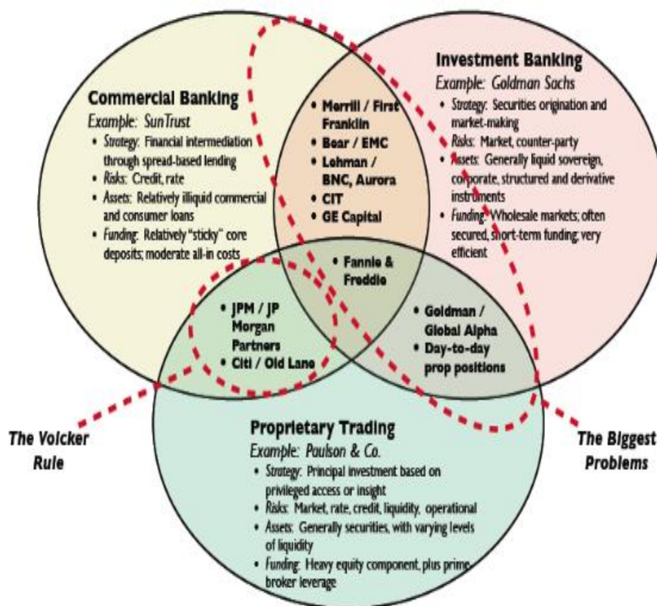
Enjoy your reading!

Mr. Luke E. Ombara
DIRECTOR, REGULATORY POLICY & STRATEGY

SPECIAL FEATURE: A Review of the United States Volcker Rule and Kenya's Financial Sector Reforms – any Lessons?

The Volcker Rule is a section of the Dodd–Frank Wall Street Reform and Consumer Protection Act[1] that restricts U.S. banks from making speculative, high-risk investments that do not benefit customers. It specifically sets forth rules for implementing Section 13 of the Bank Holding Company Act of 1956 and aims to protect bank customers from exposure to the banks' engagement in proprietary trading activities as this was noted to have contributed to the global financial crisis.

Fig 1: Diagrammatic representation of the Volcker Rule



Source: Naked Capitalism

The Rule is therefore aimed at preventing federally insured banks from trying to boost profits with risky trades, to forestall trading excesses that led to the 2007-2009 financial crisis, requiring taxpayer bailouts of banks.

Bank proprietary trading is defined by the Rule as a trading practice in which a bank serves as a principal of a trading account in buying or selling a financial instrument. Over the years, the Volker Rule has faced wide criticism. For instance, the US Chamber of commerce noted that the costs associated with the Volcker Rule implementation outweigh the benefits. Additionally, International Monetary Fund and the Federal Reserve's Finance and Economics Discussion Series (FEDs) note that Volcker Rule could unintentionally diminish liquidity in the bond market due to a reduction in banks' market-making activities. In view of this, the US Treasury recommended changes to the Volcker Rule citing regulatory compliance burden created by the Rule and suggested simplifying and refining the definitions of proprietary trading and covered funds to allow banks to more easily hedge their risks.

Further, according to Securities Industry and Financial Markets Association (*SIFMA*), the Volcker Rule, as currently implemented, negatively impacts market liquidity, capital formation and economic growth; has overbroad and burdensome provisions that impinge on traditional banking and asset management activities, is too complex and is duplicative.

According to Bloomberg[2], the plan for revising Volcker, is a significant achievement for banks that have long argued that the original rule was overly complex and costly to comply with. The Federal Reserve became the first agency to move the proposal forward at the end of May 2018, followed by the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency and the Commodity Futures

[1] The Dodd-Frank Act (officially called the Dodd-Frank Wall Street Reform and Consumer Protection Act) is legislation put in place in the U.S. in 2010 to Protect consumers of financial products and services, in response to the financial crisis that became known as the Great Recession in which consumers lost significantly.

[2] https://www.bloomberg.com/news/articles/2018-06-05/volcker-rule-changes-move-forward-after-sec-votes-on-overhaul

Trading Commission. The proposal is to maintain Volcker's requirement of a ban on proprietary trading but that the regulators ensure that foreign funds that are exempt from the ban on proprietary trading by U.S. commercial banks do not face regulatory scrutiny.

The regulators indicated that they had heard from several foreign banking entities and Government officials, expressing concern that current regulations may be improperly applying the rule to some foreign funds. The point of argument has been that if a fund is organized and offered outside the United States, it is typically excluded from the Volcker Rule, which is primarily aimed at banks with U.S. federal Deposit Insurance. However, in some cases, certain governance structures and investment arrangements have been leading to Volcker enforcement anyway.

The regulators have already indicated that they would halt enforcement of the Volcker Rule for one year for qualifying foreign funds while they conduct the review[3]. The regulators are expected to launch a more comprehensive review of the rule in the coming months. On their part, Banks have been complaining that the rule is too restrictive, making it almost impossible to distinguish between prohibited trading from permitted activities like market-making. Specifically, the other proposed changes aim to:

- Tailor the rule's compliance requirements based on the size of a firm's trading assets and liabilities, with the most stringent requirements applied to firms with the most trading activity;
- Provide more clarity by revising the definition of "trading account" in the rule, in part by relying on commonly used accounting definitions;
- Clarify that firms that trade within appropriately developed internal risk limits are engaged in permissible market making or underwriting activity;
- Streamline the criteria that apply when a bank seeks to rely on the hedging exemption from the proprietary trading prohibition and;
- Simplify the trading activity information that banks are required to provide to the agencies.

Other changes include:

- Creating categories of banking entities based on the size of their trading assets and liabilities that would be used to tailor certain requirements of the rule;
- Revising and better defining terms relevant to proprietary trading activity; and
- Amending the rule's annual Chief Executive Officer (CEO) attestation requirement.

Lessons for Kenya

- The unstructured multi-agency enforcement of the Volker Rule by at least five institutions raises the need to have significant buy-in from all strategic stakeholders at the onset before implementing new legislations and more coordinated approach to enforcement to ensure all gaps are sealed. In the advent of new draft legislations such as the Financial Market Conduct Bill 2018 ,whose purpose is to promote a fair,

[3] https://www.reuters.com/article/us-usa-banks-volcker/u-s-regulators-announce-review-of-volcker-rule-for-certain-foreign-funds-idUSKBN1A62JH

non-discriminatory marketplace for access to credit, as well as to facilitate provision of uniform practices and standards in relation to the conduct of providers of financial products and financial services, while the intentions are good, there is need for its thorough scrutiny, among other financial laws for fitness of purpose, to avoid negative unintended consequences;

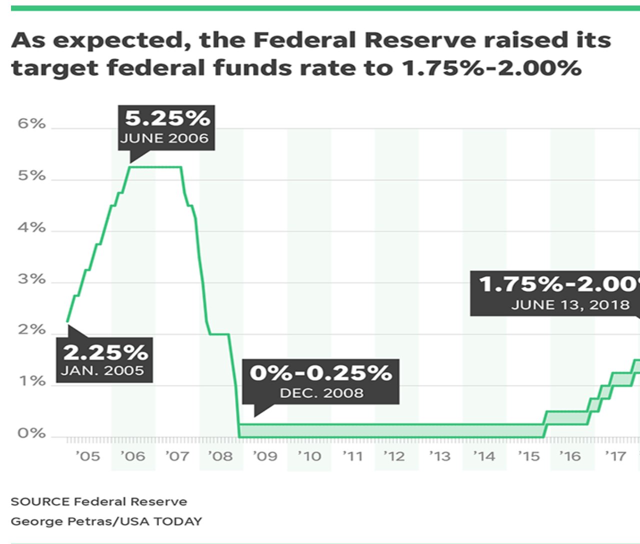
- Financial sector regulators should always consider the long-term implications of reactionary policy and regulatory stop-gap measures taken to address crises. This can be achieved by stepping up their market intelligence capacity to identify new draft legislations that are lined up for enactment or gazettement and conduct timely cost-benefit analysis, as well as appropriate enforcement mechanisms to be employed;
- While the primary role of regulation is protection of investors, it should be observed that regulation should ensure protection of a subset of investors without breaching the economic rights and benefits of a different class of investors such as foreign investors, as the latter set of investors play a significant role in driving growth of economies.

Changing Global interest rates and their impact

i. United States

In mid-June 2018, the Federal Reserve raised its benchmark interest rate, while also signaling that it has plans to do so more times than expected in 2018. The apex policy-setting body - the Federal Open Market Committee (FOMC) lifted the target range for the federal funds rate by 25 basis points to between 1.75% and 2%. This was the seventh-rate hike since late 2015, when the Fed first began lifting interest rates from almost zero.

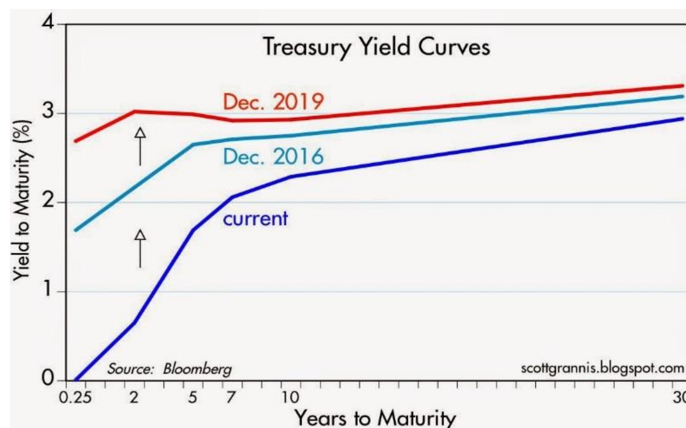
Fig 2: United States Federal Reserve Rates



Source: The Federal Reserve

Benchmark rates had been kept low to keep borrowing costs low and encourage businesses and consumers to spend and grow the economy after the financial crisis.

Fig 3: US Treasury Yield Curve



Source: Bloomberg

ii. United Kingdom

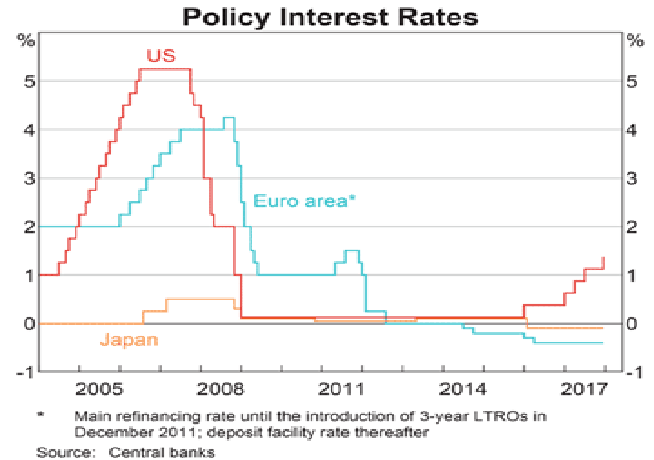
In late June 2018, the Bank of England (BoE) voted by majority to leave interest rates at 0.5%, with some of its members voting for a raise in borrowing costs to 0.75%. Further, BoE changed its guidance about when it might start unwinding its quantitative easing (QE) stimulus programme, opting to start to sell some of its bonds when interest rates rise to 1.5% (compared to the current 0.5%). It had previously aimed for 2%. The Bank currently holds £435bn of bonds bought through QE using newly-created electronic money.

iii. Euro area

The European Central Bank has for some time now been of the view that significant monetary policy stimulus is still needed to support the further build-up of domestic economies over the medium term. With a stock of acquired assets worth approximately 2.4 trillion euros as of May 2018, together with reinvestments of the principal payments from maturing securities purchased after the end of the asset purchase program, as well as forward guidance on interest rates, the ECB appears reluctant to tighten the interest rate environment for the time being. The European Central Bank's (ECB's) Governing Council has indicated that it expects the key ECB interest rates to remain unchanged from the rates as of June 2018 at least through June to August of 2019.

The Bank has indicated that it will keep rates unchanged for as long as necessary to ensure that the evolution of inflation remains aligned with the Area's current expectations of a sustained adjustment path.

Fig 4: Policy Interest Rates in Selected Countries



Source: Central Banks

iv. China

On the same date the Fed rate was hiked, the Chinese central bank made a net injection of 70 billion yuan through an auction of 7-day, 14-day and 28-day reverse repos, with rates for all tenors left unchanged at 2.55%, 2.70% and 2.85% respectively. This implies that China's response to the US Fed hike was muted, with the country signaling its intention to keep rates unchanged. China appears to have chosen to soften its stance on market tightening, opting for moderate policy easing measures aimed at keeping the cost of funds within manageable levels.

Lessons for Kenya

- Being a small open economy and part of the Frontier markets that have been adversely affected by the global trends, Kenya should evaluate its benchmark policy rate stance and focus on stimulating domestic demand by keeping the cost of funds affordable;
- Despite a hike in interest rates in the U.S. that could negatively affect decisions of some funds to invest in Frontier markets like Kenya, the country still presents opportunity to investors keen on diversification and

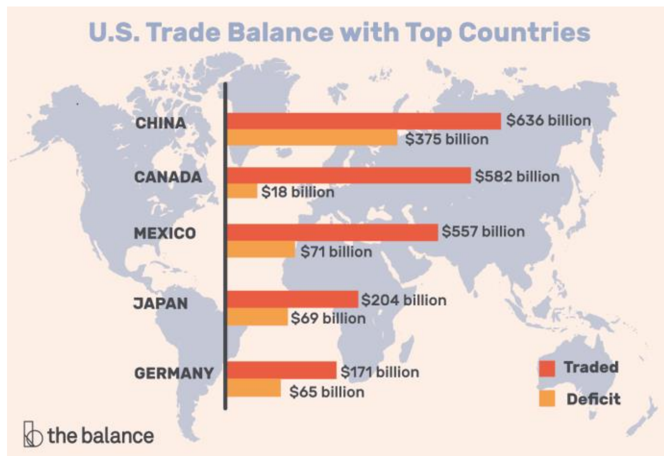
unique risk profiles that may not be available in developed markets.

Overview – International Markets

i. Persistent Trade Differences

In the recent past, the US trade deficit with China and a number of other countries including Canada and the EU has been expanding, making raise concerns on unfair trade. The U.S. trade deficit with China, which rose to U. S$375.2 billion in 2017 from U.S. $347 billion in 2016 has particularly been making headlines.

Fig 5: US Trade Balance as of June 2018



Source: The balance

Being a significant player in the global economy, the US' concerns have introduced a new risk of uncertainty, with Canada already taking the U.S. to the WTO. The complaint mainly anchored on technical details of the U.S. trade rulebook, focusing on issues ranging from the U.S. treatment of export controls to the use of retroactive duties. On its part, China has requested consultations with the United States under the WTO's Dispute Settlement Mechanism regarding the United States' tariff measures on certain Chinese goods.

ii. US Interest Rate Hike and Dollar Strengthening

Since 1995, the United States has maintained a 'strong dollar policy', meaning that it does not intentionally act to devalue the dollar against foreign currencies. In effect, the United States has encouraged foreign bondholders to buy U.S. Treasury securities, in the process, keeping key economic variables including inflation within manageable levels. This policy stance has recently been augmented by rate hikes which have made U.S. Treasuries more attractive, leading to capital outflows in countries like Argentina and Turkey. Other countries identified to be facing some risk include, Ghana, Mongolia, Pakistan, Sri Lanka, and Zambia. According to Credit Rating Agency *Moody's Investor Service*, countries with large current account deficits, high external debt repayments and substantial foreign-currency Government debt are most exposed to the impact of a stronger US dollar.

iii. Rising Oil Prices

Since June 2017, Oil prices have risen 82%, similar to price rises in the past. However, in the Year to June 2018, the drivers are different from the previous times in which Oil price appreciation used to occur with appreciation in Emerging markets' currencies. Uniquely, this time round, these currencies are depreciating. Further, previous increases in Oil prices were driven largely by rising global demand. However, this time round, the driver is mainly lower oil supply due to OPEC production cuts. Further, supply could fall even more when new US sanctions against Iran start to take effect. There also are challenges that could arise from pipeline capacity constraints for US shale oil production over the next 12 months. Consequently, Oil exporters could be winners, while importers could suffer. Winners could

include Kazakhstan, Angola, Russia, and Colombia. Countries that may be adversely affected in include Vietnam, Kenya, Philippines, Pakistan, Belarus, Jordan and Lebanon.

Lessons for Kenya

Kenya should:

- Actively and periodically evaluate its trade balance position to address any glaring deficits that could be narrowed in order to improve the welfare of its people;
- Actively monitor its current account deficit, external debt repayment obligations and foreign-currency-denominated Government debt to minimize exposure to international interventions, such as US Fed actions, that have an impact on the international interest rates and US Dollar exchange rate; and
- Prudently manage its Oil resources to transform from a 'loser' to a 'winner' when international Oil price rise.

Global IPO Trends

A report on Global Initial Public Offering trends 2018 released by Ernst and Young indicates risks and uncertainties affected the IPO market in Q2 2018, resulting in declines in IPO activity for the first half of 2018. The key highlights to note.

- With 660 IPOs raising US$94.3b , H1 2018 saw the highest proceeds for the first half of the year since H1 2015 (704 IPOs raising US$110.1b);
- The Americas, led by the US, were up 18% by deal numbers and 31% by proceeds in H1 2018 relative with H1 2017. There were 122 IPOs on Americas exchanges, which raised US$35.3b for H1 2018.
- In Asia -Pacific, Japan was in the lead with its IPO volumes in H1 2018 declining by 5% and proceeds increasing by 8% over H1 2017 figures. In Greater China, despite a decline in IPO activity, China's Shanghai Stock exchange (SSE) hosted Q2 2018's largest IPO globally and was second among exchanges by proceeds.

Fig 6: Trend of Global IPO Activity (2009 – 2018)

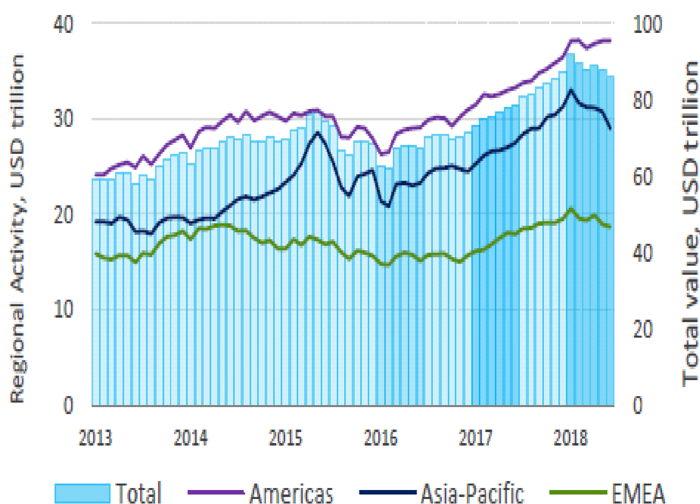
Source: EY

- In Europe, Middle East, India & Africa (EMEIA), India was the top performer with H1 2018 IPO activity at 32% and 31% higher, respectively than H1 2017 in terms of number of deals and proceeds. Across EMEIA, H1 2018 IPO volumes declined by 4%, even as proceeds rose 10%.
- Given the uncertainties in the IPO market, issuers have been considering a multi-track approach, where organizations prepare for their IPO so that they are ready to go when the window opens but

remain open to alternate funding options and remain flexible in terms of timing and pricing.

Further, market highlights by the World Federation of Exchanges indicates that the first six months of 2018 were characterized by a gradual month-on-month decline in overall market capitalization, with an average monthly growth rate of -1.3%. This was in contrast to the trend observed in 2017 when there was a positive growth rate in market capitalization over the entire period. In H1 2017, the average monthly market capitalization growth rate was 1.5%.

Fig 7: Domestic Market Capitalization across regions

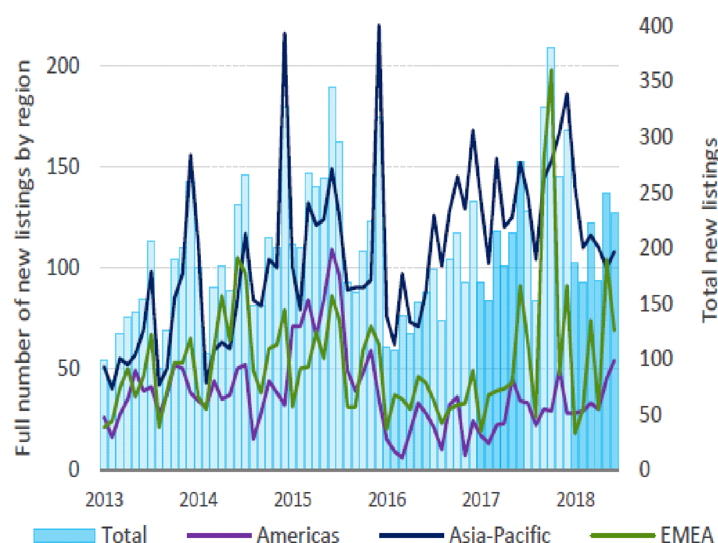


Source: World Federation of Exchanges

Increases in IPO investment flows in India, Australia and Indonesia were offset by falls in other markets including China, Korea, Japan, Philippines, Thailand, Malaysia and New Zealand. Similarly, an increase in the number of new listings through IPOs on exchanges in India, Hong Kong and Taiwan were offset by falls across most other markets in the region. The Chinese exchanges (Shanghai and Shenzhen Stock Exchange) saw IPO listings decline by 74.4% on H1 2017.

The two Indian exchanges (BSE Ltd and National Stock Exchange of India) together accounted for the second largest number of IPOs (110) in a country in H1 2018, with proceeds of nearly US$6.5 billion, driven by steady investor confidence, a positive earnings outlook for financial services, infrastructure, and consumer companies, and a rise in domestic capital in the equity market. In the presence of a new listings regime in Hong-Kong, IPOs listings were up by 44.1% versus H1 2017.

Fig 8: Trend of New Listings (2013 – 2018)



Source: World Federation of Exchanges

Lessons for Kenya

- Overall, most jurisdictions worldwide have faced limited initial public offerings in the recent past except for vibrant exchanges most of which are in Eastern Asia and Americas such as the Hong Kong Stock Exchange and the New York Stock Exchange. Kenya has equally suffered the same fate with the last major IPO being Safaricom, in 2008. Aware of the challenges facing the industry, the Authority is working closely with its key stakeholders in pursuing innovations such as the business incubator,

accelerator and listings experience and the NSE's Rapid Mass Visibilities Strategy, the ultimate objective being to identify a pipeline of companies considered viable to list. These efforts are expected to provide a platform through which market stakeholders may jointly participate in the process of helping companies meet necessary requirements for listing;

- The Nairobi Securities Exchange is further encouraged to develop a relationship with Small and Medium Enterprise companies in the country by developing a database of all SMEs while determining their needs to inform approach to issuance and if need be, change in regulations aimed at attracting more SMEs to list;
- Private equity contributions to investments in the country has continued to grow overtime, presenting an opportunity for the Authority and the Exchange to directly engage private equity firms to consider exiting the market through the NSE. In the same vein, the Authority will be engaging private equity companies more aggressively in the financial year 2018/19 with a view of identifying incentives that will promote their active participation in the market;
- Cognizant of the fact that the problem of low listings is closely related to low uptake of capital markets products and instruments, the Authority hosted a workshop in June 2018 aimed at determining a critical path to boosting uptake of capital markets products. An action plan has been drawn up based on feedback from the forum that will form the basis of reforms in the market to attracting more participation. Some of the strategies to be implemented include; having one on one interactions with listed firms, stratified into different sectors with priority being given to companies that fit within the 'Big 4' Agenda profile, review of regulations as well listing requirements amongst others considerations;
- The importance of creating market awareness on capital markets instruments cannot be underestimated. Therefore there is need to have a more aggressive approach towards investor education in a consistent manner throughout the year using simplified and relatable approaches to break away from the myth that capital markets investments is complex. Further, investors need to be enlightened of greater benefits derived from the capital markets other than capital raising. The Authority through its investor education impact analysis and opportunities study has identified various targeted market segments that will be a focus of its investor education programs based on segmented needs and maturity levels;
- Additionally, promotion of indirect investments through Collective Investment Schemes and new products such as REITs and ABS will continue to be promoted as flexible approaches to investing in the capital markets;
- The question of sound valuations of companies remains a controversial topic as the emergence of private equity activity in the country continues to present higher than expected valuations for Kenyan companies. Stakeholders therefore need to consider standardized approach towards valuation with the aim of ensuring that the value of companies

post listing remains favorable to encourage participation in the secondary market.

- While Kenya has remained a market leader in the region over the years, emergence of economies such as Ethiopia and Rwanda present competition for capital flows. Therefore, we need to ensure that our financial intermediation is efficient and attractive to retain and attract more capital.

Key Global Opportunities

In the advent of technological innovation and Fintech disruption, economies have sought to leverage on these evolutions to drive business efficiency and improve operations. Noting the developments around this area and the ongoing progress in Kenya on Fintech and related innovation, there is an opportunity to implement a regulatory sandbox benchmarking from other jurisdictions Below is a summary of the latest developments in this area;

a. Singapore

The Ministry of Health (MOH) in Singapore launched a new Licensing Experimentation and Adaptation Programme (LEAP) in April 2018, beginning with telemedicine services. The Ministry will provide regulatory sandboxes that enable new and innovative healthcare models and services to be developed and refined in a safe and controlled environment. Participating providers and MOH will achieve this through clear boundary conditions, data governance measures and risk mitigation strategies.

Telemedicine, which enables greater convenience and improved accessibility to medical support and medication through new digital self-help options, will be the first service to be explored under LEAP and has the potential to enhance productivity and cost-effectiveness, and become an impactful enabler in Singapore's healthcare landscape.

MOH will take a risk-based approach by focusing on tele-consultation services, which provide direct clinical care such as diagnosis and intervention between a doctor and patient, and work with the participating providers to bring about a safe and vibrant telemedicine environment. The plan is to eventually regulate telemedicine as a licensed healthcare service after the successful completion of the regulatory sandbox[4]. Earlier in the year, Singapore's MOH invited public feedback on a proposed Bill for regulation of healthcare services, which will replace the Private Hospitals and Medical Clinics Act (PHMCA). The Bill will shift the regulatory basis from 'premises-based' licensing to 'services-based' licensing and include telemedicine which was not regulated under the PHMCA.

b. South Africa

The South African Reserve Bank (SARB) set out the primary objectives of its recently-established FinTech task force, assigning priority to cryptocurrency regulation, sandbox and accelerator assessments and Blockchain experimentation. SARB announced the formation of a dedicated full-time three-man FinTech unit in February 2018 to monitor the impact of new technology developments on deposit taking, payments,

[4] https://www.opengovasia.com/articles/first-healthcare-regulatory-sandbox-launched-in-singapore-for-telemedicine-services

lending, insurance, and investments and reporting directly to the deputy governor.

The first objective of the unit was to review SARB's position on private cryptocurrencies, addressing regulatory issues such as clearing and settlement risks, exchange control impacts, monetary policy and financial stability.

Cybersecurity, tax implications, consumer and investor protection, and money laundering activities will also be scoped out. The SARB expects to complete the review in the second half of 2018. This will then be followed with a third quarter report into the establishment of a regulatory sandbox and innovation accelerator, setting out eligibility and participation criteria for future use cases. The Central Bank also intends to launch an experimental Distributed Ledger Technology (DLT) project dubbed 'Project Khokha' to develop a proof-of-concept application in collaboration with local banks.

According to the South African Reserve Bank, the objective of the Proof of Concept is to replicate interbank clearing and settlement on a DLT which will allow the SARB and industry to jointly assess the potential benefits and risks of DLTs[5].

c. Malaysia

In Malaysia, the Ministry of Finance (MOF) has started to implement its National Regulatory Sandbox Initiative. Already, a brain-storming group has been formed from regulators and selected industry players to enable innovators to test their solutions or products in a conducive environment.

The strategy identifies sectors for the Sandbox Initiative to include agriculture; biotechnology; building; education; energy; financial; food; green technology; healthcare; hospitality; smart city; sports; telecommunication; transportation; tourism; water management; and, waste management. Participation within the sandbox is through making applications to a secretariat where the solutions and/or products are tested prior to roll out. Additionally, the Securities Commission of Malaysia has its own programmes under the its Digital Market Strategy aimed at;

i. Enhancing access to finance through equity crowd funding and peer to peer lending;
ii. Increasing investor participation through implementing innovations to increase investor participation such as digital only stock brokers and automated portfolio management;
iii. Augmenting the institutional market through facilitating ease of access in one platform; and
iv. Fostering synergistic ecosystems through the Alliance for Fintech Community programme which facilitates engagement sessions with stakeholders on Fintech and the Innovation Laboratories. The Innovation Laboratory under the Alliance for Fintech Community Programme gives priority areas in the FinTech space based on feedback from the market on priority areas such as Distributed Ledger Technology and an Alternative Trading System.

d. Sierra Leone, the second country in Africa to launch the sandbox framework to test innovations

[5] https://www.finextra.com/newsarticle/31676/cryptocurrencies-sandboxes-and-blockchain-experimentation-top-sarb-fintech-agenda

Sierra Leone is perhaps not an obvious place to find experimentation with novel regulatory approaches to financial technology, coupled by the fact that the West African nation has one of the lowest financial inclusion rates in the world.

With support from the Mobile Money 4 the Poor (MM4P) programme of the United Nations Capital Development Fund (UNCDF) and Financial Sector Deepening Africa (FSDA), the Bank of Sierra Leone invited financial technology (FinTech) companies to apply in April 2018.

The pilot program is scheduled to last 12 months, where cohort participants will work with a dedicated, cross-functional regulatory sandbox team within the Bank of Sierra Leonne to test and evaluate regulatory aspects of their respective technologies and business models.

Four companies have already been identified for the pilot program. These include;

i. **InvestED;** a company that provides a platform for training low-income entrepreneurs using a mobile app on topics such as entrepreneurship, business skills and financial literacy. Users can qualify for credit products offered by SMT and other lending partners. Loans repayment is managed via mobile money;
ii. **iCommit;** helps farmers save between harvests to have sufficient funds to buy inputs for the next growing season. iCommit allows farmers to pre-commit resources to buy inputs by pre-purchasing exchangeable vouchers on an ongoing basis;
iii. **MyPay;** is an interoperable e-money platform that integrates financial institutions and provides point-of-sales machines to agent networks to manage financial transactions; and
iv. **Noory;** is open payments Application Programming Interface (API) that allows third-party developers to connect to banks and mobile money networks, therefore improving interoperability between platforms. The founder team recognized the need for interoperability when they tried to create mobile payments solutions for first responders and rescue workers during the 2014-2015 Ebola crisis in Sierra Leone.

It's inevitable that new technologies introduce new risks, and new twists on old risks, as well as different ways of working. Systems can fail and undermine market stability; machines can make decisions with unintended consequences that harm customers and markets; and the almost limitless data that is the lifeblood of the digital world can be manipulated, misused, stolen or, because of its sheer volume and complexity, even inadvertently disguise criminal behavior. But new technologies also offer significant opportunities to improve risk management and enhance the efficiency, safety, and soundness of markets. Financial services firms are tapping into new tools to strengthen risk management and compliance, while improving the customer experience:

- **Open banking** enabled by aapplication programming interface platforms (APIs) allows multiple firms to interact and access and update data to deliver new customer services;
- A combination of algorithms and **natural language processing** (NLP) delivers financial advice. These advanced machines can also "read" news and digital information sources to evolve strategies, initiate trades and analyze market and customer activity;

- **Distributed Ledger Technologies** (DLT) are underpinning new methods of record-keeping and transacting and even new mediums of exchange; and
- **Artificial intelligence** combined with other tools is enhancing the scope and effectiveness of monitoring and surveillance tools that seek out fraud, market abuse and money laundering, and extending the scope and quality of controls application and testing.

Regulators are also exploring how to use technology in their role for example;

- Using **machine learning** to enhance surveillance of market activity and check the validity and accuracy of reports and models that firms submit to them;
- Some are considering how **digitization and automation** could change the way regulations are written, distributed and complied with;
- **Others, along with Governments, have or plan centralized digital records** of individual and company identities, such as "digital passports," which can accelerate onboarding of clients to new institutions and services;
- Regulators are also doing what they can to facilitate new technology-driven business as well as supervise it. Many are establishing **regulatory "sandboxes"** – innovation hubs – to test new, technology-led services in safe environments where possible harm to markets or consumers can be limited; and
- Regulators are also analysing new products such as **cryptocurrencies** to determine whether these products should be covered by existing regulations for other financial activities and products or defined as a new asset and subject to new rules. [6]

Lessons for Kenya

- The realization that across the world jurisdictions are willing to test all sorts of innovations across all sectors of their economies and are not limited to FinTech, lends credence to the establishment of the Block chain and Internet of Things Task Force by the Kenyan Government whose mandate also touches on transport and health. Further, the Authority notes efforts made by the Government of Kenya in digitizing Government services as currently, there are 200 Government services that can be accessed on-line at the Huduma centers across the country and on mobile handsets, confirming the revolutionary power of technology across sectors and functions;
- The Authority will be monitoring commitment made in July 2018 by Government through the Ministry of ICT to move all its services onto a digital platform in the next 36 months to make Government services convenient and easily available to citizens, as herein lays an opportunity for FinTech developers to provide home grown solutions to digitizing targeted services;
- As institutions venture into open banking and borderless transactions, data protection remains crucial to ensure consumer rights are protected. Data manipulation will further require that data conventions are standardized across industries and sectors;
- The implementation of the regulatory sandbox for capital markets products and services remains a

[6] EY

primary focus for the Authority as it aims to foster FinTech developments in the industry. However, given the interrelatedness of the various sectors within the financial industry ranging from insurance, banking, pensions, cooperatives and the capital markets, the Authority is looking towards working with other financial sector regulators to ensure efforts made on this front bear fruits as most innovations cross cut sectors;

- Further, regulators need to work in harmony in order to standardize cross border requirements and policies to ensure seamless access to markets by innovators;
- Further, the Authority proposes development of a National Strategic roadmap for Fintech innovations in the country to act as a springboard in directing priorities and investments with the aim of increasing proportion of contribution to GDP by the technology sector; and
- Overall, involvement of the private sector in the formulation of policy and legal framework remains a primary focus as strategic direction is sought.

Global Topical Risk

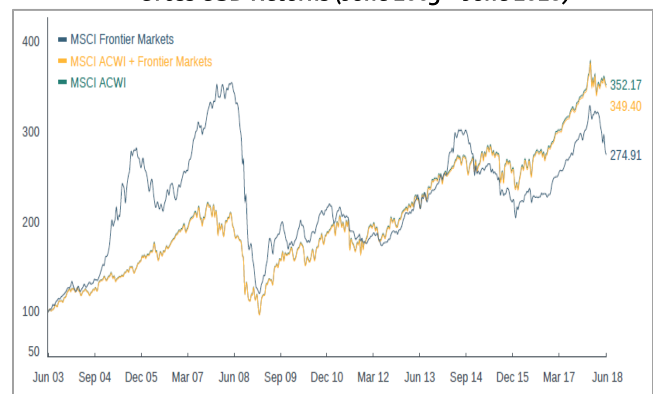
Increased Regulatory Concern on Cybersecurity

Cybersecurity has become as much of a legal and policy issue as it is a technical problem. Cybersecurity continues to threaten profit, data privacy, and reputation, and regulators have been paying attention. With this development, financial institutions not only need awareness of technical security issues but also compliance requirements. This means firms have room to think about how to make compliance investments more efficient, particularly given recent advances in RegTech[7]. The world has recognized the need for more targeted efforts towards mitigating on the effects of cybersecurity attacks both within the financial services industry and general principled relating to use of client data in various capacities.

Performance of Frontier Markets during the Quarter

Emerging and Frontier Markets[8] experienced performance turbulence during the quarter, with stocks, currencies and bonds getting adversely affected by a strengthening US Dollar and persistent fears of escalating international trade disputes. In the Year to June 2018, the MSCI Frontier Markets Index closed 10.70% lower at 274.91 points.

Fig 9: Cumulative Frontier Market and ACWI[9] Index Performance – Gross USD Returns (June 2003 – June 2018)



Source: MSCI

[7] https://www.pwc.com/us/en/industries/financial-services/research-institute/top-issues.html

[8] Frontier Markets countries include: Argentina, Bahrain, Bangladesh, Burkina Faso, Benin, Croatia, Estonia, Guinea-Bissau, Ivory Coast, Jordan, **Kenya**, Kuwait, Lebanon, Lithuania, Kazakhstan, Mauritius, Mali, Morocco, Niger, Nigeria, Oman, Romania, Serbia, Senegal, Slovenia, Sri Lanka, Togo, Tunisia and Vietnam.

[9] MSCI ACWI stands for Morgan Stanley Capital International (MSCI), All Country World Index) - a market capitalization weighted index designed to provide a broad measure of equity-market performance throughout the world and is comprised of stocks from both developed and emerging markets.
Source: MSCI

According to a Reuters' publication[10], among the Emerging and Frontier Markets, Argentina and Turkey experienced the largest drop in portfolio values after their currencies fell 30 percent and 17 percent respectively, during the period. In general, in the year to June 2018, Emerging and Frontier Markets registered lower performance, catalyzed by a hike in U.S. interest rates, higher international Oil prices and a degree of uncertainty following international trade tiffs.

However, despite emerging markets suffering a setback in the first half of 2018 precipitated by investor concerns over rising US interest rates, US dollar strengthening and rising trade tensions, analysts do not foresee a derailment in emerging-market fundamentals, which are expected to grow at a strong pace going forward.

Market Performance (MSCI EM Index, USD)
Cumulative Return

Best	Worst
+Columbia (6.8%)	-Brazil (-26.4%)
+Qatar (3.5%)	-Turkey (-25.7%)
+India (-0.6%)	-Pakistan (-20.6%)

Sector Performance (MSCI EM Index, USD)
Cumulative Return

Best	Worst
+Energy (-4.6%)	-Financials (-12.6%)
+Information Technology (-5.0%)	-Industrials (-11.2%)
+Health Care (-5.0%)	-Real Estate (-11.2%)

Currency Performance (vs. USD)
% Change

Best	Worst
+Qatar (0.0%)	-Brazil (-13.6%)
+United Arab Emirates (0.0%)	-South Africa (-13.6%)
+Peru (-1.5%)	-Turkey (-13.5%)

Source: FactSet, three-month period ending 30/06/18.

According to Franklin Templeton Investments, EMs generally have a higher proportion of local currency issuance, and much of the US dollar-denominated debt is backed by US dollar-denominated revenues at the corporate or sovereign level. The effects of a stronger dollar are therefore likely to be different than previous episodes of dollar strength, because most EM currencies now have floating foreign exchange regimes. Further, emerging markets (as a group) run a current account surplus, and the effect of a strong dollar will differ for countries depending on each nation's economic structure and policies.

Moreover, on June 20 2018, MSCI announced the inclusion of the MSCI Saudi Arabia Index in the MSCI Emerging Markets Index and the reclassification of the MSCI Argentina Index from Frontier Markets to Emerging Markets status beginning June 2019. In addition, MSCI also disclosed that the MSCI Kuwait Index will be included in the 2019 Annual Market Classification Review for a potential reclassification from Frontier Markets to Emerging Markets status. This, as part of its Annual Market Classification Review aimed at ensuring MSCI indexes remain relevant. The framework is based on a three-point criterion including;

- **Economic development**: Considers the sustainability of economic development and is only used in determining the classification of developed markets, given the wide range of development levels within emerging and frontier markets
- **Size and liquidity requirements**: Determines those securities that meet the minimum invest ability requirements of the MSCI Global Standard Indexes

[10] https://www.reuters.com/article/us-emerging-markets-performance/how-emerging-markets-became-submerging-markets-in-first-half-idUSKBN1JP21O

- **Market accessibility criteria:** Aims to reflect international institutional investors' experiences of investing in a given market and includes several sub-criteria such as: openness to foreign ownership, ease of capital inflows / outflows, efficiency of operational framework, competitive landscape and stability of the institutional framework

Lessons for Kenya

- The Lower performance of Frontier Market Indices implies that international funds flows into these markets (including Kenya's where equity portfolio outflows totaled Kshs. 16.2 billion in H1/2018) slackened. This trend may be reversed by aggressive initiatives aimed at stabilizing exchange rate, developing and maintaining strategic Oil reserves and improving the country's trade negotiating power through developing a pool of well-trained manpower. The Authority will continue to monitor, and track performance of initiatives related to this outcome.
- As emerging markets continue to remain competitive in the global scope, Kenya needs to work towards gaining entry into the EM MSCI Index as Saudi Arabia and Kuwait as a way of positioning itself competitively globally. This can only be achieved by fast tracking efforts aimed at increasing the size and liquidity requirements of our market; a persistent misgiving for the Kenyan capital markets despite supportive regulation for foreign investors including the removal of a cap on foreign ownership of listed companies as a way of attracting international institutional investors.

Overview – Global Economic Growth Forecasts

According to the World Economic Situation and Prospects as of mid-2018 report, global economic growth is expected to reach 3.2 per cent in both 2018 and 2019, marking an upward revision of 0.2 and 0.1 percentage points compared to forecasts released in December 2017. This is the fastest rate of growth since 2011 and reflects upward revisions to forecasts for roughly 40 per cent of the world's economies. Underpinning this is a stronger outlook for developed economies, reflecting rising wages, favorable investment conditions and the short-term impact of fiscal stimulus measures in the United States. Many commodity-exporting countries are also benefitting from higher prices of energy and metals.

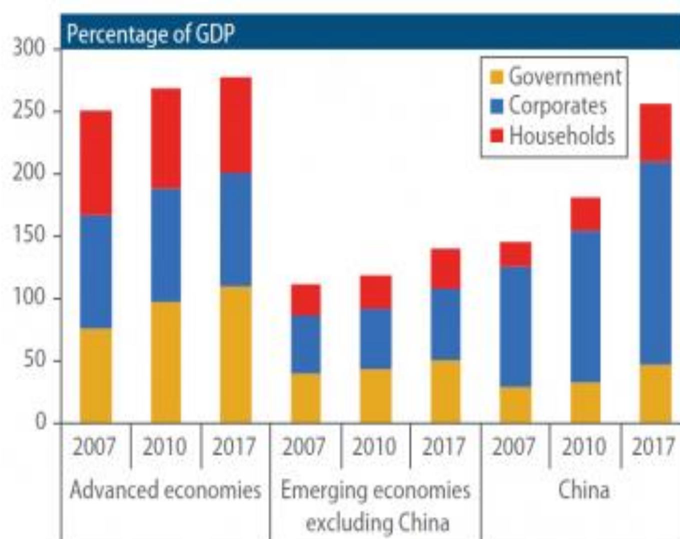
Fig 10: Growth of World Gross Product

Source: UN/DESA

However, alongside the improvement in short-term prospects, downside risks to global growth have also been building. Key risks include the build-up of trade tensions among major economies; increasing geopolitical tensions; greater uncertainty about the path of monetary policy adjustment in developed economies; and high and rising levels of debt in both developed and developing

countries. Public and private debt levels remain at historically high levels in many developed economies, and both household and corporate debt is higher than before the global financial crisis. In emerging economies, the debt-to-GDP ratio (all credit to non-financial sector) has increased from 139 per cent in 2010 to nearly 200 per cent in 2017. Non-financial sector debt in China increased from 180 to over 250 per cent of GDP (figure 2). Debt levels in Latin America have also increased visibly, for example in Brazil (from 125 to 145 per cent) and Mexico (from 56 to 77 per cent).

Fig 11: Breakdown of non-financial sector debt of advanced and emerging economies



Source: BIS Total Credit Statistics

Overview – Sub Saharan Africa Growth Forecasts

Africa Outlook 2018

Global Economic Prospects June 2018 Report[11] by the World Bank forecasts that Growth in Sub-Saharan Africa region is projected to strengthen to 3.1 percent in 2018 and to 3.5 percent in 2019, below its long-term average. Nigeria is anticipated to grow by 2.1 percent this year, as non-oil sector growth remains subdued due to low investment, and at a 2.2 percent pace next year. Angola is expected to grow by 1.7 percent in 2018 and 2.2 percent in 2019, reflecting an increased availability of foreign exchange due to higher oil prices, rising natural gas production, and improved business sentiment. South Africa is forecast to expand 1.4 percent in 2018 and 1.8 percent in 2019 as a pickup in business and consumer confidence supports stronger growth in investment and consumption expenditures.

Sub-Saharan Africa Country Forecasts [12]

Table 1: Real GDP growth at market prices in percentage

Country	2015	2016	2017e	2018f	2019f	2020f
Burundi	-3.9	-0.6	0.5	**1.9**	2.3	2.5
Congo Republic	2.6	-2.8	-4.6	**0.7**	4.6	-1.2
Ethiopia	10.4	7.6	10.3	**9.6**	9.7	9.9
Ghana	3.8	3.7	7.8	**6.9**	6.7	5.4
Kenya	**5.7**	**5.9**	**4.9**	**5.5**	**5.9**	**6.1**
Nigeria	2.7	-1.6	0.8	**2.1**	2.2	2.4
Rwanda	8.8	6	6.1	**6.8**	7.1	7.5
South Africa	1.3	0.6	1.3	**1.4**	1.8	1.9
Tanzania	7	7	6.4	**6.6**	6.8	7
Uganda	5.2	4.7	4	**5.5**	6	6.5

e- expected; f- forecasted

Implication

- Rising mining output and stable metals prices are anticipated to boost activity in metals exporters.
- Growth in non-resource-intensive countries is expected to remain robust, supported by improving Agricultural conditions and infrastructure investment.

[11] World Bank

[12] Global Economic Prospects: The Turning of the Tide , June 2018

Kenya's Economy – Overview

Kenya's Growth Prospects

The International Monetary Fund expects an average annual growth of around 5.5% in Kenya for the remaining half of the year. This is based on the Government's commitment to economic reforms such as modification of bank interest rates. Other positive strides noted by IMF include the Government-backed campaign of making public expenditure and procurement transparent as well as financial regulators being keen on the adoption of emerging International Financial Reporting Standards.

To complement this, the World Bank Kenya Economic Overview Report notes that Kenya has made significant political, structural and economic reforms that have largely driven sustained economic growth, social development and political gains over the past decade. However, World Bank indicates that it's key development challenges still include poverty, inequality, climate change and the vulnerability of the economy to internal and external shocks.

Closer home, the Central Bank of Kenya through its Monetary Policy Committee(MPC) Market perception survey issue of March 2018 projected economic growth in 2018 at an average of 5.4 percent based on survey feedback from expectations of bank and non-bank private sector firms on the trajectory of the economy.

Lessons for Kenya

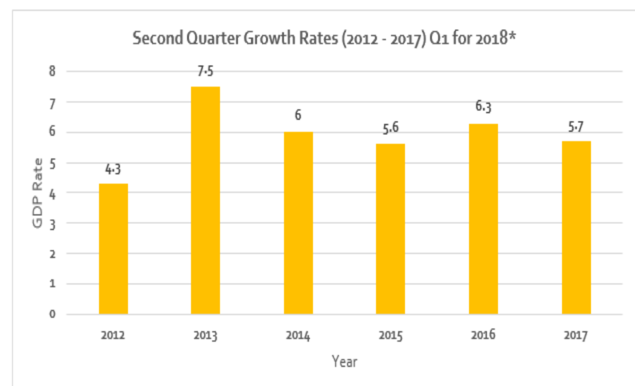
- In implementing Fiscal Consolidation, Kenya needs to avoid compromising public investments in critical infrastructure key to unlocking the economy's productive capacity;
- In addition to aligning fostering economic development through the country's development agenda to the long-term development plan; Vision 2030, the Big Four Agenda that will prioritize manufacturing, universal healthcare, affordable housing and food security is fundamental as it charts Kenya's direction to becoming an upper-middle income economy;
- Kenya with its pivotal role in East Africa's economic development has the potential to be one of Africa's success stories from its growing youthful population, a dynamic private sector, highly skilled workforce, improved infrastructure, and a new constitution; and
- Fostering inclusive growth and financial growth through addressing the challenges of poverty, low investment and low firm productivity to achieve rapid, sustained growth rates that will transform lives of ordinary citizens, will be a major goal for Kenya.

Foreign Currency Fluctuation

The KShs depreciated against USD, Sterling Pound, EURO and SA Rand at the end of June 2018 compared to end period exchange rates as at June 2017. It however recorded an appreciation against the Uganda Shilling, Tanzanian Shilling, Rwandan Franc and Burundi Franc over the period.

GDP Growth Rate

Figure 12: Q1 GDP Growth Trend (2012-2018)



Source: First Quarter 2018 GDP Report 2018

The recent release on GDP data by the Kenya National Bureau of Statistics (KNBS)[13] indicate that Kenya's economy expanded by 5.7 per cent during the first quarter of 2018 compared to 4.8 per cent in a similar quarter of 2017. The significant acceleration in growth was mainly attributable to improved weather conditions and a boost in business and consumer confidence after the conclusion of general elections in 2017 at commitment to building bridges for national development by the leading political proponents. From the supply side, growth was mainly driven by a recovery in Agriculture as well as improved output in Wholesale and Retail Trade, Manufacturing, and Real Estate sectors. On the other hand, Financial and Insurance; Transportation and Storage; Construction; Electricity Supply; and Mining and Quarrying recorded marked slowdown in the growth. This could be attributed to a decline in producer prices in the manufacture of fabricated metal products, as reported by the Kenya National Bureau of Statistics Q2.2018 report. Growth of activities in the Information and Communication was robust while Accommodation and Restaurants slowed significantly but remained relatively strong.

Overview – Capital Markets Performance and Stability

Review of the NSE 20 and NSE 25 Share Index by the Nairobi Securities Exchange

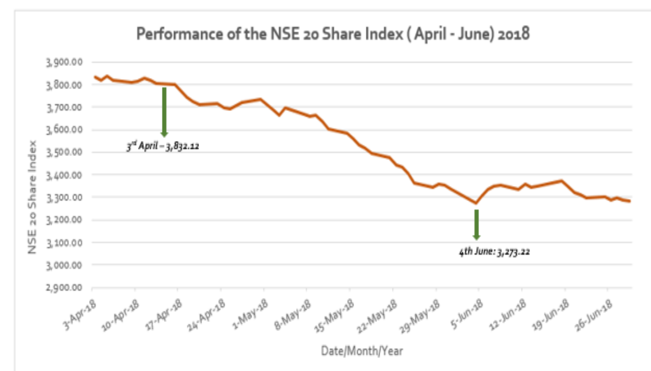
With effect from April 3, 2018, the Nairobi Securities Exchange reviewed the constituent counters of its NSE 20 and 25 Share Index following board approval. The market index is reviewed periodically to ensure that it reflects an accurate picture of market performance. The review of the NSE 20 share index resulted in the inclusion of Kenya Reinsurance Corporation Limited, NIC Group Plc and Nairobi Securities Exchange Plc as index constituent companies replacing CIC Insurance Group Limited, Stanbic Holdings Plc and Sasini Plc.

While the review of the NSE 25 share Index incorporates the inclusion of Nairobi Securities Exchange Plc as an index constituent company replacing HF Group Plc.

The NSE 20 Share Index is a price weight index calculated as a mean of the top 20 best performing counters. The constituent companies are selected based on a weighted market performance during the period under review based the following criteria:

- Trading activity measures i.e. market capitalization, shares traded, deals/liquidity and turnover during the period under review are weighed in the ratio of 4:3:2:1 respectively;
- A company must have at least 20% of its shares quoted at the NSE; and
- Must have a minimum market capitalization of Kshs. 20 million;
- A company should ideally be a blue chip with superior profitability and dividend record.

Figure 13: Performance of the NSE 20 Share Index (April to June) 2018



Source: NSE/CMA

[13] Kenya National Bureau of Statistics

However, despite the change in constituent companies of the NSE 20 share index, the index remained relatively stable in the following days post 3rd April 2018 showing relative stability in the prices of constituent companies. On the other hand, the performance of the NSE 20 share index has been on a decline in the quarter under review with the highest point of 3,836.49 recorded on 5th April 2018 and the lowest of 3,273.22 recorded on 4th June 2018.

While many factors could be attributed to the fall in the index, a key factor observed in the quarter is fall in prices of at least six listed companies by more than thirty percent including ARM, Deacons, Uchumi, NBV,NBK and Umeme. Other factors include profit taking by foreign investors resulting into decline in valuations, having taken out a net of Sh8.2 billion during the second quarter[14] with major activity observed on the Safaricom, Equity, KCB and EABL counters. The NSE 20 constituent counters account for 87 per cent of the market's total capitalization, making their performance a key determinant of the entire market's direction.

Equity Market Performance & Stability

Table 2: Snapshot of Annual Market Performance

Year	Equity Turnover KShs. Bn	Share Volume (Mn)	NSE 20-Share Index	NSE All Share Index	Market Cap (KShs. Bn)
2013	155.75	7,665.92	4,926.97	136.65	1,920.72
2014	215.73	8,133.67	5,112.65	162.89	2,316.00
2015	209.38	6,812.14	4,040.75	145.70	2,053.52
2016	147.18	5,813.49	3,186.21	133.34	1,931.61
2017	171.61	7,065.36	3,711.94	171.20	2,521.77
2018*	108.29	3,718.99	3,285.73	174.34	2,576.23

As at June 2018

Equity turnover for Q2.2018 stood at KShs. 47.15 Billion, compared to KShs. 44.90 Billion registered in Q2.2017; a slight 5.01% increase. Similarly, an increase of 15.98% was also recorded in end period market capitalization as Kshs. 2,576.23 Billion was recorded in Q2.2018 compared to KShs. 2,221.29 Billion recorded in Q2.2017.

On the other hand, Share Volumes and NSE 20 share index recorded decreases of 16.56% and 8.91% to close the quarter at 1,580.03 Million and 3,285.73 points respectively.

Table 3: Secondary Equity Market Performance; Q2.2018/17

Month	Equity Turnover (KSHS. Bn)	Share Volume (Mn)	NSE 20-Share Index	Market Cap (KSHS. Bn)
Q2.2017				
April	11.41	446.64	3,157.58	1,935.28
May	16.35	697.06	3,441.05	2,155.36
June	17.14	749.91	3,607.18	2,221.29
End-period	**44.90**	**1,893.61**	**3,607.18**	**2,221.29**
Q2/2018				
April	15.08	449.24	3,735.06	2,644.69
May	18.38	677.28	3,333.36	2,549.13
June	13.69	453.51	3,285.73	2,576.23
End-period	**47.15**	**1,580.03**	**3,285.73**	**2,576.23**
% Change	**5.01%**	**16.56%**	**8.91%**	**15.98%**

Performance of Listed Companies

Price Gainers

Table 4: Top 10 Price gainers as at 29th June 2018

Counter	30th March 2018	29th June 2018	% Change
EXPRESS	4.90	5.95	**21.43%**
SAMEER	2.30	2.70	**17.39%**
BRITAM	12.50	14.60	**16.80%**
KENOLKOBIL	17.55	18.10	**3.13%**
BAMBURI	175.00	179.00	**2.29%**
KAPCHORUA	67.00	68.00	**1.49%**
LIMURU TEA	500.00	500.00	**0.00%**
ATLAS	1.05	1.05	**0.00%**

14

KURWITU	1,500.00	1,500.00	0.00%
ORCHARDS	82.00	82.00	0.00%

Express Kenya:

Express Kenya has been experiencing a price rally since the start of 2018. Among the possible reasons is the takeover bid by Daniz Holdings in December 2017, the then majority shareholder owned up to 61.64 per cent stake in Express Kenya Limited.

Sameer Africa:

Sameer share price increased by **17.39%** from KShs 2.30 as at end March 2018 to KShs 2.70 recorded end June 2018. This could be attributed to among other factors, the significant growth of the company's profits for the year ended December 2017. The firm is working towards transitioning to become a selling company from a manufacturing company in order to protect its margins as well as cut costs.

Britam:

Britam share price increased by **16.80%** from KShs 12.50 in March 2018 to KShs 14.60 in June 2018. The group had a stable financial year. In May 2018, the company concluded the sale of a 14.3 per cent stake to private equity firm AfricInvest in a capital raising drive. The company has also brought in a new shareholder (Swiss-Re) through the sale of 348.5 million shares worth Sh4.8 billion by one of its previous shareholders.

Price losers

Table 5: Top ten price losers as at 29th June 2018

Counter	30th March 2018	29th June 2018	% Change
ARM CEMENT	8.25	3.05	63.03%
DEACONS	2.85	1.25	56.14%
UCHUMI	2.45	1.45	40.82%
NBV	2.50	1.70	32.00%
NBK	9.15	6.25	31.69%
UMEME	12.25	8.40	31.43%
HF	11.65	8.50	27.04%
EA CABLES	4.90	3.60	26.53%
EVEREADY	2.00	1.50	25.00%
C&G	25.00	19.00	24.00%

Source: NSE

ARM share price depreciated by **63.03%** from KShs 8.25 in March 2018 to KShs 3.05 in June 2018. The cement manufacturer has been facing liquidity challenges and will be relying on shareholder loans to lift its production up to capacity, while seeking strategic investors to help it improve its financial position.

Deacons:

Deacons' share price declined by 56.14% from KShs 2.45 in March 2018 to KShs 1.45 in June 2018. In February 2018, the Authority approved a shareholder's circular in respect of the sale of Mr. Price Franchised Business in Kenya by Deacons to Mr. Price Group Limited.

Uchumi:

Uchumi share price slumped by 40.82% from KShs 2.45 in March 2018 to KShs 1.25 in June 2018. The company has been facing corporate governance and financial challenges.

National Bank of Kenya

NBK has also been facing corporate governance and financial challenges. The Bank recorded a KSh278.5 million net loss in Q1.2018.

Nairobi Business Ventures (NBV)

NBV share price slumped by **32.00%** from KShs 2.50 in March 2018 to KShs 1.70 in June 2018. The company has been grappling with working capital challenges.

Bond Market Performance & Stability

Primary Market Performance

In the primary treasury bonds market, during Q2.2018, five (5 Treasury bonds were issued with 4 new issues and 1 re-opening. During the quarter the Government sought to raise KShs. 120 Billion against which KShs. 63.11 Billion worth of bond applications were received with the Government only accepting KShs. 44.96 Billion worth of bonds, indicating a 37.43% acceptance rate. This is contrary to an average performance rate of 130% recorded in Q2.2017 for treasury bonds.Further, auction results of the bond issue show low levels of subscription for longer tenure bonds such as the 20-year FXD 1/2018/20 issued in April 2018 and the 25-year FXD 1/2018/25 where bids worth Kshs 9.90 Bn and Kshs 10.13 Bn were received respectively, out of an offer of Kshs 20 Bn in each issue, accounting for 49.5% and 50.65% performance rate in issuance.

Table 6: Primary Treasury Bond Performance; Q2.2018/17

Bond Issue	Offered (KShs. Bn)	Bids (KShs. Bn)	Accepted (KShs. Bn)	Performance Rate (%)
Q1.2018				
Apr. 2017				
FXD3/2008/10		21.76	14.62	
Tap sale	30.00	-	3.25	
FXD1/2009/10		27.63	18.15	164.63%
Tap Sale		-	3.93	
May. 2017				
FXD 2/2010/10	40.00	14.49	8.53	97.11%
Tap Sale		-	4.75	
FXD 1/2009/15		24.35	11.46	
Tap Sale		-	10.41	
Jun. 2017				
FXD2/2007/15	30.00	39.07	26.41	130.23%
Apr. 2018				
FXD1/2008/15		22.86	20.15	
FXD1/2018/20	40.00	9.90	6.78	81.92%
May 2018				
FXD1/2018/15	40.00	20.22	12.86	50.54%
Jun. 2018				
FXD1/2018/25	40.00	10.13	5.17	25.33%

Source: CBK

Liquidity Risks Corporate Bond Market

Treasury bond trading accounted for 99.88% of total Bond trading in during the period April 2018 to June 2018, with a mere 0.12% attributable to the corporate bond market. In retrospect, the corporate bond market has faced significant challenges following the delayed and unresolved issues following the financial challenges faced by Chase Bank and Imperial Bank in 2016, particularly settlement of proceeds by respective bond investors.

To address this, the Authority is making progress in engaging the Central Bank of Kenya and the National Treasury to ensure that section 30 of the KDIC Act is considered going forward.

Table 7: Secondary Bond market Performance; Q2: 2018/17

Month	Government Bond Turnover (KSHS. Bn)	Corporate Bond Turnover (KSHS. Bn)	Total Bond Turnover (KSHS. Bn)
Q2.2017			
April	29.29	0.16	29.45
May	56.34	0.30	56.64
June	48.38	0.15	48.53
TOTAL	**134.01**	**0.61**	**134.62**
Q2.2018			
April	42.44	0.02	42.46
May	57.29	0.02	57.31
June	58.60	0.15	58.75
TOTAL	**158.33**	**0.19**	**158.52**
Q2.2018/17 %Δ	**18.15%**	**68.85%**	**17.75%**

Source: NSE Monthly Reports

Major Market Risks

Equity Market Liquidity risk

In the quarter to June 2018, average quarterly equity market liquidity stood at 2.17 percent, compared to 1.83 percent registered in the quarter to March 2018, indicating a 0.34% decrease in turnover ratio in the equities market mainly attributable to a 22.91 decrease in turnover between Q1/2018 and Q2/2018.

Table 8: Market Liquidity Concentration in 2017/18

Period	Turnover (KShs Bn)	Market Cap (KShs Bn)	Turnover Ratio
Q2/2018	47.14	2,576.23	1.83%
Q1/2018	61.15	2,817.36	2.17%
Q4. 2017	36.02	2,521.77	1.43%
Q3 2017	53.57	2,376.69	2.25%
Q2 2017	44.90	2,224.06	2.02%

Source: CMA

Kenya like other emerging market economies is characterized by a capital markets with low liquidity levels averaging between seven percent and nine percent per annum over the last two years.

Foreign Investor Exposure risk

Table 9: Equity Market Foreign Investor Exposure by Turnover as at June 2018

	Month	Foreign Investor Purchases	Foreign Investor Sales	Equity Turnover	
		KShs. Millions	KShs. Million	KShs. Millions	%
Q1. 2018	Jan	13,813	15,277	20,340	71.51%
	Feb	6,324	11,461	17,919	49.63%
	March	10,927	12,410	22,890	50.98%
Q2. 2018	April	8,673	10,488	15,076	63.55%
	May	7,700	11,722	18,377	52.84%
	June	8,244	10,583	13,688	68.77%

Source: NSE

Settlement Guarantee Fund (SGF) Exposure Risk

SGF Ratio for the quarter to June 2018 averaged 1.10 compared to 0.84 as at end March 2018. Whereas the actual value of the SGF balances remained relatively stable between the respective quarters, the observed increase in the ratio could be attributed to the decrease in average daily turnover recorded in Q1.2018 compared to Q2.2018 with the former averaging at Kshs. 969.84 Mn and the latter Kshs 771.85 Mn, hence higher ratio The SGF ratio is computed as the ratio of SGF balance for the month to the average daily turnover. To address the exposure risk, the Authority remains pro-active in monitoring the performance of its intermediaries with the aim of ensuring breaches are flagged prior to the manifestation of adverse effects on investors.

Table 10: Capital Market activity in East Africa

Indicator	Uganda	Tanzania	Kenya
	Q2.2018		
Number of Shares Traded (million)	96.46	21.18	1,580.04
Turnover (USD Billion)	0.01	0.23	0.47
Number of Deals	1,707.00	3,037.00	83,477.00
Market Cap (USD Billion)	7.35	9.70	25.54
Turnover Ratio	0.00097	0.00234	0.01830
All Share Index (Closing)	2,061.51	2,281.12	174.36
Exchange rate to the USD	3,884.75	2,266.44	100.89

Source; CMAUG, CMSA, CMAKE

Kenya remains relatively ahead of the other East African countries in the performance of its capital markets as characterized by international recognition and awards earned by the Authority in the recent past with the latest being recognition by the International Finance Awards 2018 as the most innovative capital markets regulator, 2018.

This could be attributed to the clear strategy adopted by the Authority through its Vision 2030 flagship project, the Capital Markets Master Plan coupled with its visionary strategic plans.

Despite these milestones, foreign outflows within the quarter under review remain a concern for the country as the

markets are highly characterized by foreign trades and participation.

Major Economic Developments

Policy Pronouncements in the 2018/19 Annual Budget

In February 2018, The Authority submitted Policy Proposals for incorporation into the 2018/19 Annual Budget. The proposals were anchored in the following thematic areas:

a. Policies to support tax efficiency and Capital Market Development;
b. Policies to support investor protection; and
c. Policies to support Kenya's emergence as an International Financial Centre.

The Cabinet Secretary for the National Treasury and Planning, delivered the Budget Statement to the National Assembly on 14th June 2018 and made policy pronouncements with implications on the capital markets.

Below is a highlight of some of the policy pronouncements and the expected direct and indirect implications to the capital markets

Table 11 : Snapshot of the 2018/19 Budget Policy Pronouncements and Implications

	Policy Pronouncement	*Implication*
1	Expansion of the scope of definition of dividends to include other distributed assets	This is highly likely to dis-incentivize companies from distributing corporate earnings in the form of additional shares as a way of tax avoidance, in favour of cash dividends. This could would reduce the stock of new shares (usually created through capitalization of reserves), thereby having an adverse impact on the capital markets
2	Proposal to increase the excise duty fees charged on money transfer services by cellular phone service providers from 10% to 12%	This will increase the mobile money transfer charges; and is hence likely to adversely impact capital markets FinTech innovations that are pegged on the mobile money transfer platforms such as M-Akiba transactions
3	The Robin Hood Tax of 0.05% proposed to be introduced on any amounts of five hundred thousand shillings (KSh 500,000) or more transferred through banks and other financial institutions	It will negatively impact capital markets by making transactions in the sub-sector more expensive

4	The Proposed foreign income tax amnesty filing extension to 30th June 2019 as well as the extension of declaration period to allow individuals to repatriate income earned up to 31st December 2017	This is a positive development and has the potential of attracting Diaspora inflows into the country, in which case some of the inflows will find their way into the capital markets
5	Establishment of the Kenya Mortgage Refinancing Company (KMRC)	It is expected that the KMRC will leverage on capital markets to raise funds through bonds for on-lending to banks and other mortgage financing companies and is therefore also a positive development for capital markets deepening
6	Establishment of the Kenya Development Bank	It is anticipated that the new bank will leverage the capital markets to meet the financing requirements of the sectors previously served by the three entities, a positive impact
7	Revival of the privatization program	The program will be partly carried out through the capital markets and could stimulate the capital markets through new listings of State Owned Enterprises and a multiplier effect of listing of private sector entities
8	Establishment of a National Toll Fund to support the development of national trunk roads	This will reinforce the roll out of the Debt Infrastructure Fund program and other securitization transactions in the medium to long term
9	Setting up of the National Credit Guarantee Fund	This will provide support to potential NSE Growth Enterprise Market Segment (GEMS) entities and FinTech startups (in the proposed Regulatory Sandbox);
10	Repealing of 33B of the Banking Amendment Act 2016 on capped lending at 4%	This is expected to reverse the negative impact of the interest rate capping which was introduced in 2016, especially on listed commercial banks
11	Amendments to the Capital Markets Act	This is expected to address key capital markets malpractices including corporate governance, embezzlement of investor funds, front running, and provision of misleading information amongst others. Additionally, it will incentivise whistle-blowers to provide information because reward mechanisms will be in place. It will also ensure that the

		ICF is managed more efficiently by abolishing the ICF Board and vesting the management of the fund into the Authority
12	Amendments to the Kenya Revenue Authority Act and the Public Finance Management Regulations to allow Kenya Revenue Authority collect the surplus from regulatory authorities and remit to the Consolidated Fund	This is expected to negatively impact the Authority in the following ways; a. Monies that could have been utilized for market development may form part of the remittance and would have been foregone; b. Staff incentives may reduce significantly. For instance; it will negatively impact on staff loans thus affect future development prospects; and **c.** Remitting ninety percent of CMA surpluses to KRA means that the Authority will be left with much less thereby hampering innovative prospects. For instance, if the Authority was to implement an innovative initiative, part of the Funding model would encompass money from surplus funds.
13	Completion of the Sovereign Wealth Fund legislation to help deal with the windfall of resources from the extractive sector	The fund will act as stabilization fund to counter cyclical economic shocks by diversifying the country's incomes. The fund is also expected to invest in the capital markets hence contributing to the growth of the market.
14	Creation of a more robust framework for implementation of PPP and launch of the PPP disclosure portal	This will provide Local institutional investors and pension funds an opportunity to participate in Private Public Partnerships with the Government therefore providing local currency financing for PPP projects de-risking projects from foreign currency funding exposure.
15	Establishment of the Financial Markets Conduct Authority	This will deal with inadequacies in consumer protection and unregulated lending in the financial sector. The Authority is expected to address problems of predatory lending by credit providers.

Source: CMA/National Treasury Kenya 2018/19 Budget Statement

Lessons and opportunities presented by the new policy provisions;

Provisions by the 2018/19 budget statements has continued to raise questions amongst industry players. Following stakeholder engagement on these provisions, a few lessons can be drawn by policy making bodies.

- That introduction of new policy and regulations should be based on market intelligence and analysis to avoid resistance from industry players upon implementation. Case in point is the Robin Hood tax debate which has been countered with court proceedings as operationalization mechanisms as well as overall effect on foreign investments are contextualized;
- The Government's intent to support privatization activities of some of the State Owned Enterprises presents an opportunity for stakeholders,; CMA and NSE included to be proactive and approach select State Owned Enterprises with potential to raise funds through the capital markets as a mechanism of creating awareness on requirements for active participation in the market while emphasizing on the critical importance of good corporate governance practices to enhance transparency;
- The Authority intends to leverage on the above opportunity through implementing the recommendations of its funding gap study that targets both National Government and County Government entities as potential issuers in the capital markets.

Capital Markets Developments

Capital Markets Authority 2018-2023 Strategic Plan

Following the expiry of the 2013-17 Strategic Plan, the Authority has developed a new Strategic Plan running from July 2018 to June 2023 to guide it over the next five years to achieve its mandate

The CMA Strategic Plan further serves as a blueprint for the Authority to steer the development of Kenya's capital markets to support national development objectives and the achievement of MSCI emerging market status aspirations as per the Capital Markets Master Plan.

The Plan encompasses six key Strategic objectives including:

1. Ensuring a robust, facilitative and responsive policy and regulatory framework for capital market development and efficiency;
2. Facilitating the development, diversification and uptake of capital markets products and services;
3. Ensuring sound market infrastructure operations and market institutions;
4. Leveraging technology to drive efficiency in the capital markets value chain;
5. Ensure optimal institutional efficiency and effectiveness of CMA; and
6. Enhancing strategic influence.

The Plan was developed using a comprehensive process, which involved consultations with key stakeholders such as partner regulators, licensed intermediaries and investors, benchmarking with developed and emerging markets (including the US, UK, Australia, Malaysia, South Africa and Brazil) and support from capital market consultants with expertise from across the UK, Europe, Latin America, Asia and Africa.

In order to ensure that Kenya's capital markets have their desired impact in supporting economic development and

empowerment, the Plan has been aligned with a number of local and international priorities, including the Government's National Development Agenda, the Big 4 Agenda, The Vision 2030 Third Medium Term Plan (MTP III), the Capital Market Master Plan (CMMP) and the United Nations' Sustainable Development Goals.

The Plan is also timely as it aims at addressing the technological revolution happening in Kenya and the evolving needs of local and international investors. The Plan, therefore, provides a blueprint for the Authority to align its resources to best meet the demands of a more connected, digital and sophisticated capital market in the country. The Strategic Plan shall be launched in July 2018.

CMA Hosts the Regional Islamic Finance Services Board (IFSB) workshop

As identified in the Capital Markets Master Plan, Islamic finance is one of the fields of finance that if nurtured, could potentially catapult the East and Central African region to become competitive as a hub for capital inflows.

During the Quarter, the Authority as a coordinator of Kenya financial Sector Regulators on the Islamic Finance Project Management Office, under the patronage of the National Treasury (Kenya) and in collaboration with the International Financial Services Board (IFSB) organized a 3-day Workshop on Islamic Finance Principles for the financial sector (Banking, Capital Markets, Insurance, and Retirement Benefits & Microfinance) to be held between 14th and 16th May 2018 in Nairobi, at the Kenya School of Monetary Studies (KSMS), Nairobi. The Participants were trained on Islamic Capital Markets Principles and Takaful standards.

The Capital Markets Authority has partnered with the Islamic Financial Services Board on various fronts to facilitate Capacity Building for Islamic Finance and Capital Markets in Kenya. This has been very crucial in facilitating the build-up of key competencies, knowledge and skills in Islamic Finance.

- **CMA hosts a Consultative Workshop on Low Uptake of Capital Markets Products and the Rapid Mass Visibilities Strategy**

While the CMA has made significant progress towards innovation, development and introduction of new products through supporting legal and regulatory frameworks, uptake of both traditional and structured products has remained characteristically low.

In order to address this issue, the Authority undertook a study aimed at determining the underlying reasons behind the low uptake of capital markets products and services.

During the quarter, on 29th June 2018, the Authority in conjunction with the Nairobi Securities Exchange conducted a full day consultative workshop with stakeholders at the Kenya School of Monetary Studies to probe the findings and recommendations of the research paper as well as craft a path to recovery on the performance of both traditional and structured products in the country.

The event was well attended with representation from the National Treasury, CMA, NSE, EAVCA, KASIB, Stock brokers, Investment Banks, Listed Companies, Fund Managers, Fintech Firms, SMES and family owned businesses representatives, amongst others.

The recommendations from the consultative workshop will be instrumental in addressing the low uptake challenge with the capital markets space, Reversing the perception that the capital market is expensive and removing identified obstacles to listings and improving other capital market products' uptake, increasing Listings at the NSE, addressing gaps in market issuance practice that have resulted to low listings in the equity and debt space as well as potential ways

of leveraging on the NSE/KASIB Rapid Mass Visibilities Strategy (RMVS) proposition to spur capital markets listings interest and ultimately develop the market.

- **The African Securities Exchange Association (ASEA) held its 7th Building African Financial Markets (BAFM)**

The African Securities Exchange Association (ASEA) held its 7th Building African Financial Markets (BAFM) seminar in Nairobi on April 19th to 20th April 2018 at Villa Rosa Kempinski Nairobi.

The theme for this year's seminar **was 'Adaptive innovation as a lever for the growth and sustainable development of African Financial Markets'**. The ASEA Conference is an annual conference that brings together members of exchanges within Africa and leaders of various financial institutions in the continent. The Authority participated in the Conference as a Gold Sponsor.

The event was graced by the Deputy President of the Republic of Kenya, Hon William Ruto who noted the key fundamental role that financial markets and in specific the Capital Markets can play in achievement of the Big 4 agenda for the Government namely: manufacturing, universal healthcare, affordable housing and food security.

Some of the key lessons from the Conference specific to Capital Markets Regulators include the following;

a. Current supervision models need to adopt an interactive and outcome-based approach to meet future needs;
b. Green bonds should be a key area of focus for capital markets as sustainability factors are increasingly having a material impact on investment flows;
c. Effective regulatory cooperation and harmonization could be achieved by Capital Markets regulators by early and proactive engagement of exchanges, other supervisory authorities, IOSCO and regional harmonization entities;
d. Capital Markets Regulators should consider issuing guidelines to its licensees on standards for cyber security in addition to having in place measures to manage third party cyber risk; and
e. Regulatory alignment and harmonization of laws in line with international best practices and standards such as the IOSCO principles is key to achieve well-functioning exchange linkages.

- **Update on the implementation of the Hybrid Bond Market Kenya**

The development of a liquid and transparent bond market is imperative for Kenya to achieve the Capital Markets Master Plan aspirations to transform Kenya into the ultimate choice market for domestic, regional and international issuers and investors looking to invest and realize their investments in Kenya, within East Africa and across Central Africa by 2023.

To achieve the aforementioned the Authority on-boarded Consultants from FDHL-Salonica Consortium to support the Capital Markets in actualizing the hybrid bond market model with support from the World Bank under the National Treasury Financial Sector Support Programme.

During the quarter, FDHL-Salonica Consortium submitted the Inception Report to the Authority which encompasses a comprehensive review of the Kenyan bond market incorporating stakeholder views in addition to charting a roadmap for successful implementation of Kenya's Hybrid Bond Markets.

The consultancy will further support the development/amendment of regulations, rules and guidelines for effective and transparent bond trading operations and oversight and also develop approval/ licensing framework or requirements for recognition of an appropriate industry body to take up the role of a Self-Regulatory Organization (SRO) for Over the Counter bond transactions and act as a market coordinator/organizer.

- **Progress on Fintech and Regulatory Sandbox**

During the Quarter, the Authority in conjunction with Open Capital Advisors and Financial Sector Deepening Africa finalized the landscaping study aimed at establishing the position, size and FinTech firms whose innovations are aligned to the Authority's regulatory sandbox. Some of the potential regulatory sandbox use cases identified in the study include; Portfolio Management Services, Unit Trust Wealth Management Services, Crowd Funding, Block chain, Artificial Intelligence and Reg Tech.

Additionally, the CGAP consultants finalized the inception report, Policy framework and the Policy Guidance Note on the establishment of a Regulatory Sandbox for Capital Markets based on the input received from the mapping study.

The Policy Guidance Note shall be progresses for stakeholder consultation during Quarter 3 2018.

- **Progress on the County Financing and Funding Gap Consultancy**

Upon completion of the phase I and phase II involving state owned enterprises and counties respectively, the consultant generated a legal report that examined regulatory environment upon which access to Capital Markets Products and Services by both National and County Government entities is anchored with the objective of identifying existing legal and policy gaps.

Upon finalization of the report, The Capital Markets Master Plan Working Group 1 Committee and other relevant stakeholders shall convene a retreat to deliberate and adopt the Legal review report and study findings prior to publishing. Finally, the Authority shall conduct a stakeholder workshop to update all the relevant stakeholders on the findings of the study and to culminate the funding gap project.

- **Derivatives Market Update**

The Authority finalized the preparations for the derivatives pilot test roll out scheduled to take place in a period of six months within the first half of the 2018/19 Financial Year. The pilot test rollout is restricted to select market participants and a select product category focused on Equity Indexes and selected Single Stock Futures. The overarching aim of the pilot test phase, was to test the functionality and process of end to end transactions in a live environment. In addition, the pilot test phase which will inform stakeholders and regulators decisions on the official roll out of the Derivatives Market.

In order to ensure adequate capacity before the pilot phase commencement in July 2018, The Authority has continued to engage the market through running a series of market awareness programs on Exchange Traded Derivatives.

Various awareness sessions have been conducted by the Derivatives Unit targeting respective functional areas to support the smooth operationalization of the derivatives market. The awareness programmes focused on the following areas; market intermediaries; policy makers value proposition on derivatives; technical training in trading and use of derivatives contracts to hedge against risk; Regulatory and coordinated supervision of Derivatives Market; compliance reporting and risk management.

In order to ensure orderly and transparent market and in line with its mandate to maintain efficient and smooth

functioning financial markets, the Central Bank of Kenya (CBK) granted a provisional approval to the Stanbic Bank of Kenya and the Co-operative Bank of Kenya to participate as clearing and settlement members during the derivatives pilot testing phase.

Finally, the Authority together with CBK and NSE constituted a new Committee namely the Derivatives Market Technical Advisory Committee (DTAC) to facilitate information sharing, provide market and technical advice to the Institutional Heads of the Capital Markets Authority, the Central Bank of Kenya, and the Nairobi Securities Exchange. The committee has continued to track emerging cross-cutting issues and proposed recommendations for resolution. For example the D-Tac was at hand to advice on the structure and adoption of the following: The Derivatives Markets Risks and Mitigation Measures, a framework authored by the derivatives exchange that details the exchange's key risks and mitigation measures; the Practice Guidance Notes on Risk Management and Stress Testing for Derivatives, a principles based document authored by the Authority that is meant to guide derivatives exchanges on risk management and stress testing measures; and the Self-Inspection Risk Management Checklist for Clearing & Trading Members of a Derivatives Exchange, a checklist meant to be filled up by market intermediaries in order to self-assess their risk management processes.

- **The Authority holds a stakeholder workshop on Stewardship Code for Institutional Investors**

After a comprehensive stakeholder engagement process under the guidance of the industry-led Stewardship Code Committee, the Stewardship Code for Institutional Investors was gazetted in June 2017. The Stewardship Code is critical in supporting the effective implementation of the Code of Corporate Governance Practices for Issuers of Securities to the public, 2015 and will ultimately strengthen the quality of engagement between issuers and institutional investors.

The Stewardship Code calls upon institutional investors (asset owners and asset managers) to act and serve as responsible stewards for their beneficiaries and to help promote good governance and sustainable success of issuers. Upon Gazettement of the Code, the Authority has been working on an implementation programme that brings on board all relevant stakeholders.

During a workshop with institutional investors on 3rd May 2018, an implementation framework for the Code was developed and is now being implemented. The framework brings on board all relevant stakeholders including institutional investors and their associations, international institutional including International Finance Corporation, training institutions, retirement benefits schemes, among others. The implementation framework includes capacity building programmes, sensitization on the Code, sign-up and active engagement between institutional investors and issuers.

Capital Market Stability Indicators (CMSIs)

	1.0 Stock Market Volatility							
Equity Market Depth	**Quarter/ Year**	**Statistics**				**Assessment of Risk Level (High – Medium – Low)**	**Performance Brief for the Quarter**	**Ongoing Intervention Measures**
NSE 20 Index Volatility Base Year = 2010	**Q2.2018**	**April**	**May**	**June**	**Q. Avg**	**Low (indicative - <10% high; >10% - low)**	• The NSE 20 Share Index volatility for the quarter ending June 2018 averaged **0.41%**, compared to **0.31%** recorded in quarter 1 2018, an indication of increased volatility of the NSE 20 share index.	• To maintain low volatility, the Authority is pursuing measures aimed at increasing market liquidity including introduction of market makers, Derivatives, Securities Lending and Borrowing, Direct Market Access among others.
		0.28%	0.44%	0.51%	0.41%			
	Q1.2018	**Jan**	**Feb**	**March**	**Q. Avg**			
		0.37%	0.27%	0.29%	0.31%			
	Q4.2017	**Oct**	**Nov**	**Dec**	**Q. Avg**			
		0.62%	0.36%	0.28%	0.42%			
	Q3.2017	**July**	**Aug**	**Sep**	**Q. Avg**			
		0.40%	0.58%	0.62%	**0.53%**			
NASI Volatility Base Year = 2010	**Q2.2018**	**April**	**May**	**June**	**Q. Avg**	**Low (indicative - <10% high; >10% - low)**		
		0.41%	0.74%	0.59%	**0.58%**			
	Q1.2018	**Jan**	**Feb**	**March**	**Q. Avg**			
		0.43%	0.58%	0.37%	**0.46%**			
	Q4.2017	**Oct**	**Nov**	**Dec**	**Q. Avg**			
		0.39%	0.69%	0.42%	**0.50%**			
	Q3.2017	**July**	**Aug**	**Sep**	**Q. Avg**			
		0.27%	0.64%	0.71%	**0.54%**			
Turnover Ratio	**Q2.2018**	**April**	**May**	**June**	**Q. TR**	**Medium (indicative – annual: <8%-Low; >15% High)**	• A turnover ratio of **1.83%** was recorded in the reporting period compared to **2.24%** in quarter 1 2018 indicating slight decrease in trading activity in the quarter.	• During the quarter, the Authority concluded a study on factors underpinning low uptake of capital markets products and services and engaged stakeholders and industry participants on the findings of the paper. • The recommendations from the consultative workshop will be instrumental in addressing the low uptake challenge with the capital
		0.57%	0.72%	0.52%	**1.83%**			
	Q1.2018	**Jan**	**Feb**	**March**	**Q. TR**			
		0.76%	0.67%	0.81%	**2.24%**			
	Q4.2017	**Oct**	**Nov**	**Dec**	**QTR**			
		0.40%	0.58%	0.47%	**1.45%**			
	Q3.2017	**July**	**Aug**	**Sep**	**QTR**			
		0.90%	0.65%	0.68%	**2.23%**			

								markets space, Reversing the perception that the capital market is expensive and removing identified obstacles to listings and improving other capital market products' uptake, increasing Listings at the NSE, addressing gaps in market issuance practice that have resulted to low listings in the equity and debt space as well as identifying potential ways of leveraging on the NSE/KASIB Rapid Mass Visibilities Strategy (RMVS) proposition to spur capital markets listings interest and ultimately develop the market.
	2.0 Foreign Exposure Risk							
Foreign Investor turnover as a % of total turnover	**Q2.2018**	**April**	**May**	**June**	**Q. Avg**	**Medium (indicative – annual: <40%-Low; >90% High)**	• Average Foreign investor participation in the review period averaged at **61.72%**, an increase of **4.35%** from **57.37%** recorded in the preceding quarter.	• The Proposed foreign income tax amnesty filing extension to 30th June 2019 as well as the extension of declaration period to allow individuals to repatriate income earned up to 31st December 2017 has the potential of attracting Diaspora inflows into the country, in which case some of the inflows will find their way into the capital markets;
		63.55%	52.84%	68.77%	**61.72%**			
	Q1.2017	**Jan**	**Feb**	**March**	**Q. Avg**			
		71.51%	49.63%	50.98%	**57.37%**			
	Q4.2017	**Oct**	**Nov**	**Dec**	**Q. Avg**			
		72.41%	56.69%	64.75%	**64.62%**			
	Q3.2017	**July**	**Aug**	**Sep**	**Q. Avg**			
		49.14%	57.05%	55.68%	**53.96%**			
Net Foreign Portfolio Flow (In KES Millions)	**Q2.2018**	**Apr**	**May**	**Jun**	**Q. Sum**	**High (indicative – annual: <Kshs (50million) -High (outflow; >KShs. 50 million High inflow)**	• Net Foreign Portfolio levels for the quarter ended June 2018 amounted to a total outflow of **Kshs 8,176 Mn** compared to an	
		(1,815)	(4,022)	(2,339)	**(8,176)**			
	Q1.2017	**Jan**	**Feb**	**March**	**Q. Sum**			
		(1,464)	(5,137)	(1,483)	**(8,084)**			
	Q4.2017	**Oct**	**Nov**	**Dec**	**Q. Sum**			
		486	(450)	(218)	**36**			

	Q3.2017	**July**	**Aug**	**Sep**	**Q. Sum**		outflow of **Kshs 8,084 Mn** in the previous quarter.	
		(2,054)	(3,268)	(5,799)	**(11,121)**			
Market Concentration (Top 5 companies by market cap)	**Q2.2018**	**Apr**	**May**	**Jun**	**Q. Avg**	**High (indicative – annual: >50% High concentration)**	• During the quarter, the top five companies by market capitalization accounted for **68.06%** of the market value on average, confirming their market dominance. • The top five companies included SAFARICOM, EABL, EQUITY, KCB and CO-OP.	• The recent revival of the privatization program which will be partly carried out through the capital markets and could stimulate the capital markets through new listings of State Owned Enterprises and a multiplier effect of listing of private sector entities • This will help address issues around market concentration and drive market liquidity. • The Setting up of the National Credit Guarantee Fund will provide support to potential NSE Growth Enterprise Market Segment (GEMS) entities thus reducing market concentration risk
		67.21%	68.13%	68.83%	**68.06%**			
	Q1.2017	**Jan**	**Feb**	**March**	**Q. Avg**			
		66.45%	66.69%	68.50%	**67.21%**			
	Q4.2017	**Oct**	**Nov**	**Dec**	**Q. Avg**			
		65.94%	65.89%	64.96%	**65.60%**			
	Q3.2017	**July**	**Aug**	**Sep**	**Q. Avg**			
		66.10%	66.19%	65.62%	**65.97%**			
	3.0 Government Bond Market Exposure							
Treasury Bond market turnover Concentration	**Q2.2018**	**Apr**	**May**	**Jun**	**Q. Avg**	**High (indicative – annual: >50% High concentration)**	• The Treasury bond market remains dominant in the Kenyan bond market, accounting for an average of **99.88%** during the quarter; indicating an increase of **0.17%** compared to the preceding quarter.	• To counter this challenge of an illiquid corporate bond market in Kenya, the Authority has procured a consultancy to support the introduction and implementation of the hybrid bond market model that will allow trading of
		99.93%	99.97%	99.75%	**99.88%**			
	Q1.2017	**Jan**	**Feb**	**March**	**Q. Avg**			
		99.91%	99.57%	99.66%	**99.71%**			
	Q4.2017	**Oct**	**Nov**	**Dec**	**Q. Avg**			
		98.39%	98.10%	99.95%	**98.81%**			
	Q3.2017	**July**	**Aug**	**Sep**	**Q. Avg**			
		99.97%	97.68%	99.93%	**99.19%**			

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<td>Corporate Bond Market ownership</td>
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<table>
<tr><th>Category</th><th>No of Investors</th><th>Amount Outstanding (Mn)</th><th>% of total outstanding</th></tr>
<tr><td>Local Investors</td><td>4,731</td><td>68,279.38</td><td>98.94 %</td></tr>
<tr><td>East African Investors</td><td>20</td><td>181.99</td><td>0.26%</td></tr>
<tr><td>Foreign Investors</td><td>115</td><td>550.72</td><td>0.80%</td></tr>
</table>
Source: CDSC Data as at June 2017
</td>
<td>High (indicative – annual: >50% High concentration</td>
<td>• Local Corporate bond investors were the leading investors in corporate bonds at 99.20% of amounts outstanding, while foreign bond investors held 0.80% of total corporate bond holdings.</td>
<td>bonds both on and off the Exchange.
• The recent establishment of the Kenya Mortgage Refinancing Company (KMRC) will enable bond markets deepening as it is expected that it will leverage on capital markets to raise funds through bonds for on-lending to banks and other mortgage financing companies.</td>
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<td colspan="4">4.0 Investor Profiles - Equity Market</td>
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<table>
<tr><th>Type of Investor</th><th>2015</th><th>2016</th><th>2017</th><th>2018</th></tr>
<tr><td>E.A. Institutions (%)</td><td>65.68</td><td>66.38</td><td>68.36</td><td>33.90%</td></tr>
<tr><td>E.A. Individuals (%)</td><td>12.84</td><td>12.49</td><td>11.47</td><td>45.92%</td></tr>
<tr><td>Foreign Investors (%)</td><td>21.48</td><td>21.13</td><td>20.17</td><td>20.18%</td></tr>
</table>
Source: CMA- *Data as at June 2018
</td>
<td>High (indicative – annual: >50% High concentration)</td>
<td>• Local investors, a sum of East African institutional and individual investors accounted for 79.82% of shares held in the equity market with 20.18% being held by foreign investors.</td>
<td>• In order to address low uptake issue and attract local investors and issuers the Authority undertook a study aimed at determining the underlying reasons behind the low uptake of capital markets products and services.
• The Authority concluded an Investor Education Impact and Opportunities Analysis Study that will be instrumental in the development of a National Consumer Financial Education Strategy as well as development of an Impact Assessment Measurement Index that the Authority can use to gauge the impact of its investor</td>
</tr>
</table>

								education program going forward. • This will translate to more targeted engagements to onboard and drive increased market participation within the capital markets.
	5.0 Investor Compensation Coverage							
Settlement Guarantee Fund (SGF) Coverage Ratio[15]	**Q2.2018**	**Apr**	**May**	**Jun**	**Q. Avg**	**Medium (indicative – annual: > 1 times, implies full coverage)**	• SGF Ratio for the quarter to June 2018 averaged **1.10.** This is an indication that the Guarantee Fund balances are sufficient to cover liabilities that would arise following default by securities brokers.	• Through Risk-based supervision, the Authority has been monitoring the SGF figures and the financial position of the firms to ensure that they are in good standing and that investors are protected. • The recent Amendments to the Capital Markets Act will also ensure that the ICF is managed more efficiently by abolishing the ICF Board and vesting the management of the fund into the Authority. This is expected to address key capital markets malpractices including corporate governance, embezzlement of investor funds, front running, and provision of misleading information amongst others.
		1.11	**1.01**	**1.17**	**1.10**			
	Q1.2017	**Jan**	**Feb**	**March**	**Q. Avg**			
		0.87	**0.91**	**0.76**	**0.84**			
	Q4.2017	**Oct**	**Nov**	**Dec**	**Q. Avg**			
		1.58	**1.12**	**1.21**	**1.30**			
	Q3.2017	**July**	**Aug**	**Sep**	**Q. Avg**			
		0.75	1.06	1.00	**0.93**			
	6.0 Asset Base of Fund Managers, Stockbrokers, Investment Banks							
	As at April 2018 (Amount in KShs Millions)					**Medium**		

[15] **Source: CDSC**

Assets Under Management	CMA Licensee	Total Assets	Total Liability	Net Assets		(Indicative – the higher the figure, the more stable is the market)	• The total Asset Base of Fund Managers, Stockbrokers, Investment Banks and Investment advisers as at April 2018 was Kshs 6,840.68 Million, 2,280.29 Billion, Kshs.8,145.89 Million and Kshs 269.82 Million respectively.	• The Authority continuously monitors asset levels of its licensees to ensure accurate reporting of assets and liabilities and monitoring sufficiency of liquid capital to monitor potential bankruptcy of licensees.
	Fund Managers	8,108.83	1,268.16	6,840.68				
	Stockbrokers	3,330.37	1,050.08	2,280.29				
	Investment Banks	11,787.54	3,641.65	8,145.89				
	Investment Advisors	397.88	128.06	269.82				

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