CONSUMER PROTECTION IN THE KENYAN FINANCIAL SECTOR: A CASE FOR A TWIN PEAKS MODEL OF FINANCIAL REGULATION

by

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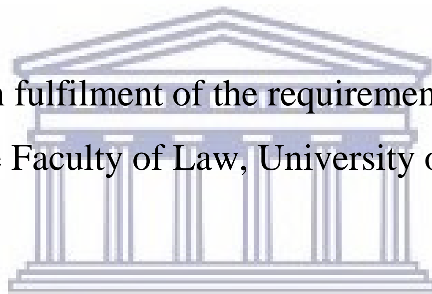

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DECLARATION

I, SOLOMON LEMPERE, do hereby declare that *Consumer Protection in the Kenyan Financial Sector: A Case for a Twin Peaks Model of Financial Regulation* is my original work and has not been submitted for any degree or examination in any other university or institution of higher learning. While I have relied on numerous sources and materials to develop the main argument presented in this mini-thesis, all the materials and sources used have been duly and properly acknowledged.

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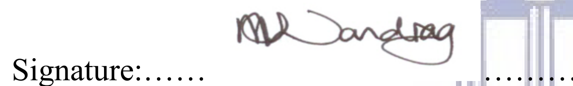
Supervisor: Professor Riekie Wandrag

Signature:……  ………

Date:……23/08/2019……………………

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DEDICATION

This research is dedicated to my family without whose support and love I would not be where I am today.

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KEY WORDS

Consumer Protection

Financial Regulation

Financial Services

Kenyan Financial Sector

Market Conduct Regulation

Prudential Regulation

Sectoral Model

Twin Peaks

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LIST OF ACRONYMS

CBK	Central Bank of Kenya
CMA	Capital Markets Authority (Kenya)
DFI	Development Finance Institutions
DPFB	Deposit Protection Fund Board
EACB	East African Currency Board
FCA	Financial Conduct Authority
FSA	Financial Services Authority
GFC	Global Financial Crisis
IRA	Insurance Regulatory Authority (Kenya)
KBA	Kenya Bankers Association
KPOSB	Kenya Post Office Savings Bank
MFDI	Micro-Finance Deposit Taking Institutions
MFI	Micro-Finance Institutions
NBFI	Non-Bank Financial Institutions
NSE	Nairobi Securities Exchange
NSSF	National Social Security Fund
PRA	Prudential Regulation Authority
RBA	Retirement Benefits Authority (Kenya)
SACCOS	Savings and Credit Cooperative Societies
SASRA	Sacco Societies Regulatory Authority (Kenya)

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Table of Contents

CHAPTER 1 9

1 INTRODUCTION 9

1.1 Introduction 9

1.2 Statement of the Problem 13

1.3 Research Aims and Objectives 13

1.4 Thesis Statement 14

1.5 Significance of the Research 14

1.6 Preliminary Literature Review 15

1.7 Research Methodology 18

1.8 Overview of Chapters 18

Chapter One 18

Chapter Two 19

Chapter Three 19

Chapter Four 19

Chapter Five 19

CHAPTER TWO 20

2 APPROACHES TO FINANCIAL REGULATION AND THE KENYAN REGULATORY FRAMEWORK 20

2.1 Introduction 20

2.2 Approaches to Financial Regulation 21

2.2.1 Sectoral Regulation 21

2.2.2 Integrated/Unified Regulation 23

2.3 Financial Regulation in Kenya 25

2.3.1 The Kenyan Financial Sector 26

2.4 Reform Bills 44

2.5 Conclusion 47

CHAPTER THREE 48

3 CONSUMER PROTECTION IN THE KENYAN FINANCIAL SECTOR 48

3.1 Introduction 48

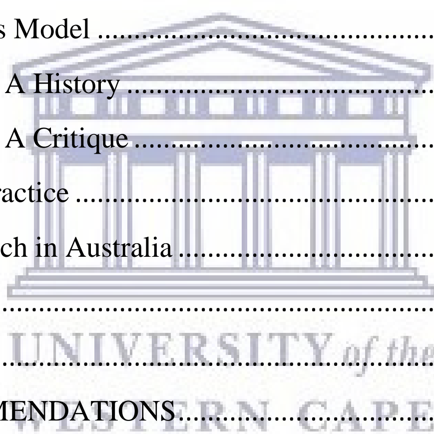
3.2 Conceptual Framework 49

3.2.1 Who is a Consumer? 49

UNIVERSITY of the
WESTERN CAPE

http://etd.uwc.ac.za/

3.2.2 What is Financial Consumer Protection? 50
3.2.3 What is the rationale for Financial Consumer Protection? 50
3.3 Legal framework on consumer protection in Kenya 51
3.3.1 The Constitution 51
3.3.2 The Consumer Protection Act 52
3.3.3 The Competition Act 54
3.3.4 Sector-Specific Acts 55
3.4 Conclusion 61
CHAPTER FOUR 64
4 TWIN PEAKS REGULATORY FRAMEWORK IN FINANCIAL CONSUMER PROTECTION 64
4.1 Introduction 64
4.2 Twin Peaks Model of Financial Regulation 64
4.2.1 Defining the Twin Peaks Model 64
4.2.2 The Twin Peaks Model: A History 65
4.2.3 The Twin Peaks Model: A Critique 68
4.3 The Twin Peaks Model in Practice 72
4.3.1 The Twin Peaks Approach in Australia 73
4.5 Conclusion 83
CHAPTER FIVE 84
5 CONCLUSION AND RECOMMENDATIONS 84
5.1 Conclusions 84
5.2 Recommendations 89
BIBLIOGRAPHY 91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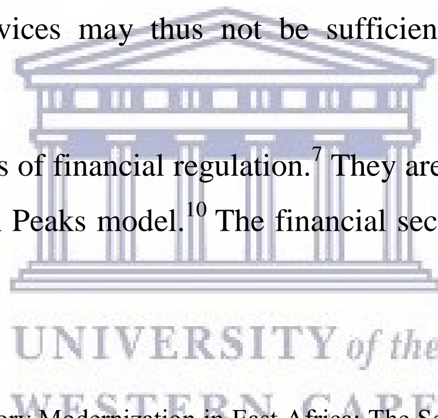
CHAPTER 1

1 INTRODUCTION

1.1 Introduction

The dynamic character of the financial services industry necessitates frequent appraisal of the regulation of the sector.[1] The main objectives for regulation of the financial sector include financial stability, promotion of competition and protection of the consumers.[2] In ensuring consumer protection, there is need to balance this with all the other objectives to ensure optimal protection in the entire financial sector.[3] This can be difficult as it is mostly dependent on the regulatory framework in the financial sector for the basic reason that most of the failures are associated with regulation.[4] Key to the challenges is that consumer protection is served by measures that ensure proper conduct on the part of the service providers.[5] Interests of the providers of the financial services may thus not be sufficiently aligned with those of the consumers of the products.[6]

There are three common models of financial regulation.[7] They are the sectoral model,[8] unified or integrated model[9] and the Twin Peaks model.[10] The financial sector in Kenya follows a sectoral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[1]Gakeri J 'Financial Services Regulatory Modernization in East Africa: The Search for a New Paradigm for Kenya' (2011) 1(16) *International Journal for Humanities and Social Science* 163.
[2] Norton J 'Global Financial Sector Reform: The Single Financial Regulator Model based on the UK FSA Experience- A Critical Re-evaluation' (2005) 39 *The International Lawyer* 33 available at http://heinonline.org/HOL/Licence (accessed 27 November 2016).
[3]Cordray R 'Foreword: Consumer Protection in the Financial Marketplace' 2015 *Havard Law and Policy Review* 307 available at http://heinonline.org/HOL/Licence (accessed 27 November 2016).
[4] Pan E 'Four Challenges to Financial Regulatory Reform' (2010) 55 *Villanova Law Review* 743 available at http://heinonline.org/HOL/Licence (accessed 27 November 2016).
[5]Lumpkin S 'Consumer Protection and Financial Innovation: A few basic propositions' (2010) 1 *OECD Journal: Financial Market Trends* 1 123.
[6] Lumpkin S 'Consumer Protection and Financial Innovation: A few basic propositions' (2010) 1 *OECD Journal: Financial Market Trends* 1 123.
[7] Huang H 'Institutional Structure of Financial Regulation in China: Lessons from the Global Financial Crisis' (2010) 10 *Journal of Corporate Law Studies* 241 available at http://heinonline.org/HOL/Licence (accessed 27 November 2016).
[8]Gakeri J 'Financial Services Regulatory Modernization in East Africa: The Search for a New Paradigm for Kenya' (2011) 1 (16) *International Journal for Humanities and Social Science* 163.
[9]Lui A 'Single or Twin? The UK financial regulation landscape after the financial crisis of 2007-2009' (2012) 13 *Journal of Banking Regulation* 23.
[10]Lui A 'Single or Twin? The UK financial regulation landscape after the financial crisis of 2007-2009' (2012) 13 *Journal of Banking Regulation* 23.

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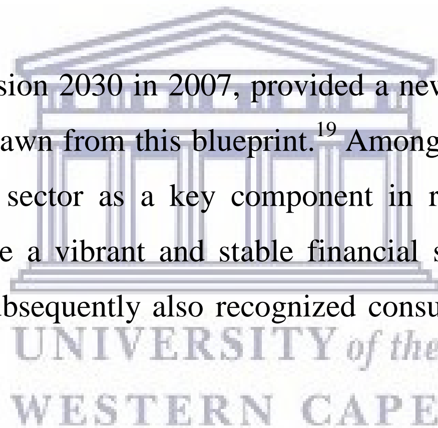
model. It is a hodgepodge of institutional and functional regulation.[11] There are five (5) government agencies that regulate specific segments of the financial sector with each of the regulators being established to operate independently within the permits of an Act of Parliament. This is without mentioning the many other segments that have no specific regulators.[12]

The Central Bank of Kenya (CBK), which is the main regulator, regulates and supervises all commercial banks and deposit taking micro-finance institutions.[13] The Insurance Regulatory Authority (IRA) regulates insurance companies.[14] The Capital Markets Authority (CMA) regulates the securities markets.[15] The Retirements Benefits Authority (RBA) regulates the pension sector and Sacco Societies Regulatory Authority (SSRA) regulates the savings and credit cooperative societies.[16]As a consequence, there have been regulatory gaps, duplication, overlaps, inconsistent regulations and cost ineffectiveness.[17] The consumers bear the brunt of all these shortcomings.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The unveiling of the Kenya Vision 2030 in 2007, provided a new growth path in the country.[18] All plans for the country are drawn from this blueprint.[19] Among its key pillars is the economic pillar which has the financial sector as a key component in realising progressive economic growth.[20] It endeavours to have a vibrant and stable financial sector that promotes consumer protection. The Constitution subsequently also recognized consumer rights.[21] Despite all these,

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[11]Gakeri J 'Financial Services Regulatory Modernization in East Africa: The Search for a New Paradigm for Kenya' (2011) 1 (16) *International Journal for Humanities and Social Science* 165.
[12]Gakeri J 'Financial Services Regulatory Modernization in East Africa: The Search for a New Paradigm for Kenya' (2011) 1 (16) *International Journal for Humanities and Social Science* 168. The financial segments that are not regulated include mobile money transfer, SACCOs that are not being regulated under SSRA and non-deposit taking financial institutions.
[13] Okioga C 'The upshot of financial sector regulation on the financial market performance in Kenya: Perspectives from Kisii County, Kenya' (2013) 2 *Business Management Dynamics* 5.
[14] Okioga C 'The upshot of financial sector regulation on the financial market performance in Kenya: Perspectives from Kisii County, Kenya' (2013) 2 *Business Management Dynamics 6*.
[15] Okioga C 'The upshot of financial sector regulation on the financial market performance in Kenya: Perspectives from Kisii County, Kenya' (2013) 2 *Business Management Dynamics 5*.
[16]Okioga C 'The upshot of financial sector regulation on the financial market performance in Kenya: Perspectives from Kisii County, Kenya' (2013) 2 *Business Management Dynamics 7*.
[17]Gakeri J 'Financial Services Regulatory Modernization in East Africa: The Search for a New Paradigm for Kenya' (2011) 1 (16) *International Journal for Humanities and Social Science* 164.
[18] The Kenya Vision 2030 (2007) available at *http://www.vision2030.go.ke* (accessed 26 November 2016).
[19] Kenya Vision 2030 Flagship Projects Progress Report of November 2014 available at http://www.vision2030.go.ke (accessed 14 November 2017).
[20] The Kenya Vision 2030 (2007) available at *http://www.vision2030.go.ke* (accessed 26 November 2016) 10.
[21] The Constitution of Kenya 2010, Article 46.

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there have been no substantial improvements in the protection and advancement of consumer rights in the financial sector.

With this regulatory framework, consumer protection has been difficult to achieve. The fact that financial services are inherently more complex than most goods or other more tangible services exacerbates the problem further.[22] The inadequacies of the fragmented system have made it ineffective to guarantee consumer protection.[23] As a result, there have been calls for a review of the regulatory framework in the Kenyan financial sector. At first, the Capital Markets Authority in its 1997-8 Annual Report argued for a consolidated regulatory regime.[24] Following subsequent other failures in the system, the four main regulators, which are, Central Bank of Kenya, Capital Markets Authority, Retirements Benefits Authority and Insurance Regulatory Authority saw the need to have a Memorandum of Understanding (MoU) for purposes of information sharing and coordination.[25] Even though it is a non-binding MoU, benefits have been drawn from it in trying to stabilize the sector and thereby protect the consumers.[26] However, this is a short term measure and thus the need to review the overall regulatory framework to accord with the minimum international standards[27] and thereby grow in tandem with market demands and remain dynamic and relevant.[28]

This research is a review of the Kenyan financial sector with a specific focus on consumer protection. This necessitates an assessment of the sectoral system of financial regulation by looking at each of the aforementioned regulators in each of the segments and the unregulated

[22] Flaming M et al 'Report on Consumer Protection Diagnostic Study: Kenya' (2011) available at https://fsdkenya.org/publication/consumer-protection-diagnostic-study-kenya-2/ (accessed on 6 May 2018).

[23]Huang H 'Institutional Structure of Financial Regulation in China: Lessons from the Global Financial Crisis' (2010) 10 *Journal of Corporate Law Studies* 243 available at http://heinonline.org/HOL/Licence (accessed 27 November 2016).

[24]Gakeri J 'Financial Services Regulatory Modernization in East Africa: The Search for a New Paradigm for Kenya' (2011) 1 (16) *International Journal for Humanities and Social Science* 16 163.

[25]Gakeri J 'Financial Services Regulatory Modernization in East Africa: The Search for a New Paradigm for Kenya' (2011) 1(16) *International Journal for Humanities and Social Science* 165.

[26]Mwega F 'Financial Regulation in Kenya: Balancing Inclusive Growth with Financial Stability' Working Paper 407 of November 2014.

[27] 'Implementing a Twin-Peaks Model of Financial Regulation in South Africa' (2013) A Paper published for Public Comment by the Financial Regulatory Reform Steering Committee 1st February 2013.

[28]Mwega F 'Financial Regulation in Kenya: Balancing inclusive Growth with Financial Stability' Working Paper 407 of November 2014.

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part of the financial sector. The performance of the various regulators will be assessed in terms of their ability to foster consumer protection.[29]

It is important to note the fact that financial consumer protection is about ensuring a fair exchange between providers and consumers of financial services.[30] This understanding is crucial for the reason that there is need to maintain a delicate balance of protecting the interests of the providers of these financial services, and hence promote competition and investors' confidence, while at the same time ensure protection of the consumers of the services from the excesses and misconduct of financial institutions[31] which take advantage of the regulatory gaps that make consumers susceptible.[32]

Moreover, there is a large section of the financial sector in Kenya that is partly regulated or completely un-regulated. It includes non-deposit taking financial institutions, Savings and Credit Cooperative Societies (SACCOS) not regulated by Sacco Societies Regulatory Authority (SSRA) and mobile phone-based financial services.[33] It is worth noting that Kenya is leading in mobile phone-based financial services in the world.[34] This is without any formal regulation. This study will demonstrate that the current unregulated sector which has taken a large portion of the consumers of financial services exacerbates the vulnerability of consumers of financial services in Kenya.

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Many countries have been reactive in reviewing their financial sector regulation policies,[35] mostly in reaction to a financial crisis or a huge scandal.[36] Undeniably, many countries have been facing challenges threatening the stability of the financial sector. The sector is normally dependent on consumer confidence and thus consumer protection is essential for its stability.[37]

[29] Taylor M 'The Road From "Twin Peaks" – And the Way Back' (2009-2010) 16 *Connecticut Insurance Law Journal* 61 available at http://heinonline.org/HOL/Licnce (accessed 27 November 2016).
[30] Flaming M et al 'Report on Consumer Protection Diagnostic Study: Kenya' (2011).
[31] Armour J & Awrey D et al, *Principles of Financial Regulation* (2016) at 3.
[32] Lumpkin S 'Consumer Protection and Financial Innovation: A few Basic Propositions' (2010) 1 *OECD Journal: Financial Market Trends* 133.
[33] Flaming M et al 'Report on Consumer Protection Diagnostic Study: Kenya' (2011).
[34] Andiva B 'Mobile Financial Services and Regulation in Kenya' 1 15.
[35] Lumpkin S 'Consumer Protection and Financial Innovation: A few Basic Propositions' (2010) 1 *OECD Journal: Financial Market Trends* 1 133.
[36] Lui A 'Single or Twin? The UK financial regulation landscape after the financial crisis of 2007-2009' (2012) 13 *Journal of Banking Regulation* 25.
[37] Lumpkin S 'Consumer Protection and Financial Innovation: A few Basic Propositions' (2010) 1 *OECD Journal: Financial Market Trend* 128.

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Kenya is a typical example of this. Instead of waiting for a crisis to occur, this study will make an argument for a proactive approach to review the regulatory framework of the entire financial sector. In doing so, it will assess the strengths of a Twin Peaks model of financial regulation in consumer protection as an alternative to the current fragmented sectoral system of financial regulation, and indeed, to any other alternative approach to financial regulation.

1.2 Statement of the Problem

This research will highlight that the Kenyan sectoral system of financial regulation is ineffective in ensuring consumer protection. The inherent inadequacies of the regulatory system have weakened consumer protection in the financial sector. The regulators currently lean towards strengthening the stability of their specific sectors and thereby increase competition for economic growth and development, without necessarily considering the adverse effects on consumer protection. This is notwithstanding the fact that consumer confidence which is dependent on a strengthened consumer protection is necessary for economic stability. This is exacerbated by a weak segmented legal regime on consumer protection.[38]

The handicap of the regulatory framework as shall be demonstrated in this study is that it is impossible to monitor the growth of the financial sector as a whole, resulting in the inability to address failures or crisis which have detrimental effects on the consumers. The problem is aggravated by lack of regulation of a large part of the financial sector and thus massive gaps that lead to adverse effects on the consumers of financial services.[39]

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1.3 Research Aims and Objectives

The objective of this study is to determine the viability of the Kenyan sectoral system of financial regulation in enhancing consumer protection in regard to the financial market dynamics and the progressive growth of the sector.[40] It will assess the strengths of the Twin Peaks model of financial regulation in consumer protection as an alternative to the current regulatory regime, as well as to other approaches to financial regulation. The study will address these objectives by conducting a case study of Australia, which was the first country to adopt the Twin Peaks

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[38]Gakeri J 'Financial Services Regulatory Modernization in East Africa: The Search for a new paradigm for Kenya' (2011) 1(16) *International Journal for Humanities and Social Science* 163.

[39] Andiva B 'Mobile Financial Services and Regulation in Kenya' 1 10available at http://ryan-hawthorne.squarespace.com/s/.../(accessed 26 November 2016).

[40]Mwega F 'Financial Regulation in Kenya: Balancing Inclusive Growth with Financial Stability' Working Paper 407 of November 2014.

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approach to financial regulation. As a result, it will point out how Australia withstood the financial crisis of 2007-2009.[41] Ultimately, the study will draw useful lessons from the Australian experience and make recommendations for the adoption of a Twin Peaks Model of financial regulation in Kenya as a measure of ensuring optimal balance between consumer protection and thus financial stability.

The research objective is broken down into the following aims:

1. To evaluate the various approaches to financial regulation in terms of their capacity to ensure consumer protection.
2. To undertake a review of the current regulatory framework in the Kenyan financial sector.
3. To point out the inadequacies of the sectoral system of financial regulation in Kenya in ensuring consumer protection.
4. To conduct a comparative study on the legal regime for financial regulation in Australia.
5. To make recommendations for a more appropriate model of financial regulation in Kenya with a view to enhance consumer protection in the country.

1.4 Thesis Statement

The central argument in this study is that the sectoral system of financial regulation in Kenya is too ineffective to guarantee consumer protection. The system is inherent with inadequacies that tend to have adverse effects on consumer protection. On the other hand, the Twin Peaks model of financial regulation is a better model that can be adopted in Kenya for the reason that it guarantees an optimal balance between consumer protection and financial stability.

1.5 Significance of the Research

The global financial crisis in 2008 led to the rethinking of the various approaches to financial regulation in terms of their ability to withstand such crises, and for the need to review domestic and global regulatory systems in the financial sector.[42] Following the financial crisis, many countries prioritized economic stability and consumer protection by strengthening their financial

[41] Lui A 'Single or Twin? The UK Financial Regulation Landscape after the Financial Crisis of 2007-2009' (2012) 13 *Journal of Banking Regulation* 23.
[42] Pan E 'Four Challenges to Financial Regulatory Reform' (2010) 55 *Villanova Law Review* 745 available at http://heinonline.org/HOL/Licence (accessed 27 November 2016).

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regulation. This is to guarantee safer and efficient financial markets.[43] As a result of this reactive approach by many countries, numerous challenges of implementation of the newly adopted regulatory systems in the financial sector may be experienced. Kenya was not adversely affected by the global crisis in 2008. This is mainly because of various reasons that include, among others, the structure of Kenya's sectoral system. However, there are numerous challenges in the financial sector regulatory framework that have adverse effects on consumers and the stability of the economy.

It is no wonder therefore that at present, there are on-going efforts at law reform in financial regulation. For example, since 2016, there have been two draft bills which if passed, would effect far-reaching changes to the financial regulation approach in Kenya.[44] While the animus for the reforms is no doubt the need to eliminate the shortcomings in the current system that may be deemed to make the regulatory regime sub-optimal in achieving its objectives, there is the equally important fact that in 2010, Kenya adopted a Constitution that has certain consumer protection imperatives that will be discussed later. Arguably therefore, there is the need to ensure that any regulatory framework that is adopted mirrors the consumer protection standards stipulated in the Constitution. This research is therefore useful not only for contributing to the on-going academic debates on issues of financial regulation but also for highlighting considerations that may be useful for those engaged in policy making in this area, especially in Kenya.

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1.6 Preliminary Literature Review

As will be discussed below, many authors have since the global financial crisis of 2008 written on the suitability of the various financial regulatory models. The focus is on the strengths of each of the models to withstand global financial crisis. Before this, there has been literature on the uniqueness of each of the models depending on their implementation in various countries.

Gakeri argues for the retention of the current fragmented regulatory system in Kenya over the short term, albeit with reforms.[45] He suggests that specialization is nurtured in a sectoral system

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[43] Pan E 'Understanding Financial Regulation' (2012) 1 *Utah Law Review* 1897 available at http://heinonline.org/HOL/Licence (accessed 27 November 2016).

[44] Draft Financial Services Authority Bill 2016; Draft Financial Markets Conduct Authority Bill 2018.

[45] Gakeri J 'Financial Services Regulatory Modernization in East Africa: The Search for a New Paradigm for Kenya' (2011) 1 *International Journal for Humanities and Social Science* 16 165.

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of regulation and that Kenya is best suited to retain its current regulatory system. Despite identifying numerous inadequacies in the system, he argues that the Kenyan market conditions do not justify a shift to a unified regulator.[46] However, he does not concentrate on consumer protection, either in the current sectoral system or in a unified regulator.

Lumpkin has written on consumer protection and the need for financial innovation.[47] He makes an argument that market confidence and consumers are undermined if the financial system is not adequately protected.[48] He states that if regulation is correctly designed and properly enforced, it sustains consumer and investor confidence.[49] In this case, he advocates for a proactive approach to policy in reviewing financial regulatory framework instead of a reactive approach that was evident in the post financial global crisis of 2008.[50]

Mwenda discusses the legal aspects of financial services regulation and the concept of a unified regulator.[51] He points out the need for independence of the regulator from political interference.[52] In doing so, he draws lessons from the United Kingdom model and the Latvian model of financial regulation.[53] There is however no focus on the ability of the unified regulator to withstand global financial crisis.

Grady has written on the recent regulatory developments in the financial sector.[54] He points out that there has been increase in complexity of financial products and services and thus the need to review the regulatory framework.[55] He gives the reason of new technologies to deliver financial

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[46]Gakeri J 'Financial Services Regulatory Modernization in East Africa: The Search for a New Paradigm for Kenya' (2011) 1(16) *International Journal for Humanities and Social Science* 163.
[47] See generally Lumpkin S 'Consumer Protection and Financial Innovation: A few Basic Propositions' (2010) 1 *OECD Journal: Financial Market Trends* 128.
[48] Lumpkin S 'Consumer Protection and Financial Innovation: A few Basic Propositions' (2010) 1 *OECD Journal: Financial Market Trends* 127.
[49]Lumpkin S 'Consumer Protection and Financial Innovation: A few Basic Propositions' (2010) 1 *OECD Journal: Financial Market Trends* 129.
[50] Lumpkin S 'Consumer Protection and Financial Innovation: A few Basic Propositions' (2010) 1 *OECD Journal: Financial Market Trends* 128.
[51] Mwenda K *Legal Aspects of Financial Services Regulation and the Concept of a Unified Regulator* (2006) 50.
[52] Mwenda K *Legal Aspects of Financial Services Regulation and the Concept of a Unified Regulator* (2006) 35.
[53]Mwenda K *Legal Aspects of Financial Services Regulation and the Concept of a Unified Regulator* (2006) 40.
[54] Grady R'Consumer Protection in the Financial Sector: Recent Developments' (2012) 1 *JASSA: The Finsia Journal of Applied Finance* 36.
[55] Grady R'Consumer Protection in the Financial Sector: Recent Developments' (2012) 1 *JASSA: The Finsia Journal of Applied Finance* 35.

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services.[56] As a result, he states that countries ought to take action at national and international level to raise standards in the financial sector.

Mwega argues that after the global financial crisis, many countries are prioritizing stability by strengthening financial regulation.[57] He states that the Central Bank of Kenya has adopted, though informally, a consolidated supervision approach, which requires information sharing and coordination amongst the various regulators in the financial sector.[58] This, he notes, led to the Memorandum of Understanding signed by the four main regulators in the Kenyan financial sector.[59] He also argues that out of the failures in the banking sector, Central Bank has shifted its focus to micro-prudential regulation for the purpose of assisting individual banks to come out of the liquidity among other problems they face.[60]

Pan discusses the challenges that must be addressed in successful financial regulatory reform.[61] They include structure, separation of prudential supervision and consumer protection regulation, assigning responsibility for monitoring and managing systemic risks and the powers therein and finally management of cross border financial services regulation.[62] He argues that there are various regulatory strategies that ought to be captured in a regulatory framework. They include rule-making, supervision, certification and enforcement.[63]

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From the foregoing, it is evident that there has been considerable literature regarding the various models of financial regulation. Their strengths and weaknesses vary from one country to another for what works for one may not work for the other. It is evident that there is no one-size-fits-all

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[56] Grady R'Consumer Protection in the Financial Sector: Recent Developments' (2012) 1 *JASSA: The Finsia Journal of Applied Finance* 37.

[57] Mwega F 'Financial Regulation in Kenya: Balancing inclusive growth with financial stability' Working Paper 407 of November 2014.

[58] Mwega F 'Financial Regulation in Kenya: Balancing inclusive growth with financial stability' Working Paper 407 of November 2014.

[59] Mwega F 'Financial Regulation in Kenya: Balancing inclusive growth with financial stability' Working Paper 407 of November 2014.

[60] Mwega F 'Financial Regulation in Kenya: Balancing inclusive growth with financial stability' Working Paper 407 of November 2014.

[61] Pan E 'Four Challenges to Financial Regulatory Reform' (2010) 55 *Villanova Law Review* 746 available at http://heinonline.org/HOL/Licence (accessed 27 November 2016).

[62] Pan E 'Four Challenges to Financial Regulatory Reform' (2010) 55 *Villanova Law Review* 746 available at http://heinonline.org/HOL/Licence (accessed 27 November 2016).

[63] Pan E 'Four Challenges to Financial Regulatory Reform' (2010) 55 *Villanova Law Review* 746 available at http://heinonline.org/HOL/Licence (accessed 27 November 2016).

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regulatory structure.[64] However, as stated above, there hasn't been any focus on consumer protection in the regulatory framework in the Kenyan financial sector. As a result, this study is distinct in the sense that it is a specific review of the regulation of the financial sector in Kenya in regard to consumer protection.

1.7 Research Methodology

This will entirely be a desk-top research, and will largely be based on library research and internet sources. This will involve assessments of the literature available on the topic. Such literature shall include published books, journal and newspaper articles, reports and legal instruments. The internet will be resourceful as a source of this literature. Therefore, both secondary and primary sources will be used. Primary sources will include the Constitution of Kenya, Acts of Parliament, regulations, reports and other policy documents. Secondary sources will include journal articles, internet sources and other scholarly material.

The research uses Australia to draw lessons on the use of the Twin Peaks model of financial regulation. Australia is used for this study for the reason that it was the first country that adopted the Twin Peaks model and it is rated among the countries with best and most effectively regulated regimes in the world.[65] Equally important still is the fact that as the first country to implement the Twin Peaks model of financial regulation, Australia offers the best study in terms of the longest experience in utilising this model of financial regulation.

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1.8 Overview of Chapters

This paper has a total of five chapters.

Chapter One

Chapter one is the introduction to the research paper. It consists of the introduction of the research that gives its background, statement of the problem, research objectives and questions, significance of the problem, methodology adopted, a preliminary review of the literature used in the research and the overview of the chapters in the rest of the work.

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[64] Gakeri J (2011) 1 *International Journal for Humanities and Social Science* 16 165.

[65] Lui A 'Single or Twin? The UK Financial Regulation Landscape after the Financial Crisis of 2007-2009' (2012) 13 *Journal of Banking Regulation* 28.

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Chapter Two

Chapter two is a discussion of the various approaches to financial regulation and also of the current regulatory framework in Kenya. The chapter will use its discussions of the various possible approaches to financial regulation as a launchpad for evaluating the Kenyan financial regulation framework. In evaluating the Kenyan framework, the chapter will discuss in detail the various regulators within the specific segments in the financial sector, and their effectiveness. The fact that a significant portion of Kenya's financial sector remains unregulated will be highlighted. It will also give a brief of the two reform Bills, which are, Financial Services Authority Bill, (FSA) 2016, and the Financial Markets Conduct Bill, 2018, currently before the National Assembly. As a result, a nexus will be drawn between this overall assessment of the regulatory infrastructure in Kenya on the one hand, and consumer protection on the other.

Chapter Three

Chapter three will discuss consumer protection in the Kenya's financial sector. The specific legislation governing consumer protection will be discussed in detail. This is to evaluate the effectiveness of this legislation in protecting consumers in the sector. In doing so, this Chapter will identify the weaknesses of the current sectoral model of financial regulation in ensuring consumer protection.

Chapter Four

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Chapter four is the assessment of the Twin Peaks model of financial regulation with a view of it being an alternative to the current regulatory framework in Kenya. The conceptual basis of the Twin Peaks approach and its defining features will be analysed in depth. The advantages and disadvantages will be considered, after which a case for the adoption of this approach in Kenya will be made. The experience of Australia as the country in which this model was first used will be reviewed, with a view to drawing lessons for Kenya.

Chapter Five

This Chapter concludes the research paper by drawing conclusions and making recommendations for the adoption of the Twin Peaks model of financial regulation in Kenya.

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CHAPTER TWO

2 APPROACHES TO FINANCIAL REGULATION AND THE KENYAN REGULATORY FRAMEWORK

2.1 Introduction

In recent years, many countries have made attempts to undertake an appraisal of their financial regulation approaches in a bid to ensure they are in tandem with the changing times. This has mainly been activated by the Global Financial Crisis (GFC) of 2008. As the debate rages on the possible causes of the GFC, many have pointed to the regulators and basically the overall regulatory infrastructure of their respective countries as one of the causes of the financial crunch.[66] This is for the basic reason that the effects of the GFC seemed to vary from country to country, depending on their regulatory frameworks.[67] As a result, reforms have been geared towards financial regulatory models that were seen to withstand the effects of the crisis.

The main objectives of financial regulation include ensuring financial stability and soundness and protecting consumers and supervising market conduct.[68] The ability of a regulatory approach to achieve these two objectives will determine its suitability. The criticisms that have been levelled against some approaches to financial regulation have been that such approaches do not strike a balance between the two sides to financial regulation. This Chapter makes an assessment of two approaches to financial regulation, the sectoral regulation and the unified regulator approaches. The Twin Peaks approach to financial regulation is considered in Chapter Four. In this Chapter, the definitive features, and the strengths and weaknesses of these approaches are highlighted. This sets the stage for a consideration of the regulatory approach that is used in Kenya's financial services sector. The ineffectiveness of the current approach in ensuring consumer protection is evaluated.

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[66] Armour JD, Davies P & Enriques L *Principles of Financial Regulation* (2016) 3.
[67] Godwin, Kourabas and & Ramsay 'Twin Peaks and Financial Regulation: The Challenges of Increasing Regulatory Overlaps and Expanding Responsibilities' (2016) 49 *The International Lawyer* 276.
[68] Wymeersch E 'The Structure of Financial Supervision in Europe: About Single Financial Supervisors, Twin Peaks and Multiple Financial Supervisors' (2007) *European Business Organization Law Review* 242.

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2.2 Approaches to Financial Regulation

Other than the Twin Peaks approach to financial regulation, the sectoral regulation and the single/unified regulator approach are the other models of financial regulation. The defining features of each of these two approaches are considered in the sections below.

2.2.1 Sectoral Regulation

This is sometimes referred to as the three-pillar approach to financial regulation.[69] Under this approach, each sector in the financial system is regulated on the basis of the type of financial services that it provides.[70] In other words, the legal nature of an entity will determine the body that will regulate it.[71] Traditionally, the regulatory divisions have been in the form of separate regulators for banks, insurance companies and securities – hence the three-pillar approach.[72] In terms of competence and jurisdiction, each regulator 'develops its own approach, techniques and practices, preventing the other supervisors from intervening in its field of competence.'[73]

One argument in favour of this approach to regulation is that it factors in the uniqueness that arises from the specialisations of the different institutions being regulated.[74] The argument is that by ensuring that each sector is regulated depending on the type of activity it engages in, an acknowledgement is given to the differences that exist between these sectors and institutions.[75] However, the difficulty with this argument is that there is potential for inconsistent regulation for

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[69]Wymeersch E 'The Structure of Financial Supervision in Europe: About Single Financial Supervisors, Twin Peaks and Multiple Financial Supervisors' (2007) *European Business Organization Law Review* 252.

[70] Botha E &Makina D 'Financial Regulation and Supervision: Theory and Practice in South Africa' (2011) *International Business & Economics Research Journal* 27; Cunningham L &Zaring D, 'Financial Regulation: A Cautionary Analysis Against Exuberance in Crisis Response' (2009) 78(39) *The George Washington Law Review* 82.

[71] Botha E &Makina D 'Financial Regulation and Supervision: Theory and Practice in South Africa' (2011) *International Business & Economics Research Journal* 27; Cunningham L &Zaring D, 'Financial Regulation: A Cautionary Analysis Against Exuberance in Crisis Response' (2009) 78(39) *The George Washington Law Review* 80.

[72] See generally Botha E &Makina D 'Financial Regulation and Supervision: Theory and Practice in South Africa' (2011) *International Business & Economics Research Journal* 27; Cunningham L &Zaring D, 'Financial Regulation: A Cautionary Analysis Against Exuberance in Crisis Response' (2009) 78(39) *The George Washington Law Review*.

[73] Wymeersch E 'The Structure of Financial Supervision in Europe: About Single Financial Supervisors, Twin Peaks and Multiple Financial Supervisors' (2007) *European Business Organization Law Review* 252.

[74] Wymeersch E 'The Structure of Financial Supervision in Europe: About Single Financial Supervisors, Twin Peaks and Multiple Financial Supervisors' (2007) *European Business Organization Law Review* 252.

[75] Wymeersch E 'The Structure of Financial Supervision in Europe: About Single Financial Supervisors, Twin Peaks and Multiple Financial Supervisors' (2007) *European Business Organization Law Review* 252.

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firms that engage in activities that are largely the same.[76] There is also the risk of other business activities developing that do not fall within the ambit of the existing regulators' mandate.[77]

It has also been argued against the sectoral approach to regulation, that due to market evolutions, the distinguishing lines that are used to differentiate between business entities for regulatory purposes often get blurred. This occurs, for example, when a firm ventures into other areas of financial activity for which it was not initially registered, for example, if a bank ventures into insurance and/or securities.[78] In such a case, it is not just the classification of the firm that is blurred; the financial products it offers may also become difficult to classify under the traditional lines.[79]

Romano has expressed the view that having multiple regulators is advantageous by itself, because it helps in 'avoiding too strong a concentration of power and maintaining a sufficient degree of regulatory or supervisory competition.'[80] In the same vein, it has been contended that having multiple regulators also increases supervisory competition.[81] Whereas these arguments have been made as advantages of the sectoral approach to regulation, they are not uncontroversial. It has been questioned, whether, for example, supervisory competition is useful, since it leads away from convergence towards a more efficient common system.[82]

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Taylor argues that the sectoral approach to regulation have had the likelihood, and actual incidents, of conflicts of interest, confusion and damage are high in such a regulatory set up,[83] and that combining the prudential regulation and consumer protection objectives of regulation

[76] Wymeersch E 'The Structure of Financial Supervision in Europe: About Single Financial Supervisors, Twin Peaks and Multiple Financial Supervisors' (2007) *European Business Organization Law Review* 253.
[77] Wymeersch E 'The Structure of Financial Supervision in Europe: About Single Financial Supervisors, Twin Peaks and Multiple Financial Supervisors' (2007) *European Business Organization Law Review* 253.
[78] Freytag A &Masciandaro D 'Financial Supervision Fragmentation and Central Bank Independence: The Two Sides of the Same Coin' (2005) *University of Lecce Economics Working Paper No. 76/37* at 1 available at <> (accessed on 5 June 2018).
[79] Wymeersch E 'The Structure of Financial Supervision in Europe: About Single Financial Supervisors, Twin Peaks and Multiple Financial Supervisors' (2007) *European Business Organization Law Review* 253.
[80] Romano R 'Empowering Investors: A Market Approach to Securities Regulation', in Hopt KJ, et al., Comparative Corporate Governance (1998) 143.
[81] Wymeersch E 'The Structure of Financial Supervision in Europe: About Single Financial Supervisors, Twin Peaks and Multiple Financial Supervisors' (2007) *European Business Organization Law Review* 255.
[82] Goodhart C 'The Political Economy of Financial Harmonisation in Europe' in Kremers, Schoenmaker & Wierts (eds) *Financial Supervision in Europe* (2003) at 132.
[83] Taylor M 'Twin Peaks': A Regulatory Structure for The New Century (1995) *Centre for the Study of Financial Innovation*, London, at 1-3; Andrew Schmulow 'Financial Regulatory Governance in South Africa: The Move Towards Twin Peaks' (2017) 23(3) *African Journal of International and Comparative Law* 393.

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under one regulator may lead to the ramification that one objective may be side-lined.[84] These arguments concerning the sectoral approach to financial regulation will be discussed further in a review of the Kenyan system, at Section 2.3.1 below.

2.2.2 Integrated/Unified Regulation

This approach to financial regulation combines all regulatory functions into one regulator.[85] This approach has been heralded for a number of reasons. First, a single financial regulator increases the scope for coordination and information sharing, at least in comparison to sectoral regulation.[86] This is because all the regulated entities are under a single regulator. Sharing information with international agencies will also be easier, as regulators will have a single point of contact.[87] Unified regulation also averts the potential for competition among different regulators for customers.[88] The need for regulatory arbitrage, where firms try to minimize or avoid regulation by either placing their products in sectors that have the least regulation, or by designing new or redesigning existing products to minimise regulation is also averted. This is because a single regulator is better placed to iron out the inconsistencies and differences in regulation.[89]

Another advantage of the unified approach to regulation has been given as its potential for flexibility. In this regard, it has been argued that a single regulator has more potential to respond to the rapidly changing physiology of the financial market.[90] This is in contrast to the sectoral approach to regulation, in which the regulatory agencies are likely to be circumscribed by statute

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[84] The Report of the UK Select House Committee on Economic Affairs, Banking Supervision and Regulation, 2008-09, H.L. 101-I at 33.

[85] Abrams K & Taylor MW 'Issues in the Unification of Financial Sector Supervision' IMF Working Paper, No. WP/00/213, International Monetary Fund (December 2000) at 1 available at https://www.imf.org/external/pubs/ft/wp/2000/wp00213.pdf (accessed 5 June 2018) 250.

[86] Wymeersch E 'The Structure of Financial Supervision in Europe: About Single Financial Supervisors, Twin Peaks and Multiple Financial Supervisors' (2007) *European Business Organization Law Review* 268.

[87] Abrams K & Taylor MW 'Issues in the Unification of Financial Sector Supervision' IMF Working Paper, No. WP/00/213, International Monetary Fund (December 2000, at 1 available at https://www.imf.org/external/pubs/ft/wp/2000/wp00213.pdf (accessed 5 June 2018) 10.

[88] Abrams K & Taylor MW 'Issues in the Unification of Financial Sector Supervision' IMF Working Paper, No. WP/00/213, International Monetary Fund (December 2000) at 1 available at https://www.imf.org/external/pubs/ft/wp/2000/wp00213.pdf (accessed 5 June 2018) 11.

[89] Abrams K & Taylor MW 'Issues in the Unification of Financial Sector Supervision' IMF Working Paper, No. WP/00/213, International Monetary Fund (December 2000) at 1 available at https://www.imf.org/external/pubs/ft/wp/2000/wp00213.pdf (accessed 5 June 2018) 11.

[90] Abrams K & Taylor MW 'Issues in the Unification of Financial Sector Supervision' IMF Working Paper, No. WP/00/213, International Monetary Fund (December 2000) at 1 available at <https://www.imf.org/external/pubs/ft/wp/2000/wp00213.pdf> (accessed 5 June 2018) 11.

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if only to prevent them from venturing beyond their jurisdiction and competence, given that there would be other regulatory actors.[91] For single regulators however, this fear is reduced, with the consequence that the enabling statute is more likely to allow room for flexibility for the regulator in light of the rapid pace of evolution in the financial sector, or could be amended more quickly.[92]

A single regulator, it has also been argued, is likely to enhance regulatory efficiency by eliminating the possibility for overlapping regulation and harnessing synergies as far as regulation is concerned. Thus, for example, the collection and sharing of data relating to the various regulated agencies becomes easier, compared to what would have been the case if there were separate regulators for each sector.[93]

In addition to the foregoing advantages, some pundits have contended that a single regulator enhances accountability, as every stakeholder knows where the buck stops.[94] On the contrary, however, it may be argued that there still are accountability problems if the objectives of the regulator are ill-defined, and that this is not necessarily an advantage that can be monopolised by single regulators: as long as the objectives of regulation are clearly defined, accountability is achievable even with sectoral regulation.[95]

The disadvantages of having a single regulator, in addition to those outlined above, include the fact that because of having to supervise a range of different institutions, the regulator may have poorly defined objectives.[96] At the same time, regulatory efficiency may not necessarily be

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[91] Abrams K and Taylor MW 'Issues in the Unification of Financial Sector Supervision' IMF Working Paper, No. WP/00/213, International Monetary Fund (December 2000) at 1 available at < https://www.imf.org/external/pubs/ft/wp/2000/wp00213.pdf> (accessed 5 June 2018) 11.

[92] Abrams K & Taylor MW, 'Issues in the Unification of Financial Sector Supervision' IMF Working Paper, No. WP/00/213, International Monetary Fund (December 2000), at 1 available at https://www.imf.org/external/pubs/ft/wp/2000/wp00213.pdf (accessed 5 June 2018) 11.

[93] Abrams K & Taylor MW 'Issues in the Unification of Financial Sector Supervision' IMF Working Paper, No. WP/00/213, International Monetary Fund (December 2000), at 1 available at https://www.imf.org/external/pubs/ft/wp/2000/wp00213.pdf(accessed 5 June 2018) 11.

[94] Abrams K & Taylor M 'Issues in the Unification of Financial Sector Supervision' IMF Working Paper, No. WP/00/213, International Monetary Fund (December 2000), at 1 available at https://www.imf.org/external/pubs/ft/wp/2000/wp00213.pdf (accessed 5 June 2018) 15.

[95] Abrams & Taylor MW 'Issues in the Unification of Financial Sector Supervision' IMF Working Paper, No. WP/00/213, International Monetary Fund (December 2000), at 1 available at <https://www.imf.org/external/pubs/ft/wp/2000/wp00213.pdf(accessed on 5 June 2018) 15.

[96] Abrams K & Taylor MW 'Issues in the Unification of Financial Sector Supervision' IMF Working Paper, No. WP/00/213, International Monetary Fund (December 2000), at 1 available at https://www.imf.org/external/pubs/ft/wp/2000/wp00213.pdf (accessed 5 June 2018) 17.

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achievable, given that the regulator will need to still have different sets of regulation for the various sectors under regulation.[97]

Equally problematic is the fact that a single regulator is susceptible to entrenching certain regulatory objectives at the expense of others.[98] It has been argued, for example, that since consumer protection has more visible political consequences, regulators may be biased towards it at the expense of prudential regulation.[99] This is significant as a disadvantage given that, in the long run, consumer protection is a common thread that runs through even prudential regulation, as a failure of prudential regulation may also ultimately undermine the interests of the consumers, when, for example, a firm collapses.[100] A classic example of these challenges was displayed when the Financial Services Authority (FSA) which was the single regulator in the United Kingdom during the financial crisis and was forced to breakdown into the Financial Conduct Authority (FCA) and Prudential Conduct Authority (PRA) after the financial crisis. This will be further be espoused when discussing Twin Peaks.

In sum, therefore, the unified approach to financial regulation does not guarantee optimal consumer protection, particularly because of the likelihood that a single unified regulator may prioritize certain objectives over others.

2.3 Financial Regulation in Kenya

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Kenya has a sectoral model of financial regulation in the regulated part of the sector. It has five (5) regulators with each focusing on each of the sectors which include, banking, insurance, saccos, capital markets or securities and pensions. This has led to, among other things, regulatory gaps, duplication, overlaps, inconsistent regulations and cost ineffectiveness.[101] As a result,

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[97] Abrams K & Taylor MW 'Issues in the Unification of Financial Sector Supervision' IMF Working Paper, No. WP/00/213, International Monetary Fund (December 2000), at 1 available at https://www.imf.org/external/pubs/ft/wp/2000/wp00213.pdf(accessed 5 June 2018) 18.

[98] Abrams K & Taylor MW 'Issues in the Unification of Financial Sector Supervision' IMF Working Paper, No. WP/00/213, International Monetary Fund (December 2000), at 1 available at https://www.imf.org/external/pubs/ft/wp/2000/wp00213.pdf(accessed 5 June 2018) 18.

[99] Taylor MW 'Twin Peaks' Revisited...a Second Chance for Regulatory Reform' (2009) Centre For the Study of Financial Innovation, London at 26.

[100] Davies H & Green D *Global Financial Regulation: The Essential Guide* (2008) 103.

[101] Gakeri J 'Financial Services Regulatory Modernization in East Africa: The Search for a new paradigm for Kenya' (2011) 1(15) *International Journal for Humanities and Social Science* 163.

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consumers of the financial services bear the brunt of all these deficiencies. This has been exacerbated by the unforeseen effects inherent in the unregulated part of the financial sector.[102]

Though Kenya was not affected by the GFC, it has not been left behind in its quest to reform its financial sector. There have been discussions to adopt a model with a leaner number of regulators with much more preference to a single or unitary model.[103] This has resulted to a draft Financial Services Authority Bill, 2016,[104] and the draft Financial Services Market Conduct Authority, 2018,[105] both of which are yet to be tabled in Parliament. The FSA Bill, 2016, unlike other government Bills, has not been backed by Policy and attempts to consolidate four regulators into one regulator. This is mainly to cut costs of the current regulatory framework. In doing so, the main underlying problems and challenges inherent in the current regulatory model remain unaddressed; especially as far as consumer protection is concerned. It thus leaves a huge for perpetuation of the ills in the current regulatory structure.

2.3.1 The Kenyan Financial Sector

Kenya has one of the most developed financial sectors in Africa.[106] Despite having its fair share of the challenges, it has struggled to have stability over the years. It is divided into two distinct parts. The first part is the regulated part of the financial sector while the other is the partly regulated or completely unregulated. This has five (5) regulators established through statutes with clear mandates and jurisdictional scope.

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2.3.1.1 The Regulated Financial Sector

The regulated part of the Kenyan financial sector has five (5) key regulators. They include; Central Bank of Kenya regulating the banking sector, Insurance Regulatory Authority being the regulator for the insurance sector, Retirements Benefits Authority for the pensions sector, Capital Markets Authority for the Capital Markets and Sacco Societies Regulatory Authority for

[102] Mwega F 'Financial Regulation in Kenya: Balancing Inclusive Growth with Financial Stability' Working Paper 407 of November 2014.
[103] See generally Gakeri J 'Financial Services Regulatory Modernization in East Africa: The Search for a new paradigm for Kenya' (2011) 1(15) *International Journal for Humanities and Social Science*.
[104] Draft Financial Services Authority Bill, 2016 (Draft Version 10, 2nd May 2016).
[105] Draft Financial Services Market Conduct Authority, 2018.
[106] Nyasha S *et al*, 'Banking Sector Reforms in Kenya: Progress and Challenges' (2012) 10 1 *Corporate Ownership & Control* 88.

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SACCOs.[107] These regulators are independent of each other and they conduct their affairs in each of the sectors without necessarily considering the activities in other segments of the financial sector.[108] With this in mind, each of the sectors will be discussed below.

2.3.1.1.1 The Banking Sector

The banking segment of the financial sector plays a very crucial role not only in the financial sector development but also in the economic development of the country. This is mainly by ensuring efficient allocation of financial resources in the Kenyan economy.[109] The sector has its regulator as the Central Bank of Kenya (CBK).

The Central Bank of Kenya was first established through the Central Bank of Kenya Act.[110] It was further entrenched in the Constitution of Kenya, 2010.[111] The Act[112] goes further to provide for its operation and the currency of Kenya. It is also the lender of last resort. Kenya being a bank-based financial system, CBK is the main regulator. It regulates all the banks and deposit-taking micro-finance institutions. Apart from the Central Bank of Kenya Act, the banking sector is governed by the Banking Act[113] as amended and CBK guidelines and regulations made pursuant to the Central Bank of Kenya Act and the Banking Act. The deposit-taking microfinance institutions are governed by the Micro-Finance Act.[114]

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The Banking Act is the substantive law that regulates the business of banking in Kenya. It provides for, inter alia, the licensing requirements, reserves and dividends provisions, accounts and audit, information and reporting requirements and inspection and control of banks. It also establishes the Deposit Protection Fund Board (DPFB).[115] With the established framework in the

[107] See generally, Gakeri J 'Financial Services Regulatory Modernization in East Africa: The Search for a new paradigm for Kenya' (2011) 1(15) *International Journal for Humanities and Social Science*.
[108] See generally, Gakeri J 'Financial Services Regulatory Modernization in East Africa: The Search for a new paradigm for Kenya' (2011) 1(15) *International Journal for Humanities and Social Science*.
[109] Nyasha S et al, 'Banking Sector Reforms in Kenya: Progress and Challenges' (2012) 10 1 *Corporate Ownership & Control* 89.
[110] Cap 491, Laws of Kenya.
[111] Constitution of Kenya, Article 231.
[112] Cap 491, Laws of Kenya.
[113] Cap 488, Laws of Kenya.
[114] Act No. 19 of 2006.
[115] Cap 488, Laws of Kenya, Section 36.

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Act, CBK is given capacity to regulate the banking sector.[116] This is enhanced through the power given by the Act to enable it make regulations for better application of the Act.

There has been substantial growth of the banking sector from independence to date. This is in line with the various transformative stages that the sector underwent.[117] At independence, the banking like many other sectors of the Kenyan economy was dominated by foreign-owned banks. They include, inter alia, Barclays Bank and Standard Chartered Bank that continue to operate today. As a result of the East African countries gaining independence, there was need for the respective countries which are Tanzania, Uganda and Kenya to have control over their monetary and financial policies.[118]

The Central Bank of Kenya was established in 1966 through an Act of Parliament.[119] This was after the dissolution of the East African Currency Board (EACB) that was the governing body for the finances and currency of the three British colonies.[120] There was steady economic growth thereafter with an estimated annual growth of 7.1% to the early 1970s.

In 1968, the government established two new banks, the Cooperative Bank of Kenya and the National Bank of Kenya. It also established specialized Development Finance Institutions (DFIs) to bridge the gap that occasioned the need for local ownership in the banking sector. The DFIs established included the Industrial and Commercial Development Corporation (ICDC), the Industrial Development Bank (IDB), the Development Finance Corporation of Kenya (DFCK) and the Agricultural Finance Corporation (AFC).[121] The aim was to increase access of loans to Kenyans and also purchase of shares in the public corporations.[122]

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[116] Cap 488, Laws of Kenya, Part II.
[117] Nyasha S et al, 'Banking Sector Reforms in Kenya: Progress and Challenges' (2012) 10 1 *Corporate Ownership & Control* 88.
[118] Nyasha S et al, 'Banking Sector Reforms in Kenya: Progress and Challenges' (2012) 10 1 *Corporate Ownership & Control* 88.
[119] Cap 491, Laws of Kenya.
[120] Upandyaya R & Johnson S, 'Transformation of Kenya's Banking Sector 2000-2012' in FSD Kenya, *Kenya's Financial Transformation in the 21st Century (2012)* 40.
[121] See generally, Barbara Grosh 'Performance of Development Finance Institutions in Kenya, 1964-89' (1987) Working Paper No. 450, Nairobi: Institute for Development Studies, University of Nairobi.
[122] See generally, Barbara Grosh 'Performance of Development Finance Institutions in Kenya, 1964-89' (1987) Working Paper No. 450, Nairobi: Institute for Development Studies, University of Nairobi.

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In the 1980s, the push to have more locally owned institutions intensified leading to an upsurge in the growth of non-bank financial institutions (NBFIs).[123] It was mainly being facilitated by political and regulatory factors. The main regulatory factor was the extremely low minimum capital requirements. This led to some banks taking advantage of this regulatory gap and thus setting up NBFIs.[124] On the political factors, the Minister of Finance then had authority to grant exemptions to the provisions of the Banking Act.[125] Politics also remained a key factor because many banks and NBFIs were owned by politicians or had politicians as Board members, and could thus influence decisions at the national level.[126] On the other hand, CBK had very little capacity to exercise supervisory roles over the growth of NBFIs.[127]

As a consequence, the seeds of weakness in the banking sector were well entrenched with the growth of the NBFIs. This led to the failure of 12 banks between 1984 and1989.[128] In 1989, the Deposit Protection Fund Board (DPFB) was established.[129] This is to provide compensation to small depositors in cases of bank failure. It also took the responsibility for liquidating failed banks.[130] This was a reactive measure to the failure occasioned by the rapid rise of financial institutions, poor regulation, shifting political economic trends and also declining economic growth.[131]

In the 1990s, there was financial liberalization in the banking sector.[132] This was influenced by McKinnon Shaw hypothesis that government control of interest rates was seen as a key

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[123] Ngugi & Wakubo 'Financial Sector Reform and Interest Rate Liberalization: The Kenyan Experience' African Economic Research Consortium, Research Paper 72, March 1998, Nairobi.
[124] Ngugi & Wakubo 'Financial Sector Reform and Interest Rate Liberalization: The Kenyan Experience' African Economic Research Consortium, Research Paper 72, March 1998, Nairobi.
[125] Cap 488, Laws of Kenya, Section 53.
[126] Ngugi & Wakubo 'Financial Sector Reform and Interest Rate Liberalization: The Kenyan Experience' African Economic Research Consortium, Research Paper 72, March 1998, Nairobi.
[127] Ngugi & Wakubo 'Financial Sector Reform and Interest Rate Liberalization: The Kenyan Experience' African Economic Research Consortium, Research Paper 72, March 1998, Nairobi.
[128] Waweru NM & Kalani VM 'Commercial Banking Crises in Kenya: Causes and Remedies' (2009) 3(3) Global Journal of Finance and Banking Issues 25.
[129] Upandyaya R & Johnson S, 'Transformation of Kenya's Banking Sector 2000-2012' in FSD Kenya, *Kenya's Financial Transformation in the 21st Century (2012)* 40.
[130] Upandyaya R & Johnson S, 'Transformation of Kenya's Banking Sector 2000-2012' in FSD Kenya, *Kenya's Financial Transformation in the 21st Century (2012)* 41.
[131] Upandyaya R & Johnson S, 'Transformation of Kenya's Banking Sector 2000-2012' in FSD Kenya, *Kenya's Financial Transformation in the 21st Century (2012)* 42.
[132] Gemech F & Struthers J 'The Mckinnon-Shaw Hypothesis: Thirty Years on: A Review of Recent Developments in Financial Liberalization Theory' (2003) Paper presented at Development Studies Association (DSA) Annual Conference on "Globalisation and Development", Glasgow, Scotland.

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constraint to financial sector development.[133] As a result, commercial banks were allowed to deal with foreign exchange in 1992. This coincided with the political transformation in the country as a result of the first multi-party elections. In 1993, a market-determined flexible exchange rate system was adopted for the Kenya Shilling.[134] In 1997, in a view to reduce political interference, the responsibility to appoint the CBK Governor and its management was transferred to a Board of Directors appointed by the President.[135] This, arguably, minimized any influence that the responsible Minister would have over the Governor, as the Minister was no longer the Governor's appointing authority.

From 1999 onwards, the banking sector has experienced numerous regulatory changes aimed at improving the regulation and supervision of banks. This has registered significant success in terms of the stability of the sector. Pursuant to the Basel I, II & III standards on capital adequacy, CBK has enforced these requirements on Kenyan banks with minimum capital requirements increasing from Kenya Shillings 250 Million in 2000 to Kenya Shillings 1 Billion in 2012. The deadline for a minimum core capital of Kenya Shillings 5 Billion is December, 2018. This has strengthened the capacity of banks in the country.[136] The establishment of the Credit Reference Bureaus in 2008 has also led to a reduction of non-performing loans in the sector.[137]

As a measure of increasing access to banking services, CBK published agent banking guidelines in 2011.[138] This entails use of agents by banks to reach customers. It has strengthened access to financial services with many local banks taking advantage to increase their service delivery

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[133] Gemech F & Struthers J 'The Mckinnon-Shaw Hypothesis: Thirty Years on: A Review of Recent Developments in Financial Liberalization Theory' (2003) Paper presented at Development Studies Association (DSA) Annual Conference on "Globalisation and Development", Glasgow, Scotland.
[134] Gemech F & Struthers J 'The Mckinnon-Shaw Hypothesis: Thirty Years on: A Review of Recent Developments in Financial Liberalization Theory' (2003) Paper presented at Development Studies Association (DSA) Annual Conference on "Globalisation and Development", Glasgow, Scotland.
[135] Gemech F & Struthers J 'The Mckinnon-Shaw Hypothesis: Thirty Years on: A Review of Recent Developments in Financial Liberalization Theory' (2003) Paper presented at Development Studies Association (DSA) Annual Conference on "Globalisation and Development", Glasgow, Scotland.
[136] Muber, Kipchumba & Ngugi 'Contribution of Credit Reference Bureau in Managing non-Performing Loans among Commercial Banks in Uasin Gishu County, Kenya' (2017) 8(18) *Research Journal of Finance and Accounting* 83.
[137] Muber, Kipchumba & Ngugi 'Contribution of Credit Reference Bureau in Managing non-Performing Loans among Commercial Banks in Uasin Gishu County, Kenya' (2017) 8(18) *Research Journal of Finance and Accounting* 83.
[138] Prudential Guidelines on Agent Banking available at http://www.centralbank.go.ke (accessed 14 December 2017).

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through the agents.[139] As a result of these transformative measures, significant progress in terms of increased financial depth, reduced concentration, increased stability and increased access has been achieved.[140]

In trying to reduce the high interest rates, the Kenyan Parliament passed a law in 2016[141] to cap interest rates ceiling to no more than four per cent the base rate set and published by CBK. This was received with relief by Kenyans. The Kenya Bankers Association (KBA) fought a strong battle to prevent the passing of this law, all in vain. As a result, the burden occasioned by the very high interest rates has been reduced after the implementation of the Act.

However, the banking sector has had systemic challenges that range from indifference in the application of regulations by CBK, segmentation of the financial sector by activities, high interest rate spreads, high overhead costs, failure to comply with regulatory requirements and also financial access and inclusion.[142] This led to the collapse of 12 banks between 1984 and 1989, 19 banks between 1993 and 1995, 6 banks in 1998, 6 banks between 2007 and 2015 and 1 bank in 2016.[143] Without doubt, this has had adverse effects on consumers of the financial services as the DPFB has limits as to the amount to compensate upon collapse of the banks. There have been different CBK regulations for the commercial banks and the NBFIs.[144] This creates a situation where the growth in the sector is not sustained due to these regulatory differences. Many banks still have hidden charges in their transactions. This is exacerbated by the diversity of financial services in the advent of technological innovation and the institutional diversity in the sector. As a result of the foregoing, CBK, as the regulator, finds it difficult to adequately protect consumers of the financial services provided by the banking institutions.[145]

2.3.1.1.2 The Insurance Sector

[139] Prudential Guidelines on Agent Banking available at http://www.centralbank.go.ke (accessed 14 December 2017).
[140] Upandyaya R & Johnson S, 'Transformation of Kenya's Banking Sector 2000-2012' in FSD Kenya, *Kenya's Financial Transformation in the 21st Century (2012)* 40.
[141] Banking (Amendment) Act, 2016, Act No. 25 of 2016.
[142] See generally, Nelson M. Waweru & Victor M Kalani, 'Commercial Banking Crises in Kenya: Causes and Remedies' (2009) 3(3) Global Journal of Finance and Banking Issues.
[143] See generally, Nelson M. Waweru & Victor M Kalani, 'Commercial Banking Crises in Kenya: Causes and Remedies' (2009) 3(3) Global Journal of Finance and Banking Issues.
[144] Ngugi RW & Kakubo W 'Financial Sector Reform and Interest Rate Liberalization: The Kenyan Experience' African Economic Research Consortium, Research Paper 72, March 1998, Nairobi.
[145] Ngugi RW & Kakubo W 'Financial Sector Reform and Interest Rate Liberalization: The Kenyan Experience' African Economic Research Consortium, Research Paper 72, March 1998, Nairobi.

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The insurance segment of the financial sector has registered tremendous growth from the pre-independence period to date.[146] It has its current regulator as the Insurance Regulatory Authority (IRA) established under the Insurance Act[147] governing it. Despite numerous challenges, it has sustained a dynamic industry that has relatively small companies in terms of global standards but resilient at the same time.[148] As a result, it has grown from a foreign-owned industry offering limited insurance and reinsurance services to an insurance industry that has diversified its ownership, players and services being provided.[149]

Before independence, the insurance sector had no legislation governing it. Instead, it was being governed by the Companies Act.[150] This created a gap in the development of the sector and thus the need to provide for legislation after independence. The Insurance Ordinance of 1960 was promulgated with its main functions being the establishment, financing and operation of the insurance companies. The implementation of the Ordinance however didn't bear results as it was a duplication of the Insurance British Ordinance.[151] As a result, there were chaos and confusion in the regulatory framework of the sector. This created fertile breeding grounds for the problems that continue to bedevil the insurance industry.[152]

In 1986, the first Insurance Act[153] was enacted and came into force in January 1987. The Act provided for a regulator, registration of insurance and reinsurance companies and other players that included agents and brokers in the industry. This gave a new re-birth to the growth of the sector. The challenges were however enormous as a result of problems entrenched in the sector. This led to many insurance companies collapsing in the 1990s, such as the Kenya National Assurance Company, United Insurance, Standard Assurance, Access Insurance, Stallion

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[146] Madzhadzhi & Heerden et al, 'Insurance Regulation in Africa: Impact on Insurance and Growth Strategies', Paper presented at the Actuarial Society of South Africa's 2014 Convention on 22nd -23rd October 2014, Cape Town International Convention Centre.
[147] Cap 487 Laws of Kenya.
[148] Madzhadzhi & Heerden et al, 'Insurance Regulation in Africa: Impact on Insurance and Growth Strategies', Paper presented at the Actuarial Society of South Africa's 2014 Convention on 22nd -23rd October 2014, Cape Town International Convention Centre.
[149] Ngugi RW & Kakubo W 'Financial Sector Reform and Interest Rate Liberalization: The Kenyan Experience' African Economic Research Consortium, Research Paper 72, March 1998, Nairobi.
[150] Olotch W 'The Kenyan Insurance Market' (2006) 20 *The African Reinsurer* 44.
[151] Gadaffi Y 'Reforming the Insurance Regulatory framework in Kenya: An analysis' (2014) 2 6 *Journal of Research in Humanities and Social Science*, 34.
[152] Gadaffi Y 'Reforming the Insurance Regulatory framework in Kenya: An analysis' (2014) 2 6 *Journal of Research in Humanities and Social Science*, 35.
[153] Cap 487, Laws of Kenya.

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Insurance, among others.[154] The government reacted to this by establishing the Policy Holders Compensation Fund in 2004.[155] This was to compensate policy holders after the collapse of insurance companies.[156] The compensation was however limited to a maximum of 1,000 US Dollars, which was too little to celebrate.[157] However, it gave new hope to policy holders. Various amendments were also introduced in 2003 to provide for stricter penalties in case of violation of the Act.

In 2006, important amendments aimed at bolstering the regulation of the insurance sector were introduced.[158] As a result, the Insurance Regulatory Authority (IRA) was established to replace the Office of the Commissioner for Insurance in the Ministry of Finance. This became the regulator of the insurance sector and started its operations in May, 2007. It had greater autonomy to fully regulate the sector. Its key functions are to ensure effective regulation, supervision and development of insurance in Kenya. In a bid to strengthen the supervisory and regulatory powers of the regulator, various amendments to the Act were introduced in 2010[159] and 2011.[160] More amendments were also introduced in 2013[161] and 2014[162] to give the regulator power to conduct inquiries and investigation on licenses, to provide new capital requirements for reinsurers and facilitate the implementation of the East African Community (EAC) Common Market Protocol that promoted business in the sector to all EAC members among its member states.

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IRA has undertaken various measures to stabilize the insurance industry. Key among them are promotion of consumer protection, establishment of Policyholders Compensation Fund, promotion of consumer education, establishment of Insurance Fraud Investigation Unit in 2011 and training of various interest groups about the insurance sector.[163] In enhancing consumer protection and education, it established departments to focus on these.[164] The Fraud Investigation

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[154] Gadaffi Y 'Reforming the Insurance Regulatory framework in Kenya: An analysis' (2014) 2 6 *Journal of Research in Humanities and Social Science*, 37.
[155] Legal Notice No. 105 of 2004.
[156] Legal Notice No. 105 of 2004.
[157] Gadaffi Y 'Reforming the Insurance Regulatory framework in Kenya: An analysis' (2014) 2 6 *Journal of Research in Humanities and Social Science*, 37.
[158] Insurance (Amendment) Act, 2006.
[159] Insurance (Amendment) Act, 2010.
[160] Insurance (Amendment) Act, 2011.
[161] Insurance (Amendment) Act, 2013.
[162] Insurance (Amendment) Act, 2014.
[163] Central Bank of Kenya, *Kenya Financial Sector Stability Report, 2010, 53.*
[164] Central Bank of Kenya, *Kenya Financial Sector Stability Report, 2010*, 54.

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unit undertakes investigation of insurance fraud. This will mitigate the risk of fraud within the insurance sector and thus bolster public confidence.[165]

In a bid to enhance industry capacity and stability, the regulator is in the process of implementing Risk Based Supervision framework.[166] The government supported this initiative by introducing Risk Based Capital in 2015.[167] Further to this, the regulator in line with the Constitution is also in the process of devolving its services to the Counties. This is in a view to increase the penetration rate in the country.[168] These measures, arguably, will align Kenya's regulatory framework with the international best practices and thereby enhance confidence in the industry.

The Kenya Vision 2030 identified the economic pillar as key to its achievement. The insurance sector is one of the main contributors to economic growth.[169] As a result, the regulator was re-energized to facilitate the growth of the insurance sector and thus propel the achievement of Vision 2030.[170] This has led to tremendous growth of the insurance sector making it the biggest in East Africa.[171]

However, despite the growth registered, numerous challenges continue to bedevil the insurance sector in Kenya. They include, inter alia, claims settlement and volume, delays in premium collection, non-compliance with the cash and carry premium system, inappropriate staff skills in some areas, fraud and the quality of intermediary services, predatory premium rate undercutting and customer retention.[172] These challenges have been exacerbated with the growth of cartels, a temperamental judicial system and inadequate use of technology and poor mobilization of

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[165] Central Bank of Kenya, *Kenya Financial Sector Stability Report, 2010*, 55.
[166] Insurance Regulatory Authority *Annual Insurance Industry Report for the Year Ended 31st December, 2015.*
[167] Finance Act Kenya 2015.
[168] Central Bank of Kenya, *Kenya Financial Sector Stability Report, 2015.*
[169] The Kenya Vision 2030 (2007) available at http://www.vision2030.go.ke (accessed 26 November 2016).
[170] The Kenya Vision 2030 (2007) available at http://www.vision2030.go.ke (accessed 26 November 2016).
[171] Gakeri J 'Financial Services Regulatory Modernization in East Africa: The Search for a New Paradigm for Kenya' (2011) 1 *International Journal for Humanities and Social Science* 15 163.
[172] Insurance Regulatory Authority, *Kenya Insurance Industry Outlook 2013.*

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investment capital.[173] As a result, these challenges have hampered success and operation in the Kenyan market leading to the slow growth of the sector.[174]

2.3.1.1.3 The Pensions Sector

The pension segment of the financial sector in Kenya has been relatively stable and has witnessed tremendous growth over the years.[175] This growth accrues mainly from the economic growth of the country and not as a result of a vibrant pensions sector.[176] It has its regulator as the Retirements Benefits Authority (RBA) established under the Retirements Benefits Act of 1997. The regulator's key functions among others are to regulate, supervise and promote the retirement benefits sector.[177]

The government under its Medium-Term Plan of 2013-17 underscored the importance of saving for retirement and use of such resources for national economic development.[178] As a result, the sector is expected to play a very critical role in mobilizing savings by raising institutional capital through pension fund reforms.[179] This entails, inter alia, increased coverage of the pension scheme, increased awareness of the benefits of saving for retirement, improved supervision and regulation. RBA thus has to undertake measures that will enable the government to achieve these goals and propel the achievement of Vision 2030.

The existing pensions sector is disjointed. Different segments of the sector have different legal frameworks.[180] The Civil Service Pensions Scheme under the Pensions Act[181] covers the civil service which is being funded from taxes. The National Social Security Fund under the National Social Security Fund Act[182] covers the formal sector workers in organizations with more than

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[173] Gadaffi Y 'Reforming the Insurance Regulatory Framework in Kenya: An Analysis' (2014) 2 6 *Journal of Research in Humanities and Social Science*, 36.
[174] Bhoola, Madzhadzhi & Heerden HH et al, 'Insurance Regulation in Africa: Impact on Insurance and Growth Strategies', Paper presented at the Actuarial Society of South Africa's 2014 Convention on 22nd -23rd October 2014, Cape Town International Convention Centre.
[175] Central Bank of Kenya, *Kenya Financial Sector Stability Report, 2015*, 43.
[176] Central Bank of Kenya, *Kenya Financial Sector Stability Report, 2015*, 42.
[177] Cap 197 Laws of Kenya.
[178] The Second Medium Term Plan of 2013-17 available at http://www.vision2030.go.ke (accessed 10 December 2017).
[179] Deloitte *Kenya Economic Outlook 2017: Joining the Dots.*
[180] Odundo E 'Pension Industry development in Kenya: Discussion by the Retirement Benefits Authority' A presentation by Edward Odundo,
[181] Cap 189 Laws of Kenya.
[182] Cap 258 Laws of Kenya.

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five employees. The Occupational Scheme,[183] which is under trust deed governs formal sector workers in organizations with their owned schemes. The Individual schemes are also under trust deed. The Retirement Benefits Act[184] governs the Occupational and Individual schemes. This attests to the bias of the pension schemes towards those in formal employment.[185]

As a result of the disjointed system, the sector is characterized by poor overall levels of coverage and benefit adequacy, small size of formal economy relative to informal economy, low levels of disposable income, insufficient insurance against longevity and competing priorities.[186] The level of coverage stands at 15% of the working population.[187] This is mainly for the reason that the existing pension schemes are limited to formal sector workers. The other reasons causing low coverage include a faster growing informal sector than formal sector. Individual retirement benefits scheme is still in infancy stage and high poverty levels making retirement savings not a priority.[188] To improve coverage, the government is in the process of converting existing provident fund for private sector workers into a national social insurance pension scheme.[189] This measure is however the short term and thus creating the need for the sector's players to move swiftly to initiate reforms to stabilize the sector.

The regulator has introduced various initiatives geared towards increased coverage to the low-income population. At the end of 2011, it launched an innovative programme known as Mbao Pension Plan along with the National Federation of Jua Kali Associations as a way of extending savings plan coverage to workers in the informal sector.[190] This was through the private sector providers of cell phone technology that are spearheading mobile money transfer.[191] The programme is a voluntary savings plan where individual workers choose the amount of their

[183] Odundo E 'Pension Industry development in Kenya: Discussion by the Retirement Benefits Authority' A presentation by Edward Odundo,
[184] Cap 197 Laws of Kenya.
[185] Kunzler D 'Social Security Reform in Kenya: Towards a Workerist or a Citizenship-Based System?' (2016) *International Social Security Review* 69.
[186] Sundeep K 'Analytical Review of the Pension System in Kenya' (2008) available at http://www.oecd.org/finance/private-pensions/41564693 (accessed 15 June 2017).
[187] Deloitte *Kenya Economic Outlook 2017: Joining the Dots.*
[188] Odundo E 'Pension Industry Development in Kenya: Discussion by the Retirement Benefits Authority' A Presentation by Edward Odundo, CEO RBA, Kenya.
[189] International Labour Organization, *Extending Social Security and Fighting Poverty: Two reform proposals to extend social security in Kenya.*
[190] Musonye R & Turner J, 'Extending Pension and Savings scheme coverage to the informal sector: Kenya's Mbao Pension Plan' (2013) 66 *International Social Security Review*, Blackwell Publishing Ltd 80-82.
[191] Musonye R & Turner J, 'Extending Pension and Savings scheme coverage to the informal sector: Kenya's Mbao Pension Plan' (2013) 66 *International Social Security Review*, Blackwell Publishing Ltd 80-82.

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contributions. Though still at its infancy, this programme will go a long way to compensate for the gap in contributory social security coverage and thus reduce the vulnerability of the uncovered population in social security.[192]

After deliberations among stakeholders, RBA in collaboration with National Treasury has set up a Working Committee that will spearhead the development of the National Pensions Policy.[193] The aim is to redesign the architecture of the pensions system. As a result, it will ensure uniformity, coordination and growth of the sector as a whole and thus address all the elements of the current fragmented pension system.[194]

2.3.1.1.4 The Capital Markets

The Capital Markets in Kenya are being regulated by the Capital Markets Authority (CMA) established by the Capital Markets Act.[195] They are an equity and bond market where investors or the government raise long term funds.[196] This makes it a very important part of the financial sector. CMA's key role is to create an environment that is conducive to the growth and development of the capital markets.[197] It is responsible for prudential, supervision and conduct of business of the securities exchange and other market intermediaries.[198]

The Kenyan capital markets have experienced a lack luster performance over the years. Comparatively though, they have had a fair growth. Nairobi Securities Exchange was established in 1954 and it was registered as a company.[199] It was exclusive for the Europeans at the time of establishment. After independence in 1963, Africans were allowed to trade in the Nairobi Securities Exchange. The sector experienced dismal growth mainly due to its small size and the

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[192] Musonye R & Turner J, 'Extending Pension and Savings scheme coverage to the informal sector: Kenya's Mbao Pension Plan' (2013) 66 *International Social Security Review*, Blackwell Publishing Ltd 80-82.
[193] Central Bank of Kenya, *Kenya Financial Sector Stability Report 2015* 43.
[194] See generally, Central Bank of Kenya, *Kenya Financial Sector Stability Report 2015*.
[195] Cap 485A Laws of Kenya.
[196] See generally, Kosgei S et al 'Factors Influencing the Development of Capital Markets in a Developing Economy: A Case Study of NSE in Kenya' (2014) 6 (16) *European Journal of Business Management*.
[197] Kosgei S et al 'Factors Influencing the Development of Capital Markets in a Developing Economy: A Case Study of NSE in Kenya' (2014) 6 (16) *European Journal of Business Management* 20.
[198] Gakeri J 'Regulating Kenya's Securities Markets: An assessment of the Capital Markets Authority's Enforcement Jurisprudence' (2012) 2 20 available at http://www.ijhssnet.com/journals (accessed 16 June 2017).
[199] Gakeri J 'Regulating Kenya's Securities Markets: An assessment of the Capital Markets Authority's Enforcement Jurisprudence' (2012) 2 20 available at http://www.ijhssnet.com/journals (accessed 16 June 2017).

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slow economic growth of the country.[200] This necessitated reforms to revamp it to ensure it contributes to the economic growth of the country.[201]

1n 1989, the Capital Markets Authority (CMA) was established[202] as the regulator. This gave a re-birth of the sector as the regulator was given autonomy to develop the capital markets in the country.[203] This is despite the influence of the Ministry of Finance. Nairobi Securities Exchange (NSE) was given double responsibilities for development and regulation of the market operations to ensure efficient trading.[204] CMA is however the overall regulator of the sector and thus NSE, which is the only securities exchange in Kenya, is subject to its authority. Since the establishment of the regulator, the sector has experienced growth following numerous reform initiatives introduced by it in a bid to develop and increase participation in the capital markets.[205]

It goes without saying that a sound and effective regulatory framework plays a critical role in the development of the securities market. CMA has tried to adhere to international practices in strengthening capital markets. The International Organization for Securities Commission (IOSCO) has three main goals of security regulation which include protecting investors, reducing systemic risks and ensuring that markets are fair, efficient and transparent.[206] CMA has endeavored to adhere to these goals. Key among the initiatives undertaken by CMA include establishment of an Investor Compensation Fund and Capital Markets Fraud Investigation Unit. This will boost public confidence in capital markets. It has also launched an anonymous reporting portal in 2016 to enable whistle blowers to report malpractices in the sector and has entered into an agreement with International Finance Corporation (IFC) to strengthen corporate governance.[207]

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[200] Gakeri J 'Regulating Kenya's Securities Markets: An assessment of the Capital Markets Authority's Enforcement Jurisprudence' (2012) 2 20 available at http://www.ijhssnet.com/journals (accessed 16 June 2017).
[201] Gakeri J 'Regulating Kenya's Securities Markets: An assessment of the Capital Markets Authority's Enforcement Jurisprudence' (2012) 2 20 available at http://www.ijhssnet.com/journals (accessed 16 June 2017).
[202] Cap 485A, Laws of Kenya.
[203] Muturi W et al 'Factors Affecting the Financial Performance of listed companies at the Nairobi Securities Exchange in Kenya' (2013) 4 15 *Research Journal of Finance and Accounting* 25.
[204] Muturi W et al 'Factors Affecting the Financial Performance of listed companies at the Nairobi Securities Exchange in Kenya' (2013) 4 15 *Research Journal of Finance and Accounting* 25.
[205] See generally, Muturi W et al 'Factors Affecting the Financial Performance of listed companies at the Nairobi Securities Exchange in Kenya' (2013) 4 15 *Research Journal of Finance and Accounting*.
[206] Gakeri J 'Regulating Kenya's Securities Markets: An assessment of the Capital Markets Authority's Enforcement Jurisprudence' (2012) 2 20 available at http://www.ijhssnet.com/journals (accessed 16 June 2017).
[207] Deloitte *Kenya Economic Outlook 2017: Joining the dots.*

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The factors influencing growth and development of the sector include strong regulatory and legal framework, good macroeconomic environment, investor education and awareness, improved market infrastructure and increased participation by foreign investors. There is need to continuously build on the progress being made on these factors. While building on the strengths CMA should also work on the challenges. They include among others political interference, corporate governance issues and fraud which have bedeviled the sector.[208] The regulator will thus have to put in concerted efforts to reduce effects of the changes so as to contribute to economic growth in the country.

2.3.1.1.5 Savings and Credit Cooperative Societies (SACCOs)

The Kenyan financial sector has a well-established Savings and Credit Cooperative Societies (SACCOs) sector. The deposit-taking SACCOs are regulated by Sacco Societies Regulatory Authority (SASRA) established under the Sacco Societies Act.[209] The sector is governed by the Sacco Societies Act, the Cooperative Societies Act[210] and the various regulations made by the Cabinet Secretary pursuant to the Acts.

The history of cooperatives in Kenya dates back to 1908 and has had tremendous growth since then.[211] During this period, cooperatives were being registered as companies under the Companies Act. This continued until 1931 when the Cooperative Ordinance was promulgated and thus the start of registration of cooperatives. The membership, as it was in many other sectors, was restricted to the white settlers until 1946 when Africans were allowed to be members of Cooperatives.[212] As a result, many Kenyans started cooperatives as a way of investment.[213] This was also due to the fact that they could not bank with many banks which were foreign owned.[214]

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[208] Central Bank of Kenya *Kenya Financial Sector Stability Report, 2015,* 43.
[209] Act No. 14 of 2008 Section 4.
[210] Cap 490 Laws of Kenya.
[211] Ministry of Industrialization and Enterprise Development, 2004, *History and organization of Cooperative Development and Marketing Sub-sector in Kenya.*
[212] See generally, Ministry of Industrialization and Enterprise Development, 2004, *History and organization of Cooperative Development and Marketing Sub-sector in Kenya.*
[213] See generally, Ministry of Industrialization and Enterprise Development, 2004, *History and organization of Cooperative Development and Marketing Sub-sector in Kenya.*
[214] See generally, Ministry of Industrialization and Enterprise Development, 2004, *History and organization of Cooperative Development and Marketing Sub-sector in Kenya.*

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After independence in 1963, the cooperative movement was given a re-birth with a focus on eradication of poverty by the government. This was actualized through Sessional Paper No. 10 of 1965 on "African Socialism". There was an impetus to rapid Africanization of the economy and eradication of poverty based on principles similar to those of the Cooperative movement. The sector grew over the years with various government initiatives geared towards effective management and operation of the cooperatives.[215] This culminated with the enactment of the Cooperative Societies Act[216] in 1997 where the government's role in the affairs of cooperative societies was removed in a bid to give members full control of the cooperative movement and thus improved efficiency in the operation of cooperatives. This is with a backdrop of mismanagement through government's interference.[217]

In recognition of the growing importance and sophistication of SACCOs, a Sacco Societies Act[218] was enacted in 2008. The Act provides for licensing, regulation, supervision and promotion of Sacco Societies and establishment of the regulator, Sacco Societies Regulatory Authority (SASRA). The main goal for the regulator is to enforce prudential standards for deposit-taking SACCOs in the country. With this development, the revenue base and performance of SACCOs has greatly improved.[219] This is for the reason that SACCOs can now diversify their services beyond their traditional customer base which has mainly been restricted to the members.[220] SASRA has enhanced efficiency and regulation of the sector through various initiatives on liquidity, qualification of managers, inspection and inquiries among others.[221]

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Kenya has been rated by the International Cooperative Alliance as the first in Africa and seventh globally among the developed cooperative movements.[222] As a result, Kenya was admitted to the group 10 of the most developed Sacco movements globally with its representative being the

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[215] See generally, Ministry of Industrialization and Enterprise Development, 2004, *History and organization of Cooperative Development and Marketing Sub-sector in Kenya.*
[216] Cap 490 Laws of Kenya.
[217] See generally, Ministry of Industrialization and Enterprise Development, 2004, *History and organization of Cooperative Development and Marketing Sub-sector in Kenya.*
[218] Act No. 14 of 2008.
[219] Mathuva D 'Revenue Diversification and Financial Performance of Savings and Credit Cooperatives in Kenya' (2006) 4 *Journal of Co-operative Organization and Management* 11.
[220] See generally, Mathuva D 'Revenue Diversification and Financial Performance of Savings and Credit Cooperatives in Kenya' (2006) 4 *Journal of Co-operative Organization and Management*.
[221] See generally, Mathuva D 'Revenue Diversification and Financial Performance of Savings and Credit Cooperatives in Kenya' (2006) 4 *Journal of Co-operative Organization and Management*.
[222] Ishengoma E et al 'Bank requirements and governance for Savings and Credit Cooperatives in Tanzania and Kenya' (2014) available on http://www.researchgate.net/publication/309116617 (accessed 16 June 2017).

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Kenya Union of Savings and Credit Cooperative Limited (KUSCCO).[223] This is evidence to the developments made in the cooperative movement in Kenya.[224] However, this does not mean that the sector is without challenges. These challenges include, inter alia, governance problems, inadequate human resource, weak regulation and inadequate supervision.[225] There has also been a low level of public discourse on SACCOs, mainly because disclosures by SACCOs are generally addressed to the members and the regulator.[226] This, arguably, undermines public confidence and reduces the SACCOs' customer base.

2.3.1.2 The Unregulated Financial Sector

Kenya has a huge part of the financial sector that is unregulated by any specific regulator. This includes mobile money transfer, non-deposit taking micro-finance institutions and the unregulated SACCOs. The operations in this unregulated part of the financial sector have continued un-abated with minimum interference from the government oblivious of the inherent risks involved. Even though there are government departments responsible for these specific segments of the financial sector, they cannot be termed as regulators in the strict sense of the meaning of a regulator. It is against this backdrop that the aforementioned segments of the financial sector will be discussed.

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2.3.1.2.1 Mobile Money Transfer

There has been a continuous increase in mobile money transfer in Africa. Kenya prides itself as the global leader in mobile money transfer.[227] The use of mobile money transfer services has been available in Kenya for a long time. Initially, the financial institutions had limited use of mobile money transfer services before the entry of telecommunication companies which have over the years taken over the market of mobile money transfer in the country.

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[223] Ishengoma E et al 'Bank requirements and governance for Savings and Credit Cooperatives in Tanzania and Kenya' (2014) available on http://www.researchgate.net/publication/309116617 (accessed 16 June 2017).
[224] Ishengoma E et al 'Bank requirements and governance for Savings and Credit Cooperatives in Tanzania and Kenya' (2014) available on http://www.researchgate.net/publication/309116617 (accessed 16 June 2017).
[225] Mumanyi EL 'Challenges and Opportunities Facing SACCOs in the Current Devolved System of Government of Kenya: A Case Study of Mombasa County' (2014) 1 (9) *International Journal of Social Sciences and Entrepreneurship* 310.
[226] Mathuva D 'Drivers of Financial and Social Disclosure by Savings and Credit Cooperatives in Kenya: A Managerial Perspective' (2016) 4 *Journal of Co-operative Organization and Management*.
[227] European Investment Bank and UN Capital Development Fund, *Digital Financial Services in Africa: Beyond the Kenyan Story*.

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In 2006, there was limited access to formal financial services through banks, micro finance institutions and Saccos.[228] Many Kenyans did not have accounts with the financial institutions for the reason that these services were not accessible to the rural population and they were also perceived to be expensive.[229] This created a huge unbanked population. The statics show that only 18% of Kenyans operated bank accounts in 2006.[230] This created an unmet demand for efficient, reliable and affordable money transfer services in Kenya.

In 2007, M-Pesa came in to fill the huge gap. M-Pesa was launched by Safaricom, a telecommunication company to facilitate mobile money transfer.[231] From the launch onwards, the transformative nature of M-Pesa has had a deep impact on financial inclusion. Financial inclusion has tremendously improved from 19% in 2006 to 67% in 2013.[232] M-Pesa is nearly ubiquitous with the daily lives of Kenyans due to a range of services that include money deposit and withdrawal, remittances delivery, bill payment and micro-credit provision.[233] Other telecommunication companies such as ZAP have also introduced this service though their market share is infeasible.[234]

Despite all this growth, mobile money transfer in Kenya has had little or no regulation. The Communications Authority is the regulator of mobile service providers. Its role is limited to the communication aspect. It was not until 2014 when the National Payment Service Regulations 2014 were enacted to give room for some control of CBK on mobile money transfer services and specifically M-Pesa. This was pursuant to the National Payment System Act in 2011.[235] However, many authors such as Muwanguzi have attributed this growth to the lean regulation

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[228] Muthiora B 'Enabling Mobile Money Policies in Kenya: Fostering a Digital Financial Revolution' (2015) available at http://www.gsma.com (accessed 17 June 2017).
[229] Muthiora B 'Enabling Mobile Money Policies in Kenya: Fostering a Digital Financial Revolution' (2015) available at http://www.gsma.com (accessed 17 June 2017).
[230] Muthiora B 'Enabling Mobile Money Policies in Kenya: Fostering a Digital Financial Revolution' (2015) available at http://www.gsma.com (accessed 17 June 2017).
[231] Muwanguzi S et al, 'The transformation of East Africa's economy using mobile phone money transfer services: A comparative analysis of Kenya and Uganda's experiences' (2006) 4(2) *Journal of Creative Communications* 134.
[232] Muwanguzi S et al, 'The transformation of East Africa's economy using mobile phone money transfer services: A comparative analysis of Kenya and Uganda's experiences' (2006) 4(2) *Journal of Creative Communications* 135.
[233] See generally, Muwanguzi S et al, 'The transformation of East Africa's economy using mobile phone money transfer services: A comparative analysis of Kenya and Uganda's experiences' (2006) 4(2) *Journal of Creative Communications*.
[234] See generally, Muwanguzi S et al, 'The transformation of East Africa's economy using mobile phone money transfer services: A comparative analysis of Kenya and Uganda's experiences' (2006) 4(2) *Journal of Creative Communications*.
[235] Act No. 39 of 2011.

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given to Safaricom in mobile money transfer. This is without considering that the technology used to deliver mobile money services carries inherent threats such as operational risks, financial fraud and money laundering.[236] There is thus the need to fully regulate this sector.

2.3.1.2.2 Non-Deposit Taking Micro-Finance Institutions

The deposit-taking micro-finance institutions are regulated by CBK. The Micro-Finance Act[237] of 2006 was enacted to give the regulatory role of deposit-taking micro finance institutions to the CBK. This left the non-deposit taking micro-finance institutions without any specific regulator. As a result, a gap has been left in the regulation of the micro-finance institutions in the country.

Since 2006, the non- deposit taking micro-finance institutions have continued to operate without any interference from any of the financial regulators. They offer various financial services such as credit to their customers. Without a substantive regulator, the customers are at risk in the use of these financial services, with risks such as unfair and lopsided terms of credit.[238] This calls for the policy makers to provide the necessary regulation for the proper management and functioning of non-deposit taking micro-finance institutions in the country.

2.3.1.2.3 The Unregulated SACCOs

The establishment of the Sacco Societies Regulatory Authority led to a new regime in the regulation of SACCOs. This entailed licensing of SACCOs with front office service activity.[239] The other aspect of regulation relates to setting prudential requirements, governance, reporting requirements among other.[240] As a result many SACCOs did not meet these requirements and thus were not licensed.

[236] Mwega F 'Financial Regulation in Kenya: Balancing inclusive growth with financial stability' Working Paper 407 of November 2014.
[237] Act No. 19 of 2006.
[238] Mwega F 'Financial Regulation in Kenya: Balancing inclusive growth with financial stability' Working Paper 407 of November 2014.
[239] Ishengoma E. et al, 'Bank requirements and governance for Savings and Credit Cooperatives in Tanzania and Kenya' (2014) available on http://www.researchgate.net/publication/309116617 (accessed 16 June 2017).
[240] Ishengoma E. et al, 'Bank requirements and governance for Savings and Credit Cooperatives in Tanzania and Kenya' (2014) available on http://www.researchgate.net/publication/309116617 (accessed 16 June 2017).

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The SACCOs that did not meet the requirements by SASRA have continued to operate.[241] They are registered and supervised by the Office of the Commissioner of Co-operatives Development established under the Cooperatives Act.[242] However, this is not a regulator per se. The registration of all SACCOs is done by this office and the SACCOs that meet the requirements of SASRA go ahead to be licensed and operate within its regulatory framework. This leaves a huge gap in the operation of the SACCOs not licensed by SASRA all at the expense of the consumers of financial services

2.4 Reform Bills

In the recent times, two Bills have been drafted, in a bid to make proposals for reform to the financial sector regulation in Kenya. These Bills are the Financial Services Authority Bill, (FSA) 2016, and the Financial Markets Conduct Bill, 2018.

The FSA Bill has the following stated objective, as captured in the preamble thereto:

> …to provide for the establishment of uniform norms and standards in relation to the conduct of providers of financial products and financial services, the establishment of the Financial Services Authority, the Financial Sector Ombudsman and the Financial Sector Tribunal, the promotion and maintenance of a fair and efficient financial sector in Kenya, and for connected purposes.

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The key highlight of the FSA Bill is the establishment of the Financial Services Authority.[243] The functions of the Authority include, inter alia, the regulation and supervision of prudentially regulated financial institutions and the regulation and supervision of the conduct of financial institutions.[244] What is clear from the functions of the Financial Services Authority as enshrined in the Bill is that an attempt is made to merge both prudential and market conduct regulation under a single body – the Financial Services Authority.[245] The essence of this is that the Bill seems to set the stage for a unified regulator.

[241] Ishengoma E. et al, 'Bank requirements and governance for Savings and Credit Cooperatives in Tanzania and Kenya' (2014) available on http://www.researchgate.net/publication/309116617 (accessed 16 June 2017).
[242] Ishengoma E. et al, 'Bank requirements and governance for Savings and Credit Cooperatives in Tanzania and Kenya' (2014) available on http://www.researchgate.net/publication/309116617 (accessed 16 June 2017).
[243] FSA Bill 2016 Section 9.
[244] FSA Bill Section 11.
[245] FSA Bill Section 11.

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However, it has to be pointed out that the Financial Services Authority is intended to have jurisdiction only on certain sections of the financial sector, which include insurance, pensions, SACCOs and capital markets.[246] In particular, the definition of financial institutions that fall under the regulation of the Financial Services Authority excludes Central Bank supervised entities.[247]

Indeed, the Financial Services Authority is intended to take over the roles of what the Bill refers to as predecessor regulators, which are outlined as being the Capital Markets Authority established by the Capital Markets Act, the Insurance Regulatory Authority established by the Insurance Act, the Retirement Benefits Authority established by the Retirement Benefits Act, and the Sacco Societies Regulatory Authority established by the Sacco Act.[248]

The FSA Bill is a half-hearted attempt to introduce the unified model of financial regulation in Kenya. It is half-hearted because the Bill establishes a uniform regulator for only certain financial institutions, while excluding others.[249] The disadvantages of having a unified regulator have already been pointed out at Section 2.2.2 above.

While some of these, in particular the potential for ill-defined objectives due to the single regulator having charge over an assortment of heterogenous institutions may be somewhat mitigated by the fact that the regulatory function is shared between the Financial Services Authority and the Central Bank, this disadvantage remains to the extent that the Financial Services Authority still has charge over a number of sectors that have different regulator demands. In this sense therefore, the FSA Bill does not portend an amelioration of the subsisting challenges, especially as far as consumer protection in the financial sector is concerned.

The Financial Markets Conduct Regulation Bill, 2018, on the other hand, is a bill to promote a fair, non-discriminatory marketplace for access to credit, provide for the establishment of uniform practices and standards in relation to the conduct of providers of financial products and financial services, including regulating the cost of credit, establishment of the Financial Markets Conduct Authority, the Financial Sector Ombudsman and the Financial Sector Tribunal,

[246] FSA Bill Section 2.
[247] FSA Bill Section 2.
[248] FSA Bill Section 2.
[249] The FSA Bill, 2016, Section 2, excludes financial institutions that are regulated by the Central Bank of Kenya.

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supervision of conduct of providers in relation to retail financial customers, promotion and maintenance of a fair and efficient financial sector in Kenya, and for connected purposes.[250]

At Section 11 thereof, the bill establishes the Financial Markets Conduct Authority with a two-fold mandate as far as consumer protection is concerned: protect retail financial services customers, and protect retail financial customers with respect to credit.[251]

As to the former, the Authority protects customers from misleading, deceptive, unfair and fraudulent conduct; by promoting fair, equitable and sustainable access to financial products and financial services; by ensuring that retail financial customers can make informed choices through the provision of useful information about financial products and services; and by promoting financial literacy and the ability of retail financial customers and potential retail financial customers to make sound financial decisions.[252]

As regards the latter, the Authority protects customers by regulating the cost of credit; from inappropriate lending practices; and by regulating the accuracy, availability and protection of financial information through credit sharing mechanisms.[253]

It is clear from the constitutional provisions of the Financial Markets Conduct Authority that it is focused primarily on market conduct regulation. This is a function that the Financial Services Authority under the FSA Bill discussed above also seems to have.[254] There is therefore an overlap of functions between the two Authorities established in the bills, and this begs the question whether, these two bills are intended to complement each other, or if they provide alternative legislative proposals. On the other hand, if the Financial Markets Conduct Authority Bill is to be deemed as an independent Bill (at least independent from the FSA Bill), the consequence will be that while the market conduct regulation function will be focused under one body (the Financial Markets Conduct Authority), the prudential function will still follow the sectoral model due to the structure provided therein. Such a situation does not fall within any of the conventional regulatory approaches, and, in any case, is likely to engender coordination and

[250] See the preamble, Financial Markets Conduct Regulation Bill, 2018.
[251] Financial Markets Conduct Regulation Bill 2018 Section 11.
[252] Financial Markets Conduct Regulation Bill 2018 Section 11.
[253] Financial Markets Conduct Regulation Bill Section 11.
[254] FSA Bill Section 11.

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information sharing difficulties, as well as undermine the development of harmonised regulatory policies.

2.5 Conclusion

As the foregoing discussion has demonstrated, Kenya has a sectoral model of financial regulation with five regulators. The banking sector is regulated by Central Bank of Kenya, the insurance sector is regulated by the Insurance Regulatory Authority, the capital markets are regulated by Capital Markets Authority, the pensions sector is regulated by the Retirements Benefits Authority and the Savings and Credit Cooperative Societies are regulated by Sacco Societies Regulatory Authority. There is also an unregulated part of the financial sector. This includes mobile phone-based money transfer, non-deposit taking micro-finance institutions and un-regulated SACCOs. The current regulatory framework is inherent with regulatory gaps, duplication, overlaps, inconsistent regulations and cost ineffectiveness. As a result, this necessitates the need to look into the effectiveness of the current fragmented regulatory system in ensuring consumer protection, stability of the economy among other factors for sustainable growth. This is with a view to provide a viable regulatory model that will address all the challenges inherent in the current regulatory framework.

The decision to merge four regulators through the draft Financial Services Authority Bill as a measure to save regulatory costs does not solve the inherent regulatory issues in the current regulatory framework, and so does the decision to merge market conduct regulation through the draft Financial Markets Conduct Bill. In any case, there seems to be an overlap between the functions of the Financial Services Authority and the Financial Markets Conduct Authority, to the extent that both have jurisdiction over market conduct regulation.

Chapter Three introduces the consumer protection imperatives that the Constitution and legislation establishes, as a benchmark for assessing the efficacy of the current sectoral framework for financial regulation.

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CHAPTER THREE

3 CONSUMER PROTECTION IN THE KENYAN FINANCIAL SECTOR

3.1 Introduction

The stability of the financial sector is dependent on various factors. Key among them is the ability of the financial regulators to cushion consumers of financial services from malpractices such as unfair lending practices from unscrupulous financial services providers. This is especially important in the financial sector for the reason that financial services are inherently more complex than most goods or other more tangible services.[255] It thus needs to be perpetually monitored in tandem with the dynamism of the financial services sector.

The Constitution of Kenya 2010, as will be discussed later, provides a right to consumer protection.[256] The Kenya Vision 2030, which provides the blueprint for growth in the country, has broad goals that include promoting financial inclusion, improving transparency, affordability of financial services and increasing competition in the sector to benefit consumers and the overall economy.[257] It further envisages a developed, vibrant and stable financial system.[258] There is a strong emphasis on financial stability. This entails considering all the factors that will guarantee financial stability and includes financial consumer protection. The need to strengthen financial consumer protection can thus not be over-emphasized.

There are established principles for good business practice in the financial services sector. They include fair and equitable treatment, commercial behavior, disclosure and transparency, education and awareness raising, protection of privacy and consumer complaints and disputes.[259] These principles are key determinants in providing financial consumer protection. The achievement of each and every principle hereinabove enhances consumer protection. It is in light of these principles that the research paper will endeavour to make an assessment of the Kenyan legal framework in financial consumer protection.

[255] Financial Sector Deepening, -Kenya, *Consumer Protection Diagnostic Study Kenya, January 2011*.
[256] Constitution of Kenya, Article 46.
[257] The Kenya Vision 2030 (2007) available at *http://www.*vision2030.go.ke (accessed 26 November 2016).
[258] The Kenya Vision 2030 (2007) available at *http://www.*vision2030.go.ke (accessed 26 November 2016).
[259] United Nations Conference on Trade and Development (UNCTAD), *Manual on Consumer Protection 2016.*

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This Chapter will discuss consumer protection in the Kenyan financial sector. Firstly, it will capture the conceptual framework. This will mean defining the meaning of the key word, consumer, and the meaning of financial consumer protection and the rationale for financial consumer protection. In doing so, it will contextualize the use of the words in the discussion thereafter. Secondly, it will discuss the legal framework of financial consumer protection in Kenya. This will entail discussing the constitutional provisions on consumer protection, the available legislation on consumer protection and provisions on consumer protection in the sector-specific legislation. Lastly, it will give a conclusion to the discussion.

3.2 Conceptual Framework

For a proper understanding of this Chapter, it is important to conceptualize the meanings of consumer, consumer protection and the rationale for consumer protection. By doing so, an objective assessment of how financial consumer protection is provided in the Kenyan financial sector will be undertaken.

3.2.1 Who is a Consumer?

The Black's Law Dictionary defines a consumer as someone who buys goods or services for personal, family, or household use, with no intention of resale; a natural person who uses products for personal rather than business purposes.[260]

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The Kenya Consumer Protection Act,[261] captures a broad definition of the meaning of consumer as—

a) a person to whom particular goods or services are marketed in the ordinary course of the supplier's business;

b) a person who has entered into a transaction with a supplier in the ordinary course of the supplier's business, unless the transaction is exempt from the application of this Act;

c) a user of particular goods or a recipient or beneficiary of particular services, irrespective of whether that user, recipient or beneficiary was a party to a transaction concerning the supply of those particular goods and services; and

[260] Garner BA *Black's Law Dictionary* (2014) 10 ed, Thomson Reuters 382.
[261] Act No. 46 of 2016.

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d) a franchisee in terms of a franchise agreement, to the extent applicable in terms of this Act.[262]

From the above definitions, it can be deduced that the Black's Law Dictionary defines a consumer as a natural person. The Kenyan Consumer Protection Act, on the other hand, defines a consumer broadly to mean both natural and artificial persons. The use of the words "user" and "franchise" can attest to reference to an artificial person. As a result, the research paper will adopt the later definition in the Kenyan Act for the reason that it captures broadly various elements of consumer protection. The provision in the Consumer Protection Act, however, is generally and not specific to consumers of financial services. In this regard, the definition of a consumer in the Consumer Protection Act is adapted, for the purposes of this research paper, to the extent that the goods and services under references are those provided by financial services providers.

3.2.2 What is Financial Consumer Protection?

There is no standard definition to financial consumer protection. Generally, it is about ensuring a fair exchange between providers and consumers of financial services.[263] It entails measures meant to safeguard consumers of goods and services from unfair market practices and fraudulent transactions.[264] The research paper will adopt the aforementioned meaning for the purpose of discussing consumer protection in the Kenyan financial system. To that effect, the necessary evaluation of the available legal framework on consumer protection and compliance by the regulators in the financial sector will be undertaken.

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3.2.3 What is the rationale for Financial Consumer Protection?

In 2016, The United Nations came up with a Manual on Consumer Protection. It captures broadly the essentials of consumer protection. The rationale provided for financial consumer protection is that it addresses disparities found in the consumer-supplier relationship which includes bargaining power, knowledge and resources and that state intervention is necessary for economic efficiency, individual rights, distributive justice and right to development.[265] As a

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[262] Act No. 46 of 2016, Section 2.
[263] Financial Sector Deepening, -Kenya, *Consumer Protection Diagnostic Study Kenya, January 2011*.
[264] Harvey BW& Penny DL *The Law of Consumer Protection and Fair Trading* 6 e (2000) 25.
[265] United Nations Conference on Trade and Development (UNCTAD), *Manual on Consumer Protection 2016* 2.

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result, financial consumer protection is undertaken. This is the basic rationale for financial consumer protection.

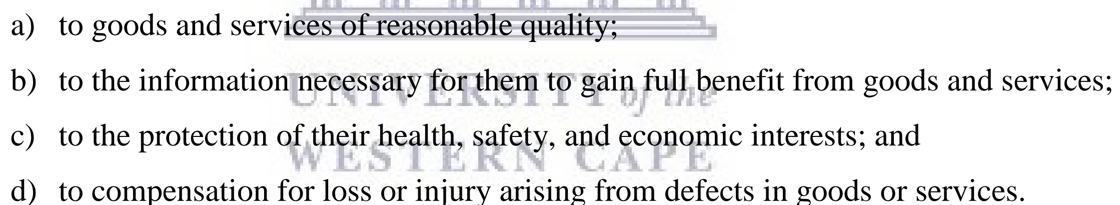
3.3 Legal framework on consumer protection in Kenya

The legal framework on consumer protection is provided for by the Constitution, the Consumer Protection Act, the Competition Act, several sector-specific statutes and the relevant regulations or guidelines enacted pursuant to this substantive legislation. The effectiveness of the regulators in enforcement is thus assessed against the provisions provided for by the aforementioned laws. It is against this background that a detailed discussion on each of the aforementioned laws is conducted.

3.3.1 The Constitution

The need for consumer protection was evident during the Constitution making process prior to 2010. This is because Kenya had no substantive law governing consumer protection. With the promulgation of the Constitution of Kenya 2010, a right to consumer protection was entrenched as a part of the Bill of Rights. It provides as follows;

> Consumers have the right[266]—
>
> a) to goods and services of reasonable quality;
> b) to the information necessary for them to gain full benefit from goods and services;
> c) to the protection of their health, safety, and economic interests; and
> d) to compensation for loss or injury arising from defects in goods or services.



From this provision, there is a deliberate emphasis on quality, information, protection and compensation. These are key elements in ensuring the consumer is provided the necessary protection. As a result, financial consumer protection is a constitutional right and it ought to be treated as such. This bestows enormous responsibility on the regulators of the financial sector to inculcate and enforce it. What this implies in terms of financial regulation is, arguably, that the approach in place must be such that it secures the constitutional imperatives on consumer protection. In addition to setting out specific entitlements for consumers, the Constitution also

[266] Constitution of Kenya, Article 46.

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mandated Parliament to enact legislation within a specified timeline to provide for consumer protection. This culminated with the enactment of the Consumer Protection Act, 2012.[267]

3.3.2 The Consumer Protection Act

This Act was mainly to provide for the protection of the consumer and prevent unfair trade practices in consumer transactions.[268] Broadly, the Act provides for, inter alia, consumer rights, what it considers unfair practices, rights and obligations in consumer agreements, consumer remedies and a consumer protection advisory committee.[269] The Consumer Protection Act, as pointed out above, is a general statute that applies to the protection of all consumers, including those of financial services. This Act therefore forms a logical starting point on the discourse on consumer protection, because it formulates the basic tenets of consumer protection overall. The Act captures varied aspects on financial consumer protection.

The Act provides for its purpose as being to promote and advance social and economic welfare of consumers by, among others, establishing a legal framework for the achievement and maintenance of a consumer market that is fair, accessible, efficient, sustainable and responsible for the benefit of consumers generally; reducing and ameliorating any disadvantages experienced in accessing any supply of goods or services by consumers; promoting fair and ethical business practices and protecting consumers from all forms and means of unconscionable, unfair, unreasonable, unjust or otherwise improper trade practices including deceptive, misleading, unfair or fraudulent conduct.[270] These are issues that ought to be addressed in financial consumer protection.

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Further, the Act provides for consumer rights.[271] These rights include, inter alia, the right to quality goods and services, the right not to be charged for assistance to obtain a benefit and the right to commence proceedings. These rights are read together with the constitutional rights entrenched in the Bill of Rights and rights provided in other consumer protection provisions in the different segments of the financial sector.

[267] Act No. 46 of 2012.
[268] Act No. 46 of 2012 Part I.
[269] Act No. 46 of 2012.
[270] Act No. 46 of 2012 Section 3(4).
[271] Act No. 46 of 2012 Part II.

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Furthermore, the Act also provides for what it considers unfair practices, though not a conclusive list, and goes ahead to prohibit these. In doing so, it not only gives room for what it might not have captured but also gives certainty as to the meaning of unfair practices.[272] This is necessary especially for the financial services sector which is very dynamic and complex giving room to unfair practices among the providers of financial services that may be unforeseeable. It goes further to provide for the rights and obligations respecting specific consumer agreements.[273]

The establishment of the consumer protection advisory committee is a great achievement in the enforcement of consumer rights in Kenya. The main reason for this is that it will monitor cross-sectoral threats to consumer protection. The functions are provided as, among others, advising the Cabinet Secretary and ensuring relevant action on all aspects relating to consumer protection; formulation of policy relating to this Act and legislative proposals in the interest of consumers and the modification, consolidation or updating of legislation providing protection to consumers 'in the areas covered under, or related to this Act.

Further to this, it also provides the co-ordination and networking of consumer activities and the development of linkages with consumer organizations and the competent authorities and agencies locally and outside Kenya for the protection of consumer interests and promotion or participation in consumer education programmes, locally and elsewhere, and activities, the dissemination of consumer issues with a view to proposing corrective measures and doing anything or all things that are necessary, expedient or convenient for or in connection with the performance of its functions under this Act.[274]

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The functions as provided hereinabove are broad to promote consumer protection measures in Kenya. Even though the Act is not specific to the financial sector, it remains a great milestone in the advancement of consumer protection measures in the country. For enforcement, collaboration between the financial sector regulators on one hand and the government, non-governmental organizations such as Consumer Federation of Kenya (COFEK) and other stakeholders on the other hand is important. Further, the Cabinet Secretary of Trade and Industry is given authority

[272] Act No. 46 of 2012 Part III.
[273] Act No. 46 of 2012.
[274] Act No. 46 of 2012 Section 90.

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by the Act pass regulations for the better implementation of the Act.[275] However, while it is acknowledged that the Consumer Protection Act is a remarkable achievement as far as consumer protection generally is concerned, it must be made clear that the generality of the Act means that it does not necessarily address issues that are specific to financial regulation, which require unique regulatory approaches, as will be demonstrated in Chapter Four.

3.3.3 The Competition Act

The Competition Act was enacted in 2010.[276] Its key objects are to promote and safeguard competition in the national economy, protect consumers from unfair and misleading market conduct, provide for the establishment, powers and functions of the Competition Authority and the Competition Tribunal.

Before the enactment of the Consumer Protection Act in 2012, the Competition Act was the only legislation that had largely captured consumer protection provisions.[277] It had provisions akin to those in the current Consumer Protection Act. It made it an offence to make false misleading representations to consumers[278] or engage in unconscionable conduct in relation to the supply of goods and services.[279] Further, it had broad restrictions that afford the Competition Authority wide investigative discretions.[280] This empowers the Authority to perform its functions and at the same time protect consumers.

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However, a major weakness of the Act lies in its generality. As a general consumer protection law, the Act does not necessarily respond to the peculiarities of the financial services sector. Financial services and products are unique in certain respects, relative to other goods and services, and this uniqueness calls for more targeted legislation to address consumer protection needs. Even within the financial services sector itself, the regulatory needs of insurance companies, for instance, are very different from those of banks and capital markets. Therefore, the general stipulations of the Consumer Protection Act may not be targeted and specific enough to satisfy the consumer protection needs of the financial services sector. In other words, such

[275] Act No. 46 of 2012 Section 93.
[276] Act No. 12 of 2010.
[277] Act No. 12 of 2010 Part VI.
[278] Act No. 12 of 2010 Sections 55
[279] Act No. 12 of 2010 Sections 56.
[280] Kontos M 'Bankers Beware: Consumer Protection in Kenya: Limits on Interest Recovery' (2014) available at http://www.walkerkontos.com (accessed 15 December 2018).

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general stipulations provide financial service provides with elbowroom wide enough that they may have several options some of which may not necessarily achieve optimal consumer protection.

3.3.4 Sector-Specific Acts

As discussed in Chapter Two, the financial sector in Kenya has five key sectors regulated by independent regulators. These sectors are banking regulated by CBK, insurance regulated by IRA, capital markets regulated by CMA, pensions regulated by RBA and savings and credit cooperative societies regulated by SASRA. They all have legislation governing them and establishing the regulators.

Though previously mentioned, the legislations governing them include Central Bank of Kenya Act,[281] Banking Act,[282] Insurance Act,[283] Capital Markets Authority Act,[284] Retirement Benefits Authority Act[285] and Sacco Societies Act[286]. The consumer protection provisions available in each of these Acts will be discussed below.

3.3.4.1 The Central Bank of Kenya Act

The Act establishes the CBK,[287] and provides for its operations therein. CBK is the regulator of the banking sector in Kenya. As a result, it formulates and implements monetary policy directed to achieving and maintaining stability, foster the liquidity, solvency and proper functioning of a stable market-based financial system and support the economic policy of the government.[288] It exercises regulatory and supervisory roles over the banking sector.

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In exercising its regulatory and supervisory roles over banks and deposit-taking micro finance institutions, CBK enacts regulations and guidelines to that effect. This is in a bid to increase efficiency and stability in the financial sector. Though the Act fails to define a specific mandate for consumer protection, CBK's regulatory and supervisory functions in the banking sector are

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[281] Cap 491 Laws of Kenya.
[282] Cap 488 Laws of Kenya.
[283] Cap 487 Laws of Kenya.
[284] Cap 485A Laws of Kenya.
[285] Cap 197 Laws of Kenya.
[286] Act No. 14 of 2008.
[287] Cap 491 Section 3.
[288] Cap 491 Section 4.

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geared towards protecting consumers.[289] This is because, while much of the regulatory function of the CBK is prudential, there is no doubt that prudential regulation is itself important in ensuring the health and stability of financial institutions, and this is key to consumer protection because the collapse of such institutions is arguably, the ultimate blow to consumer interests.[290]

3.3.4.2 Banking Act, 2016

The Act establishes the framework for CBK to regulate the conduct of banks in the interest of consumer protection.[291] Broadly, it provides among others licensing of institutions to undertake banking business, provides for prohibited business in banking, provides for reserves and dividends, accounts and audit, information and reporting requirements and inspection and control. All these facilitate the regulating of the sector.

The Act prohibits imposition of charges on savings, seven-day call or fixed deposits accounts. Instead, the banking institution shall pay interest accruing to the account.[292] This is aimed at protecting consumers from unnecessary charges on their accounts. This is with a backdrop of various classes of charges levied on various accounts by Kenyan banks[293] without the necessary approvals being undertaken by CBK.

Before the establishment of the legislation on deposit insurance,[294] the Banking Act established Deposit Protection Fund Board (DPFB) under Section 36 thereof. This fund is meant to compensate depositors upon collapse of banks. Though the amount is limited to 1000 US Dollars and to individual depositors, it came as a relief to many Kenyans who have fallen victim of bank failure.

The Act goes further to limit the interest recoverable from defaulted loans.[295] This provision prohibits the increase of interest by banks on defaulting loans. Various restrictive measures are also undertaken by CBK to ensure it effectively regulates banking institutions. CBK is further empowered to impose penalties through regulations on non-compliance with the Act or

[289] Davies H & Green D *Global Financial Regulation: The Essential Guide* (2008) at 190.
[290] Davies H & Green D *Global Financial Regulation: The Essential Guide* (2008) at 192.
[291] Cap 48 Laws of Kenya.
[292] Cap 488 Laws of Kenya Section 16A.
[293] Financial Sector Deepening-Kenya, Financial Consumer Protection in Kenya: Key Findings and Policy Recommendations, Issue 03, January 2011.
[294] Kenya Deposit Insurance Act, Act. No. 10 of 2012.
[295] Cap 488 Section 44A.

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prudential guidelines that it stipulates.[296] It is worth noting that the Act does not expressly provide for a dispute resolution mechanism. From the foregoing, the Act gives a fair measure of consumer protection in the banking sector. Though limited to banking services within the sector, the regulator, CBK, has the necessary functions and powers to ensure financial consumer protection. A handicap of the regulatory framework in this sector, however, is that new technology-driven forms of banking, such as mobile phone banking, are not sufficiently regulated. This makes it inadequate to proper cushion consumers of the financial services.

3.3.4.3 The Insurance Act

The Act establishes IRA,[297] the regulator of the sector. The objects and functions of the regulator are provided as, among others, ensure the effective administration, supervision, regulation and control of insurance and reinsurance business in Kenya; formulate and enforce standards for the conduct of insurance and reinsurance business in Kenya; license all persons involved in or connected with insurance business, including insurance and reinsurance companies, insurance and reinsurance intermediaries, loss adjusters and assessors, risk surveyors and valuers and protect the interests of insurance policy holders and insurance beneficiaries in any insurance contract.

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Further to these, it also promotes the development of the insurance sector; advise the Government on the national policy to be followed in order to ensure adequate insurance protection and security for national assets and national properties; Issue supervisory guidelines and prudential standards from time to time, for better administration of the insurance business of persons licensed under the Act; conduct inquiries and share information with other regulatory authorities and to carry out any other related activities in furtherance of its supervisory role; and undertake such other functions as may be conferred on it by this Act or by any other written law.[298]

From the regulator's functions, the protection of the interests of policy holders and beneficiaries in any insurance contract has been provided. This is important in the regulator's efforts to enhance public confidence in the sector and thus encourage more Kenyans to take policies with

[296] Cap 488 Section 55(2).
[297] Cap 487 Laws of Kenya.
[298] Cap 487 Laws of Kenya Section 3.

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insurance companies. It is especially with a backdrop of low penetration and a stagnated growth of the sector over the years.

The Act provides for a dispute resolution mechanism. It gives the Cabinet Secretary power to establish a Tribunal to hear appeals from the Act.[299] This is important in financial consumer protection. Further, it provides for the policy holders compensation fund.[300] The Cabinet Secretary is empowered to establish this fund to compensate policy holders in case an insurance company is wound up.[301] The compensation however is limited to a specified amount. It also gives the Cabinet Secretary power to enact regulations for the better implementation of the Act. One challenge with the framework in the insurance sector, however, is that the overall challenge facing the regulation of the Kenyan financial sector – the system is sectoral. This creates challenges, for example, with the emergence of entities that provide services that do not fall under a single specific sector, for example, where institutions licensed as banks also provide insurance services, or communication service providers also offering insurance services.[302]

3.3.4.4 Capital Markets Authority Act

The Act establishes CMA,[303] for the purpose of promoting, regulating and facilitating the development of an orderly, fair and efficient Capital Markets in Kenya. The regulator is responsible for prudential, supervision and conduct of business of the securities exchange and other market intermediaries. Among its objects is protection of investor interests.[304] This is important in promotion of the interests of the consumers in the sector and thus enhancement of investor confidence.

Further, the Act establishes the Investor Compensation Fund. This Fund compensates investors who suffer pecuniary loss resulting from the failure of a licensed stockbroker or dealer to meet his contractual obligations and paying beneficiaries from collected unclaimed dividends when they resurface.[305] It also prohibits insider trading which gives an undue advantage against other

[299] Cap 487 Section 169.
[300] Cap 487 Section 179.
[301] Cap 487 Section 179.
[302] Wymeersch E 'The Structure of Financial Supervision in Europe: About Single Financial Supervisors, Twin Peaks and Multiple Financial Supervisors' (2007) European Business Organization Law Review 253.
[303] Cap 485A Section 5.
[304] Cap 485A Section 11.
[305] Cap 485A Section 18.

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investors.[306] Insider trading erodes investor confidence in the securities exchange and thus the need to prohibit it.

Furthermore, it also establishes the Capital Markets Tribunal.[307] The tribunal entertains appeals from the capital markets.[308] Dispute resolution is an essential element in consumer protection. It is thus prudent to provide for it in ensuring efficient capital markets. Like in other legislations, the Act empowers the Cabinet Secretary to issue rules and regulations.[309] These rules and regulations, together with the regulator's guidelines and notices, enable efficient and effective management of capital markets in Kenya. Furthermore, the efficacy of the Capital Markets Authority Act, insofar as consumer protection is concerned, should be understood in the context of the shortcomings of the extant regulatory system, which is sectoral.

3.3.4.5 Retirements Benefits Authority Act[310]

The Act establishes the RBA[311] for the regulation, supervision and promotion of retirement benefits schemes and the development of the pensions sector. Broadly, it provides for the establishment of the regulator, registration of benefits schemes, regulation and supervision of schemes and inspection and appointment of interim administrators among others.

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The objects and functions of the regulator are to regulate and supervise the establishment and management of retirement benefits schemes; protect the interests of members and sponsors of retirement benefits sector; promote the development of the retirement benefits sector; advise the Minister on the national policy to be followed with regard to retirement benefits schemes and to implement all Government policies relating thereto and perform such other functions as are conferred on it by this Act or by any other written law.[312]

From the objects, it is clear that the regulator has to protect the interests of members and sponsors to the schemes. Further, the Act provides for a restriction on the use of scheme funds.[313] This is for example in the giving of loans or invested contrary to guidelines prescribed. For the

[306] Cap 485A Section 32B.
[307] Cap 485A Section 35A.
[308] Cap 485A Section 35A (1).
[309] Cap 485A Section 12.
[310] Cap 197 Laws of Kenya.
[311] Cap 197 Section 3.
[312] Cap 197 Section 5.
[313] Cap 197 Section 38.

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development of the pensions sector, it is necessary to ensure prudence in the investment of the members' funds.

The Act also provides for a dispute resolution mechanism. A person dissatisfied with a decision of the manager, administrator, custodians or trustees of the scheme may appeal to the Chief Executive Officer to review such decision with a view to ensuring that such decision is made in accordance with the provisions of the relevant scheme rues and the Act under which the scheme is established.[314] Further, it establishes an Appeals Tribunal to entertain disputes from the Chief Executive Officer.[315] The process is thus well established before resorting to the courts. The Cabinet Secretary is also given authority to enact regulations for the proper implementation of the Act.[316] However, the dispute resolution mechanisms have not adequately protected the consumer.

3.3.4.6 Sacco Societies Act[317]

The Act establishes SASRA[318] and makes provision for the licensing, regulation, supervision and promotion of Sacco societies. The regulator has its objects and functions as to license Sacco societies to carry out deposit-taking business in accordance with this Act; regulate and supervise Sacco societies; hold, manage and apply the General Fund of the Authority in accordance with the provisions of this Act; levy contributions in accordance with this Act; do all such other things as may be lawfully directed by the Minister and perform such other functions as are conferred on it by this Act or by any other written law.[319]

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The regulatory and supervisory roles of the regulator enable deposit-taking Sacco societies to provide services taking into consideration the interest of the consumers. The regulator has also power to revoke licenses in cases of non-compliance with the Act or when a Sacco society engages in criminal or fraudulent acts.[320] Considering the importance and the development of Sacco movement in Kenya, these roles by the regulator are fundamental for the stability of the Sacco sector.

[314] Cap 197 Section 46.
[315] Cap 197 Section 47.
[316] Cap 197 Section 47.
[317] Act No. 14 of 2008.
[318] Act No. 14 of 2008 Section 4(1).
[319] Act No. 14 of 2008 Section 5.
[320] Act No. 14 of 2008 Section 27.

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The Act also establishes the Deposit Guarantee Fund. This is for protection of members' deposits.[321] The amount limit is 1000 US Dollars.[322] On the dispute resolution mechanisms, the Sacco societies will use the Cooperative Tribunal[323] under the Cooperative Societies Act.[324] The fund and the tribunal are essential elements in consumer protection. Further, the Cabinet Secretary is empowered to make regulations for the better implementation of the Sacco Societies Act[325] and the Cooperative Societies Act[326] governing the Sacco sector.

From the foregoing discussion on the sector-specific laws, each of the regulators has a restricted mandate to enforce consumer protection within its sector. It is worth noting that the provision of financial services has been diversified. For example, there are banking institutions offering insurance services. As a result, these banking institutions are regulated by CBK for their banking activities and IRA for their insurance activities. This essentially means the application of consumer protection provisions of the two Acts that are different, all for the same purpose. CBK further applies different regulations to deposit-taking microfinance institutions.

Though there are a few similarities on dispute resolution mechanisms in SASRA, IRA, CMA and RBA, the procedures and the applicable laws are different. This creates inconsistencies and ineffectiveness in providing financial consumer protection. This is further exacerbated by a huge unregulated part of the financial sector which has little or no financial consumer protection. It can thus be deduced that the Kenyan sectoral model of financial regulation, as discussed in Chapter Two above, and the legal framework hereinabove, are an inefficient framework that cannot be relied upon to protect financial consumers. They overall underlying challenge that the framework faces, lies in the fact that it is a sectoral model. The shortcomings of the sectoral model of financial regulation, as discussed in Chapter Two, are therefore attendant to Kenya's model.

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3.4 Conclusion

The Constitution of Kenya entrenches consumer protection as part of the Bill of rights. Pursuant to this constitutional right, substantive legislation on consumer protection was enacted by the

[321] Act No. 14 of 2008 Section 59.
[322] Act No. 14 of 2008 Section.
[323] Cooperative Societies Act Section 77.
[324] Cap 490 Laws of Kenya.
[325] Act No. 14 of 2008.
[326] Cap 490 Laws of Kenya.

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Kenyan Parliament in 2012.[327] Though not specific to financial consumer protection, it attempts to capture most of the principles for good business practice necessary for consumer protection. The various other legislation governing the financial sector have also varied provisions on financial consumer protection. This is a manifestation that theoretically, Kenya is not lacking in entrenching consumer protection in its laws to say the least.

From the discussion, the sector-specific legislation has made attempts to provide some provisions on consumer protection. With each of the regulators expected to enforce consumer protection provisions available in their specific sector-specific legislations together with those in the Consumer Protection Act, the effectiveness of each and every regulator in enforcement is compromised. This is for the reason that some of the sector-specific legislation do not have comprehensive provisions on consumer protection and those that have, are different to each other. This is evidence that there are inconsistencies, regulatory arbitrage and uncertainty in providing financial consumer protection in the Kenyan financial sector.

As a result, though consumer protection legislation is in place and that some sector-specific laws also have consumer protection provisions, they may not necessarily address the issues specific to financial services. The lack of coherence and market oversight in consumer protection, the indifference in regulation, overlaps and with each sector having its own regulator for enforcement exacerbates the ability of the regulators to provide financial consumer protection in the broader financial sector.

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Essentially, the regulatory framework in the Kenyan financial sector, as discussed in Chapter two, provides an inherent barrier to proper financial consumer protection. The fact that some financial institutions provide diverse services that require regulation by different regulators necessitates the need for a market-wide regulator to fully capture the regulatory needs for financial consumer protection. The problem is further exacerbated by the complexities and novelty of some financial services. With a huge part of the unregulated financial sector in Kenya, the need for a market-wide regulator cannot be over-emphasized.

[327] Act No. 46 of 2012.

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Chapter Four presents an argument for a Twin Peaks model of financial regulation, as a possible panacea to the shortcomings in the current framework, in so far as consumer protection is concerned.

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CHAPTER FOUR

4 TWIN PEAKS REGULATORY FRAMEWORK IN FINANCIAL CONSUMER PROTECTION

4.1 Introduction

The previous chapters have set the stage for the discussion in this chapter by revisiting the extant framework for financial regulation in Kenya, and the legal architecture in place for consumer protection. In identifying the various models of financial regulation, emphasis has been placed on the respective model's potential for ensuring consumer protection. It has been demonstrated, through critical evaluations of the various models, that consumer protection imperatives as prescribed under Kenyan law are hardly met under the current regulatory framework. It is for this reason that this chapter develops an argument for the adoption of the Twin Peaks model of financial regulation.

The definitive features of the Twin Peaks model of financial regulation will be the starting point of the discussion in this chapter. The two "peaks" of the model – prudential regulation and market conduct regulation, will then be analysed, with a view to locating the place of consumer protection under this model. The next section of this chapter will consider the Twin Peaks model in practice. This section will proceed by way of a case study. Australia, the first country to adopt the Twin Peaks model will be used as the focal for the case study. The Australian model will be analysed with a bias towards the mechanisms it has to ensure consumer protection. Subsequently, a case for the adoption of the twin peaks model of financial regulation in Kenya will be made, before concluding the discussion.

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4.2 Twin Peaks Model of Financial Regulation

4.2.1 Defining the Twin Peaks Model

The Twin Peaks Model of financial regulation is built to separate the market conduct and consumer protection authority from the prudential regulation.[328] Schmulow, succinctly captures the defining character of this model of financial regulation in the following words:

[328]Schmulow A 'Financial Regulatory Governance in South Africa: The Move Towards Twin Peaks' (2017) 23(3) *African Journal of International and Comparative Law* 393; Goodspeed I 'Twin Peaks' (2017) *South African Financial Regulation Journal*, available at http://financialregulationjournal.co.za/2017/09/19/twin-peaks/ (accessed

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> 'The Twin Peaks model of financial system regulation calls for the establishment of two, independent, peak regulatory bodies, one charged with ensuring safety and soundness in the financial system, the other with preventing market misconduct and the abuse of consumers in the financial sector.'[329]

An insight into the provenance of the Twin Peaks model may be helpful to provide further insights into its workings, as well as elaborate on the circumstances of its emergence. This in turn would be helpful in latter portions of this work that shall make the case for this model of financial regulation in Kenya.

4.2.2 The Twin Peaks Model: A History

Although Australia was the first country in the world to implement the Twin Peaks model, the model was first proposed for implementation in the United Kingdom.[330] Taylor first made the case for the Twin Peaks model, as the structure for financial regulation that would eliminate the challenges that the financial regulation system in the United Kingdom was facing at that time.[331] The context in which Taylor made the proposal was characterised by what Taylor described as the 'alphabet soup' of regulators – numerous regulators for conduct and systemic issues in the financial services sector.[332] Each regulator was assigned a jurisdiction defined by the type of entity being regulated.[333] According to Taylor, the likelihood, and actual incidents, of conflicts of interest, confusion and damage were high in such a regulatory set up.[334] Taylor painted the picture of the serendipity that characterised the emergence and development of this regulatory framework as thus:

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7June 2018); Wymeersch E, 'The Structure of Financial Supervision in Europe: About Single Financial Supervisors, Twin Peaks and Multiple Financial Supervisors' (2007) *European Business Organization Law Review* 258.

329 Schmulow A 'Financial Regulatory Governance in South Africa: The Move Towards Twin Peaks' (2017) 23(3) *African Journal of International and Comparative Law* 393.

330 Taylor M ''Twin Peaks': A Regulatory Structure for the New Century' (1995) Centre For the Study of Financial Innovation available at http://static1.squarespace.com/static/54d620fce4b049bf4cd5be9b/t/55241044e4b03769e017208a/1428426820095/Twin+Peaks+Revisited.pdf (accessed 7 June 2018).

331 Taylor M ''Twin Peaks': A Regulatory Structure for the New Century' (1995) Centre For the Study of Financial Innovation 4.

332 Taylor M ''Twin Peaks': A Regulatory Structure for the New Century' (1995) Centre For the Study of Financial Innovation 7.

333 Taylor M ''Twin Peaks': A Regulatory Structure for the New Century' (1995) Centre For the Study of Financial Innovation 7.

334 Taylor M ''Twin Peaks': A Regulatory Structure for the New Century' (1995) Centre For the Study of Financial Innovation 1-3.

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> 'Britain's system for regulating financial services, as was once said of its Empire, has been acquired in a fit of absence of mind'.[335]

The fact that the jurisdiction of each regulator was defined by the type of entity being regulated also posed another regulatory challenge. This took the form of the fact that there was an increasing 'blurring of boundaries' between various financial institutions.[336] As Schmulow notes, '[b]anks were combining with insurers and investment banks with stockbroking firms. Added to this was the presence of large, systemically important building societies.'[337]

It was in light of these difficulties, that Taylor proposed both an institutional framework – the Twin Peaks model, and certain principles to undergird the proposed institutional framework.[338] Institutionally, Taylor objected to the traditional tripartite distinction of banking, securities and insurance.[339] Instead, Taylor proposed the establishment of a dual-regulatory agency system, which would not be informed by the legal nature of the entity being regulated. The proposed regulatory agencies were a Financial Stability Commission (FSC) and a Consumer Protection Commission (CPC). The FSC would be responsible for 'the stability of the financial system as a whole, primarily through the application of prudential regulations.'[340] The CPC was to be charged with consumer protection – 'ensuring that firms deal with their (retail) customers in a fair and transparent manner.'[341]

One part of the financial service regulation (peak) of Taylor's proposal – as epitomised by the FSC, would see the combination of the multiple regulators, previously in charge of insurance, securities and banking, into one single regulator responsible for the overall stability of the

[335] Taylor M ''Twin Peaks': A Regulatory Structure for the New Century' (1995) Centre For the Study of Financial Innovation 2.
[336] See generally, Schmulow A 'Financial Regulatory Governance in South Africa: The Move Towards Twin Peaks' (2017) 23(3) *African Journal of International and Comparative Law*.
[337] Schmulow A 'Financial Regulatory Governance in South Africa: The Move Towards Twin Peaks' (2017) 23(3) *African Journal of International and Comparative Law* 394.
[338] Taylor M ''Twin Peaks': A Regulatory Structure for the New Century' (1995) Centre For the Study of Financial Innovation 395.
[339] Taylor M ''Twin Peaks': A Regulatory Structure for the New Century' (1995) Centre For the Study of Financial Innovation 4.
[340] Taylor MW 'Twin Peaks' Revisited...A Second Chance for Regulatory Reform' (2009) Centre for Financial Studies and Innovation, at 4, available at http://static1.squarespace.com/static/54d620fce4b049bf4cd5be9b/t/55241044e4b03769e017208a/1428426820095/Twin+Peaks+Revisited.pdf (accessed on 8 June 2018).
[341] Taylor M ''Twin Peaks': A Regulatory Structure for the New Century' (1995) Centre For the Study of Financial Innovation 5.

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financial system by regulating bank capital and the control of risk.[342] In his words, this single regulator would address 'financial soundness of institutions - including capital adequacy and large exposure requirements, measures relating to systems, controls and provisioning policies, and the vetting of senior managers to ensure that they possessed an appropriate level of experience and skill.'[343]

The second peak of Taylor's proposal, that of market conduct regulation, was to ensure that consumers were treated fairly and honestly and that they were shielded from 'fraud, incompetence, or the abuse of market power.'[344] To ensure this, the market conduct regulator could take measures such as restrictions on the advertising, marketing and sale of financial products, as well as minimum fit and proper standards for salespeople.[345]

For the underlying principles, Taylor also had suggestions. First, that in a modern financial system, the traditional tripartite distinction between banking, securities and insurance had become obsolete and needed to be replaced by a regulatory structure that focuses on the objectives of regulation.[346] In other words, focus had to shift from the legal form of the entity being regulated, for instance insurance and banking, to the objectives of regulation, such as prudential and consumer protection. The second principle was that each regulatory agency should have a clear and unambiguous mandate and should have a specific objective for which it can be held accountable.[347] The third principle espoused in Taylor's proposal was that the regulatory structure needed to mirror the structure of the industry that is being regulated; that for example a financial industry in which some firms are too big to fail requires different regulatory arrangements to one in which all firms are at the risk of bankruptcy.[348]

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[342] Taylor M ''Twin Peaks': A Regulatory Structure for the New Century' (1995) Centre For the Study of Financial Innovation 4.
[343] Taylor M ''Twin Peaks': A Regulatory Structure for the New Century' (1995) Centre For the Study of Financial Innovation 3.
[344] Taylor M ''Twin Peaks': A Regulatory Structure for the New Century' (1995) Centre For the Study of Financial Innovation 5.
[345]Taylor M ''Twin Peaks': A Regulatory Structure for the New Century' (1995) Centre For the Study of Financial Innovation 3.
[346] Taylor M ''Twin Peaks': A Regulatory Structure for the New Century' (1995) Centre For the Study of Financial Innovation 7.
[347] Taylor M ''Twin Peaks': A Regulatory Structure for the New Century' (1995) Centre For the Study of Financial Innovation 3.
[348] See generally Taylor M ''Twin Peaks': A Regulatory Structure for the New Century' (1995) Centre For the Study of Financial Innovation.

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Since then, the Twin Peaks approach to financial regulation has been adopted in various forms, first in Australia, then the Kingdom of the Netherlands, Spain, France, Canada and the United Kingdom.[349] South Africa is also in the process of implementing the approach.[350]

4.2.3 The Twin Peaks Model: A Critique

The potential benefits of the Twin Peaks approach were extolled by Taylor in his proposal. To begin with, Taylor argued that the approach would ensure that four issues were dealt with simultaneously.[351] One of these was that the approach would ensure that a wide range of financial firms would have to be regarded as systemically important.[352] The other issue that the approach would deal with was that it would avert the risks associated with multiple regulators, namely, the opportunity for regulatory arbitrage and potential for turf battles over jurisdiction, given the sprawling of, and disparateness in, regulatory agencies.[353] This would, in turn, reduce confusion among consumers, as the same phenomenon that creates the potential for regulatory arbitrage also creates the possibility for important issues to "disappear down the gaps", and '… among consumers [confusion is created] by an "alphabet soup" of regulatory bodies.'[354] Thirdly, as per Taylor, in the ever-increasing cases of financial conglomerates, the Twin Peaks approach would address a group-wide perspective on financial soundness.[355] The Twin Peaks approach would also ensure that the rare and specialist expertise and limited supervisory resources would be pooled and used harmoniously, instead of being utilized in a duplicating and overlapping

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[349] See generally, Taylor M ''Twin Peaks': A Regulatory Structure for the New Century' (1995) Centre For the Study of Financial Innovation.
[350] See generally, Schmulow A 'Financial Regulatory Governance in South Africa: The Move Towards Twin Peaks' (2017) 23(3) *African Journal of International and Comparative Law*.
[351] Schmulow A 'Financial Regulatory Governance in South Africa: The Move Towards Twin Peaks' (2017) 23(3) *African Journal of International and Comparative Law* 396.
[352] See generally, Schmulow A 'Financial Regulatory Governance in South Africa: The Move Towards Twin Peaks' (2017) 23(3) *African Journal of International and Comparative Law*.
[353] See generally, Schmulow A 'Financial Regulatory Governance in South Africa: The Move Towards Twin Peaks' (2017) 23(3) *African Journal of International and Comparative Law*.
[354] Taylor MW 'The Road to "Twin Peaks" – and the Way Back' (2009) 16(1) *Connecticut Insurance Law Journal* 7.
[355] Taylor MW 'The Road to "Twin Peaks" – and the Way Back' (2009) 16(1) *Connecticut Insurance Law Journal* 6.

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manner.[356] With such pooling and harmonization, there would be more 'economies of scale that would result from (the admittedly more limited) regulatory consolidation that it also involved.'[357]

Taylor aptly captured some of these benefits as thus:

> The benefits of Twin Peaks are clear. The proposed structure would eliminate regulatory duplication and overlap; it would create regulatory bodies with a clear and precise remit; it would establish mechanisms for resolving conflicts between the objectives of financial services regulation; and it would encourage a regulatory process which is open, transparent and publicly accountable.[358]

There were of course, criticisms against the Twin Peaks model. One of its most pronounced criticisms, ironically, lay in what had been heralded as its strength: the definition of clear distinctions between the prudential and market conduct regulation as objectives of financial regulation.[359] A positive side-effect of this distinction, it had been argued, would be that regulatory agencies would have clearly defined regulatory aims, and this would in turn minimise areas of overlap and duplication.[360] Critics, however, expressed doubt on the possibility of a clear distinction between the various objectives of financial regulation, to wit, financial stability and consumer protection.[361] They argue, instead, that these objectives were intertwined and aligned, hence they could be pursued simultaneously. In the words of Davies and Green:

> The ultimate argument for financially sound and prudentially well-regulated financial institutions is that they are then able to provide financial services and investment opportunities to consumer and businesses which those customers may use with confidence. A breakdown in consumer protection, whether in banking, investment or insurance products, may itself precipitate a wider loss of confidence in types of product or firms. There is therefore no necessary conflict between the two aims of regulation. In the long run they are aligned.[362]

Other than the argument that prudential regulation and market conduct regulation were intertwined so that it is impossible to speak of a neat separation between the two, critics have

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[356] Schmulow A 'Financial Regulatory Governance in South Africa: The Move Towards Twin Peaks' (2017) 23(3) *African Journal of International and Comparative Law* 393.
[357]Taylor MW 'The Road to "Twin Peaks" – and the Way Back' (2009) 16(1) *Connecticut Insurance Law Journal* 79.
[358]Taylor MW 'The Road to "Twin Peaks" – and the Way Back' (2009) 16(1) *Connecticut Insurance Law Journal* 1.
[359] See generally, Taylor MW 'The Road to "Twin Peaks" – and the Way Back' (2009) 16(1) *Connecticut Insurance Law Journal.*
[360]Taylor MW 'The Road to "Twin Peaks" – and the Way Back' (2009) 16(1) *Connecticut Insurance Law Journal* 3.
[361] Davies H & Green D *Global Financial Regulation: The Essential Guide* (2008) at 192.
[362] Davies H & Green D *Global Financial Regulation: The Essential Guide* (2008) at 192.

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also contended that in practice, both prudential and market conduct regulation would entail the assessment and evaluation of very similar facts and issues, that there would be significant overlaps between both, thereby negating any institutional set up that is built on an assumed separation of the two as different regulatory objectives. Briault points this out aptly:

> [T]here is a considerable overlap – both conceptually and in practice – between prudential and conduct of business regulation. Both have a close and legitimate interest in the senior management of any financial institution subject to both of these types of regulation, in particular because of the crucial roles of senior management in setting the "compliance culture" of a firm, in ensuring that management responsibilities are properly allocated and cover comprehensively the business of the firm, and in ensuring that other internal systems and controls are in place. The detail of some of these systems and controls may indeed be specific to either prudential or conduct of business considerations, but many of them will be more general.[363]

The thrust of the criticisms is well captured by Taylor, who remarks as follows:

> There seemed little point in having two regulators reaching essentially duplicate judgments of broadly similar matters. Since there is substantial overlap between the two regulatory objectives and, in practice, prudential and conduct of business regulation will focus on the same fundamental issues, they were best administered by a single regulatory agency.[364]

However, these arguments in criticism of the Twin Peaks approach can be, and indeed have been, discounted. In the UK itself – the jurisdictional context in which the criticisms against the Twin Peaks model were levelled while advancing the case for a single regulator – the experience of the GFC, in hindsight, undermined the contentions against the Twin Peaks approach.[365] There now seems to be considerable consensus that the regulatory practices in place during the GFC – when the Financial Services Authority was the single regulator – engendered '[a] balance between conduct of business and prudential regulation which, with the benefit of hindsight, now appears biased towards the former.'[366] The principled admission here is that when a single regulator is charged with the pursuit of the various regulatory objectives, there is the inherent

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[363]Briault C 'The Rationale for A Single National Financial Services Regulator' 6 Financial Services Authority Occasional Paper No. 2, 1999, available at <http://Www.Fsa.Gov.Uk/Pubs/ Occpapers/OP02.Pdf.> (accessed on 8 June) 2018.

[364] Taylor MW 'The Road to "Twin Peaks" – and the Way Back' (2009) 16(1) *Connecticut Insurance Law Journal* 80.

[365] The Financial Services Authority *The Turner Review: A Regulatory Response to the Global Banking Crisis* (2009), at 87, available at http://www.fsa.gov.uk/pubs/other/turner_review.pdf (accessed 8 June 2018).

[366]The Financial Services Authority *The Turner Review: A Regulatory Response to the Global Banking Crisis* (2009), at 87, available at http://www.fsa.gov.uk/pubs/other/turner_review.pdf (accessed 8 June 2018).

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potential that there would be inevitable bias towards one regulatory objective over the other. As Taylor observes:

> …the argument that there were synergies between prudential and conduct of business regulation overlooked the distinct possibility that one type of regulation would come to dominate within a single regulator and that this would likely to be consumer protection given the realities of the political process.[367]

It is not just that the extent of synergies between prudential and conduct of business regulation is limited; there are also other differences inherent in the very approaches of regulation that each of these two objectives of regulation follows. The House of Lords Select Committee on Economic Affairs was categorical in noting this:

> There is also a cultural difference between conduct-of-business and prudential supervision. Conduct-of business supervision is often performed by lawyers. Prudential supervision is largely an economic activity, particularly at the macro level. It seems likely that either a lawyerly or an economic approach would dominate in a supervisory body that performed both prudential and conduct of business supervision, and that this dominance would reduce the effectiveness of the dominated half of the organisation.[368]

It is not difficult to explain why market conduct regulation would dominate over prudential regulation when a single regulator is charged with both regulatory objectives. The reason is that market conduct regulation is politically sensitive, and its results are easy to measure, while prudential regulation is conducted more privately, has a relatively lower political impact save for times of crisis and its results are harder to measure.[369] It is therefore 'natural and rational for a supervisor with responsibility for both activities to concentrate on the one with the greater immediate political sensitivity.'[370]

Overall, therefore, a case can be made that the Twin Peaks model to financial regulation provides the avenue by which there would be adequate and unbiased focus on each of the main objectives of financial regulation – prudential and market conduct regulation. As noted in the South African Treasury Report on financial sector regulation, 'the twin peaks approach is regarded as the

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[367] Taylor MW 'The Road to "Twin Peaks" – and the Way Back' (2009) 16(1) *Connecticut Insurance Law Journal* 81.
[368] Select Committee on Economic Affairs, Banking Supervision and Regulation, 2008-09, H.L. 101-I, at 33, available at https://publications.parliament.uk/pa/ld200809/ldselect/ldeconaf/101/101i.pdf(accessed 8 June 2018).
[369] Select Committee on Economic Affairs, Banking Supervision and Regulation, 2008-09, H.L. 101-I, at 33, available athttps://publications.parliament.uk/pa/ld200809/ldselect/ldeconaf/101/101i.pdf(accessed 8 June 2018).
[370] Select Committee on Economic Affairs, Banking Supervision and Regulation, 2008-09, H.L. 101-I, at 33, available at https://publications.parliament.uk/pa/ld200809/ldselect/ldeconaf/101/101i.pdf(accessed 8 June 2018).

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optimal means of ensuring that transparency, market integrity, and consumer protection receive sufficient priority…'[371] The Report further noted that in light of South Africa's neglect of consumer protection, 'a dedicated regulator responsible for consumer protection, and not automatically presumed to be subservient to prudential concerns, is probably the most appropriate way to address this issue.'[372]

4.3 The Twin Peaks Model in Practice

This section evaluates the practice that has been employed by jurisdictions that have so far adopted the Twin Peaks model of financial regulation. This section considers the context that led to the adoption of the Twin Peaks model in Australia, and the manner by which this approach to financial regulation has been implemented in Australia and other jurisdictions. The focus of analysis will be on the implementation of the prudential and market conduct arms of regulation.

Australia has been selected as a case study for this research for the simple reason that it was the first country to implement the Twin Peaks model of financial regulation. The hypothesis is that there may be significant lessons to be learnt from Australia as a pioneering jurisdiction, in terms of the general experience (the longest for any jurisdiction with a Twin Peaks approach), including the challenges that were faced and the adaptations that had to be made in the implementation of the Twin Peaks approach. It is befitting to note that prior to the adoption of the Twin Peaks model, Australia, like Kenya now, had a regulatory system in which regulation was provided by several agencies depending on the legal status of a firm, or as has been said in respect of a similar arrangement in South Africa that existed previously, 'in which banks, insurers and capital markets were regarded as separate species.'[373]

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[371] Republic of South Africa National Treasury, 'A Safer Financial Sector to Serve South Africa Better', in National Treasury Policy Document, National Treasury, Republic of South Africa (23 February 2011), at 28, available at http://www.treasury.gov.za/twinpeaks/20131211%20-%20Item%202%20A%20safer%20financial%20sector%20to%20serve%20South%20Africa%20better.pdf (accessed 8 June 2018).

[372] Republic of South Africa National Treasury, 'A Safer Financial Sector to Serve South Africa Better', in National Treasury Policy Document, National Treasury, Republic of South Africa (23 February 2011), at 28, available at http://www.treasury.gov.za/twinpeaks/20131211%20-%20Item%202%20A%20safer%20financial%20sector%20to%20serve%20South%20Africa%20better.pdf (accessed 8 June 2018) 29.

[373] Rajendaran D 'Approaches to Financial Regulation and the Case of South Africa' (2012) IFMR Finance Foundation, available at https://www.dvara.com/blog/2012/03/06/approaches-to-financial-regulation-and-the-case-

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4.3.1 The Twin Peaks Approach in Australia

As already noted, Australia was the first country in the world to introduce the Twin Peaks approach to financial regulation. This it did in 1998. Of note is that Australia adopted the Twin Peaks model prior to the GFC, and that this model of regulation has partly been credited for the relative stability that Australia enjoyed during the GFC.[374] The International Monetary Fund, for instance, noted that Australia's relative success during the GFC was partially due to its 'well-developed regulatory and supervisory structure.'[375] It is of course true that a country's economic performance during the GFC cannot merely be explained by the financial regulatory structure in place – the UK Turner Committee did in fact remark that 'it is far too simplistic to attribute the relative success of some jurisdictions in withstanding the impact of the global financial crisis to either regulatory structure or supervisory style.'[376] At the same time however, the role of regulation in mitigating the impact of the GFC on countries' economies cannot be downplayed.[377] Thus, in the case of Australia, many analysts do agree that the Twin Peaks approach to financial regulation afforded certain advantages that the preceding regulatory approaches in Australia, or contemporary regulatory approaches in other countries such as the UK and the USA, did not offer.[378] These advantages, it has been contended, were instrumental in ensuring that Australia navigated through the GFC with relative success.[379]

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of-south-africa/ (accessed 8 June 2018); see also, Botha E &Makina D 'Financial Regulation And Supervision: Theory and Practice In South Africa' (2011) 10(11) *International Business & Economics Research Journal* 32.

[374] Republic of South Africa National Treasury, 'A Safer Financial Sector to Serve South Africa Better', in National Treasury Policy Document, National Treasury, Republic of South Africa (23 February 2011), at 28, available at http://www.treasury.gov.za/twinpeaks/20131211%20-%20Item%202%20A%20safer%20financial%20sector%20to%20serve%20South%20Africa%20better.pdf (accessed on 8 June 2018) 34.

[375] International Monetary Fund (2012) Australia: Basel Core Principles for Effective Banking Supervision—Detailed Assessment of Observance. IMF Country Report No. 12/313, at 4.

[376] The Financial Services Authority, *The Turner Review: A Regulatory Response to the Global Banking Crisis* (2009), at 87, available at http://www.fsa.gov.uk/pubs/other/turner_review.pdf (accessed 8 June 2018) 91.

[377] Hill J 'Why Did Australia Fare So Well in the Global Financial Crisis?' in Ferran E et al (eds), *The Regulatory Aftermath of the Global Financial Crisis* (Cambridge University Press, 2012).

[378]Taylor MW 'The Road to "Twin Peaks" – and the Way Back' (2009) 16(1) *Connecticut Insurance Law Journal* 79.

[379] Hill J 'Why Did Australia Fare So Well in the Global Financial Crisis?' in Ferran E (eds), *The Regulatory Aftermath of the Global Financial Crisis* (Cambridge University Press, 2012) 39.

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The Twin Peaks approach to financial regulation was introduced in Australia upon the recommendation of the Financial System Inquiry.[380] The Inquiry commenced in 1996, following the assumption of power by the Liberal National Party coalition.[381] The Inquiry was chaired by Stan Wallis, after whom the Inquiry has become popularly known as the Wallis Inquiry.[382] The main task of the Wallis Inquiry was to assess the consequences of financial deregulation in Australia, and to:

> …make recommendations on the nature of regulatory arrangements that will best ensure an efficient, responsive, competitive and flexible financial system to underpin stronger economic performance, consistent with financial stability, prudence, integrity and fairness.[383]

In its final report, the Wallis Inquiry asserted that governments have a sacred role in maintaining a healthy economic and social environment in which enterprises and their customers can interact with confidence.[384] and recommended a financial regulation system that has come to be characterised as the Twin Peaks model of financial regulation. Whether the Australian approach to financial regulation is the Twin Peaks approach *stricto sensu* is a different question altogether, which will be considered in the following segments which also evaluate how the various regulatory peaks have been implemented in Australia.

4.3.1.1. Prudential Regulation

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The Australian Prudential Regulation Authority (APRA) is the body charged with prudential regulation in Australia.[385] The APRA took over the prudential regulation functions that had hitherto been in the domain of the Reserve Bank of Australia (RBA), the Australian Financial

[380] Godwin A &Ramsay I 'Twin Peaks –The Legal and Regulatory Anatomy of Australia's System of Financial Regulation' (2015) Centre For International Finance And Regulation Research Working Paper Series 4, available at http://apo.org.au/system/files/67377/apo-nid67377-99061.pdf (accessed 8 June 2018).
[381] Godwin A & Ramsay I 'Twin Peaks –The Legal and Regulatory Anatomy of Australia's System of Financial Regulation' (2015) Centre For International Finance And Regulation Research Working Paper Series 4, available at http://apo.org.au/system/files/67377/apo-nid67377-99061.pdf(accessed 8 June 2018).
[382] Godwin A &Ramsay I 'Twin Peaks –The Legal and Regulatory Anatomy of Australia's System of Financial Regulation' (2015) Centre For International Finance And Regulation Research Working Paper Series 4, available at http://apo.org.au/system/files/67377/apo-nid67377-99061.pdf(accessed 8 June 2018).
[383] Commonwealth of Australia, Financial System Inquiry: Final Report (Wallis Inquiry Report), 5, available at http://fsi.treasury.gov.au/content/downloads/FinalReport/Prelim.pdf (accessed 8 June 2018).
[384] Commonwealth of Australia, Financial System Inquiry: Final Report (Wallis Inquiry Report), 5, available at http://fsi.treasury.gov.au/content/downloads/FinalReport/Prelim.pdf(accessed 8 June 2018) 177.
[385] The Australian Prudential Authority Act 1998 Section 8.

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Institutions Commission (AFIC), and the Insurance and Superannuation Commission (ISC).[386] Simply, all prudential regulation functions and powers were converged to a single body, regardless of the respective financial sector. This seems to be in line with Taylor's view that 'a regulatory system which presupposes a clear separation between banking, securities and insurance is no longer the best way to regulate a financial system in which these distinctions are increasingly irrelevant.'[387]

Other than achieving cohesion by merging the previously institutionally-oriented prudential regulators, the establishment of the APRA had the effect of separating the prudential authority from the central bank for efficiency reasons[388] and emphasizing that there is no implied government backing of financial institutions in the event of insolvency and failure.[389]

A unique feature of prudential regulation in Australia is that while the RBA is not part of the APRA, it still retains the overall responsibility for the financial system and its function as lender of last resort.[390] The separation between the APRA and RBA was recommended by the Wallis Inquiry, which proposed that the prudential regulator 'should be separate from, but cooperate closely with, the Reserve Bank of Australia.'[391] A related recommendation was that 'strong mechanisms should be established to ensure appropriate coordination and cooperation between the two agencies.'[392] The Wallis Inquiry gave a number of reasons for this separation:

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First, that the combination of deposit taking, insurance and superannuation regulation is unlikely to be carried out efficiently and flexibly by a central bank whose primary operational relationships are with banks alone and whose operational skills and culture have long been focused on banking; secondly, the separation will clarify that, while the central bank may still

[386] Godwin A 'Introduction to Special Issue – the Twin Peaks Model of Financial Regulation and Reform in South Africa' (2017) 11 *Law and Financial Markets Review* 1.
[387] Taylor M *Peak Practice: How to Reform the UK's Regulator System* (Centre for Study of Financial Innovation, London, 1996) 53.
[388] Wallis Inquiry Report at 22.
[389] Wallis Inquiry Report at 22.
[390] Godwin A & Ramsay I 'Twin Peaks –The Legal and Regulatory Anatomy of Australia's System of Financial Regulation' (2015) Centre For International Finance And Regulation Research Working Paper Series 4, available at http://apo.org.au/system/files/67377/apo-nid67377-99061.pdf (accessed 8 June 2018).
[391] Wallis Inquiry Report Recommendation 32.
[392] Wallis Inquiry Report Recommendation 32.

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provide support to maintain financial stability, there is no implied or automatic guarantee of any financial institution or its promises in the event of insolvency, and finally, that the separation will enable both the RBA and the [prudential regulator] to focus clearly on their primary objectives and will clarify the lines of accountability for the regulatory task.[393] The essence of the argument for separation of the RBA and the APRA has been that when charged with prudential regulation as well as bank supervision, the central bank tended to focus primarily on monetary policy, at the expense of other regulatory imperatives.[394]

This separation between the APRA and the RBA, in the context of the existence of the AFIC, has led to the argument that the Australian approach is actually a 'three-peak approach' or a 'tri-partite approach', for the simple reason that the RBA seems to be a third regulatory peak. There are, however, other schools of thought on the place of central bank vis-à-vis the prudential regulation authority. In some, the prudential regulator is a subsidiary of the central bank, while in others, prudential regulator exists within the central bank. This will be analysed in detail in section 4.4 below.

4.3.1.2 Market Conduct Regulation

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Market conduct regulation, including consumer protection, is carried out by the ASIC, as noted above. This regulatory peak is established under the ASIC Act, Section 1(1) of which provides that the objects of the Act are 'to provide for the Australian Securities and Investments Commission (ASIC) which will administer such laws of the Commonwealth, a State or a Territory as confer functions and powers under those laws on ASIC; and to provide for ASIC's functions, powers and business…'[395] Section 1(2) of the ASIC Act enumerates the functions of ASIC. These are set out to include, first, that ASIC must strive to maintain, facilitate and improve the performance of the financial system and the entities within that system in the interests of commercial certainty, reducing business costs, and the efficiency and development of the economy; and to promote the confident and informed participation of investors and

[393] Wallis Inquiry Report Recommendation 32.
[394] The evidence presented to the Joint Committee on the Draft Financial Services Bill (2011), by the Assistant Governor of the Reserve Bank of Australia, at 435.
[395] ASIC Act Section 1(1).

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consumers in the financial system.[396] Another of its functions is to ensure that information is available as soon as practicable for access by the public, and to take whatever action it can take, and is necessary, in order to enforce and give effect to the laws of the Commonwealth that confer functions and powers on it.[397]

The aim of the ASIC Act therefore, is to institute a statutory body that performs functions that are distinct from those undertaken by APRA, in order to ensure that there is a clear separation between the prudential and market conduct regulation aspects of financial regulation. However, while that may be the case in the letter and spirit of the law, there is the question of whether this has actually been true in practice. The Australian Treasury, in its submission to Financial System Inquiry (2014), observed as follows:

> Market developments and policy changes since the Wallis Inquiry have blurred some of the responsibilities between the regulators, particularly between APRA and ASIC. This risks confusion about their roles and potentially reduces the benefits to industry and consumers of a regulatory architecture based on clear functional lines. It is timely for the Financial System Inquiry to address overlaps or gaps between the roles of the regulators to ensure a clear demarcation between regulators is maintained.[398]

There is therefore the need for constant appraisal of the regulatory framework in light of market dynamics to ensure that regulation is responsive to market developments.

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Separate from the potential for regulatory overlaps between what should otherwise be distinct regulators, there is also the potential for conflicts in regulatory priorities. In this regard, a 2012 IMF Report on Australia's regulatory system noted as follows:

> In practice, ASIC's approach to the supervision of the entities that fall under its sole responsibility is different from APRA's. APRA's mandate as the prudential regulator is to ensure that under all reasonable circumstances, financial promises made by prudentially regulated entities are met within a stable, efficient and competitive financial system…By contrast, ASIC's role is understood to be that of a conduct regulator, which means that it must ensure compliance with statutory obligations and other regulatory standards.[399]

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[396] Australia Securities and Investments Commission Act 2001 Section 1(2).
[397] Australia Securities and Investments Commission Act 2001 Section 1(2).
[398] Australian Government Treasury, Submission, *Financial System Inquiry*, 3 April 2014, 26.
[399] International Monetary Fund (IMF) 'Australia: IOSCO Objectives and Principles of Securities Regulation—Detailed Assessment of Implementation' (IMF Country Report No. 12/314, November 2012) 41.

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Godwin and Ramsay paint the picture of potential conflict even more clearly:

> As the legal regulator, ASIC should be relatively blind to institutional failure. APRA, on the other hand, acts as an economic regulator, the focus of which is on protecting customers of prudentially regulated institutions, such as bank depositors and insurance policy-holders, from institutional failure.[400]

Overall, it is arguable, from the foregoing discussion, that the Twin Peaks model of regulation appears to be working effectively in Australia, the only handicap being what has been pointed out above – the potential for the blurring of boundaries between the mandates of the various regulators in light of the developments in the market, as well as the potential for conflicts in regulatory priorities.[401]

4.4 A Case for the Twin Peaks Approach in Kenya

The case for the twin peaks approach to financial regulation in Kenya is as much an argument for the advantages of the twin peaks approach as it is a portrayal of the weaknesses of the current regulatory approach and the other possible alternatives. In making this case, it should be pointed out that at present, possible reforms to the financial regulation model in Kenya are being attempted through two draft Bills– the draft Financial Services Authority Bill (2016) and the Financial Markets Conduct Bill (2018). These two bills, if enacted into law, will, subject to certain amendments, in effect install a twin peaks regulatory approach in Kenya. This would be the case if the bills are to propose the establishment of a Financial Services Authority for, generally, prudential regulation, and a Financial Markets Conduct Authority, for, broadly, consumer protection and market conduct regulation.

The current regulatory architecture in Kenya is replete with shortcomings. What obtains in Kenya today is not any different from what existed, for example, in the UK, Australia and South Africa, before the adoption, or at least the proposals to adopt in the case of South Africa (and

[400] Godwin A & Ramsay I 'Twin Peaks –The Legal and Regulatory Anatomy of Australia's System of Financial Regulation' (2015) Centre For International Finance And Regulation Research Working Paper Series 4, available at http://apo.org.au/system/files/67377/apo-nid67377-99061.pdf(accessed 8 June 2018) 12.

[401] International Monetary Fund (IMF) 'Australia: IOSCO Objectives and Principles of Securities Regulation—Detailed Assessment of Implementation' (IMF Country Report No. 12/314, November 2012) 41; Godwin A & Ramsay I 'Twin Peaks –The Legal and Regulatory Anatomy of Australia's System of Financial Regulation' (2015) Centre For International Finance And Regulation Research Working Paper Series 4, available at http://apo.org.au/system/files/67377/apo-nid67377-99061.pdf(accessed 8 June 2018) 12.

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earlier, the UK), of the Twin Peaks approach to financial regulation. The situation in Kenya is in fact exacerbated by the fact that there exists a significant proportion of the financial sector that would fall under the realm of shadow banking, if the ever-growing mobile phone financial services were to be included, as they should be, in the analysis. The shortcomings of the extant regulatory framework in Kenya are rehashed below.

The regulatory system is complex, with numerous regulators in the financial services sector – the Central Bank (the CB), the Insurance Regulatory Authority (the IRA), the Capital Markets Authority (the CMA) and the Sacco Societies Regulatory Authority (the SASRA). Each of these bodies is charged with regulation and supervision over specific institutions, based on the nature of the institution.[402] The bodies undertake both prudential and market conduct regulation. The foregoing discussions have identified the demerits of such a regulatory approach.

As Taylor reckoned, the likelihood, and actual incidents, of conflicts of interest, confusion and damage would be high in such a regulatory set up.[403] The phenomenon of the blurring of boundaries that occurred in other jurisdictions that have adopted the Twin Peaks approach, such as Australia and the UK, is also a reality in the present day Kenyan financial sector. The report by Schmulow, that '[b]anks [were] combining with insurers and investment banks with stockbroking firms…,' would not be a strange one in Kenya today, where banks now provide insurance services and mobile phone companies now provide financial services.[404] The risk that one regulatory objective may be pursued at the expense of another is real in a system where a single body is charged with both regulatory objectives in respect of an institution that falls within its regulatory jurisdiction. Even if the argument is made that in such cases market conduct/consumer regulation is more likely to receive the greater focus because of its intrinsically political element, the point is that there is no justification why prudential regulation should be relegated to the periphery. In any case, while it is possible to separate between the two as regulatory objectives, in the ultimate analysis, a combination of both is actually essential to ensuring that the consumer is protected – prudential regulation, in ensuring that institutions are

[402] Schmulow A 'Financial Regulatory Governance in South Africa: The Move Towards Twin Peaks' (2017) 23(3) *African Journal of International and Comparative Law* 393.
[403] Schmulow A 'Financial Regulatory Governance in South Africa: The Move Towards Twin Peaks' (2017) 23(3) *African Journal of International and Comparative Law* 393.
[404] For instance, the Mpesa and Mshwari services by the telecommunications service provider Safaricom.

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financially stable and do not fail, actually does, arguably, reinforce the consumer protection objective of ensuring soundness and fairness in the financial services sector.[405]

The other alternative to the current system that of a unified/single regulator, also has proven shortcomings. For instance, '[p]rudential and conduct of business...regulation require[s] fundamentally different approaches and cultures and there may be doubt about whether a single regulator would, in practice, be able to effectively encompass these to the necessary degree.'[406] Further to this, a single/unified regulator might not have a clear focus on the different objectives and rationales of regulation and supervision, and might not make the necessary differentiations between different types of institution and business.[407]

The Twin Peaks approach will, in view of the foregoing, ensure that there is a clear functional separation between the prudential regulation and market conduct/consumer protection regulation. This will, in turn, ensure that there are no regulatory overlaps that may result in confusion and complexity, but also that no regulatory objective is subordinated to another because each regulatory peak will have 'dedicated objectives and clear mandates to which they are exclusively committed.'[408] In other words, the regulatory independence that would result from separation will ensure that each regulatory objective is afforded the requisite attention. At the same time, unregulated and underregulated sectors of financial system, such as mobile phone financial services, will also be attended to, especially since this 'model may be better adapted towards keeping pace with the growing complexity of financial markets and the continuing rise of

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[405]Davies H &Green D *Global Financial Regulation: The Essential Guide* (2008) at 192.
[406]Llewellyn D 'Institutional Structure of Financial Regulation and Supervision: The Basic Rules', Paper presented at a World Bank seminar Aligning Supervisory Structures with Country Needs, Washington DC, 6 and 7 June 2006, 26 (2006).
[407] Llewellyn D 'Institutional Structure of Financial Regulation and Supervision: The Basic Rules', Paper presented at a World Bank seminar Aligning Supervisory Structures with Country Needs, Washington DC, 6 and 7 June 2006, 26 (2006) 23.
[408] Llewellyn D 'Institutional Structure of Financial Regulation and Supervision: The Basic Rules', Paper presented at a World Bank seminar Aligning Supervisory Structures with Country Needs, Washington DC, 6 and 7 June 2006, 26 (2006) 27.

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financial conglomerates.'[409] The risk of having multiple regulatory cultures and of conflict of interest, as it is with a single/unified regulator, is also minimised, if not eliminated.[410]

The possible disadvantages of the twin peaks approach – the potential for regulatory overlap in respect of dual regulated agencies since it is 'inevitable that two separate regulators would have two separate rule books and two separate systems', and the possibility of poor coordination between the prudential and market conduct/consumer protection regulatory peaks – are of the kind that can be addressed within the system itself. It would therefore be necessary to ensure that there are clear demarcations of functions with attention being paid to minimising the risk of regulatory overlap, and the configuration of efficient coordination mechanisms, may help avert these potential weaknesses. The forms in which these weaknesses, and if at all they actually may manifest themselves, are questions not necessarily be determinable a priori, and would, as the Australian experience shows, often emerge in the course of the implementation of the regulatory approach.

A fundamental issue worth separate consideration is that of the place of the Central Bank of Kenya, in this case the CBK, vis-à-vis the prudential regulator, in the twin peaks approach. It has been noted above that there are three different ways by which this question may be answered: first, the CBK and the prudential regulator may be kept separate, as has been done in Australia. The justification for this has already been considered in earlier sections. Second, the prudential regulator may be a subsidiary of the CBK, as had been done in the UK prior to 2016.[411] The perceived justifications of this approach would be that since linking the prudential function with monetary policy making will result in the best regulatory outcome, because 'as the central bank has responsibility for oversight of the system as a whole, and also the stability of the payments system, there are potentially powerful synergies in also being the supervisory agency for the

[409]Godwin A &Ramsay I 'Twin Peaks –The Legal and Regulatory Anatomy of Australia's System of Financial Regulation' (2015) Centre For International Finance And Regulation Research Working Paper Series 4, available at http://apo.org.au/system/files/67377/apo-nid67377-99061.pdf(accessed 8 June 2018) 53.

[410]Godwin A &Ramsay I 'Twin Peaks –The Legal and Regulatory Anatomy of Australia's System of Financial Regulation' (2015) Centre For International Finance And Regulation Research Working Paper Series 4, available at http://apo.org.au/system/files/67377/apo-nid67377-99061.pdf(accessed 8 June 2018) 53.

[411]The Banking and Financial Services Act 2016 constituted the Bank of England into the Prudential Regulatory Authority.

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institutions that make up the system.'[412] Secondly, the risk of regulatory gaps will be lowered because the central bank can direct the prudential authority to take action.[413]

The third alternative would be where the central bank performs the prudential regulation function. The UK, the Netherlands, Belgium and New Zealand all adhere to this approach.[414] The advantage in this approach is that it is possible to harness skills and knowledge under a single body, the central bank. In its 2011 Report, the National Bank of Belgium noted that one of the 'reasons why the lawmaker wanted the central bank to combine all the activities concerning financial stability and prudential supervision is that the Bank possesses skills and data which are particularly useful for the performance of those tasks.'[415] In the Netherlands, a similar justification has been advanced:

> [T]he credit crisis has shown the added value of a combined central bank–prudential supervisor: information and expertise on supervision, payments, financial markets, macroeconomics and financial stability were all present under one roof. But even in normal circumstances it is useful to harness the full power of this combination.[416]

Arguably, the third alternative, in which the central bank and prudential functions are discharged by the same body, would be the best for Kenya under a twin peaks approach. This is because, as is the case for other jurisdictions, Kenya would be able to harness the knowledge, skills and experience of the central bank in the performance of the prudential function. At the same time, it would be possible to minimise costs and personnel requirements, while averting the possibility of a complex supervisory structure that may in effect be a 'three-peaks model' as is the case in Australia.

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[412]Llewellyn D 'Institutional Structure of Financial Regulation and Supervision: The Basic Rules', Paper presented at a World Bank seminar Aligning Supervisory Structures with Country Needs, Washington DC, 6 and 7 June 2006, 26 (2006) 30.
[413] Llewellyn D 'Institutional Structure of Financial Regulation and Supervision: The Basic Rules', Paper presented at a World Bank seminar Aligning Supervisory Structures with Country Needs, Washington DC, 6 and 7 June 2006, 26 (2006) 30.
[414] See generally, Llewellyn D 'Institutional Structure of Financial Regulation and Supervision: The Basic Rules', Paper presented at a World Bank seminar Aligning Supervisory Structures with Country Needs, Washington DC, 6 and 7 June 2006, 26 (2006).
[415] National Bank of Belgium –Corporate Report (2011) at 18.
[416] Hilbers P & Schoenmaker D, 'Experiences with the Dutch Twin Peaks Model: Lessons for Europe' in Kellermann, Haan andVries (eds.) *Financial Supervision in the 21st Century* at 188.

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4.5 Conclusion

This chapter has discussed the history and development of the twin peaks model of financial regulation, and its definitive features. The potential strengths and weaknesses of this model of financial regulation have also been evaluated. The usefulness of the model in consumer protection has been analysed in this regard. The overarching observation has been that the twin peaks approach generally provides a mechanism by which the two objectives of prudential regulation and market conduct/consumer regulation will be satisfied to the necessary extent, without one dominating over the other. In the context of consumer protection, this is without a doubt significant, especially when considered in light of the fact that by virtue of the Constitution, consumers are entitled to, inter alia, goods and services of reasonable quality, and to information necessary for them to gain full benefit from goods and services. The point here is that in order to meet the constitutional stipulations, in the financial services sector, there is need to adopt a regulatory approach that accords the consumer protection function an optimal place.

It has been indicated above that having a system by which one regulatory objective dominates the other, even if consumer protection is the dominant objective, would not, in the long run, be in the interest of consumer protection as prudential regulation by and of itself plays a reinforcing role to consumer protection. The chapter has also considered the various alternatives on the relationship between the central bank and the prudential authority if the twin peaks model was to be adopted in Kenya, and concluded that the best alternative would be where the prudential function is performed by the central bank, because that would reduce costs, promote information and date sharing while harnessing the knowledge, skills and experience that the central bank has already accumulated in the course of its regulatory functions.

The next chapter draws on the discussion in this, as well as the other chapters of this paper, to make conclusions and recommendations that can be used to construct a suitable design for the implementation of the twin peaks model of financial regulation in Kenya.

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CHAPTER FIVE

5 CONCLUSION AND RECOMMENDATIONS

5.1 Conclusions

The previous four chapters of this work have evaluated several aspects of financial regulation generally, and financial regulation in Kenya in particular. Chapter One sets out the main research problem and the methodology that this research has used to argue a solution to the problem. The problem that was identified concerned the appropriateness of the current financial regulation framework in Kenya to guarantee consumer protection. The premise is that consumer protection is one of the main objectives of financial regulation, together with the other main objective – prudential regulation.[417]

Chapter Two provides a substantive discussion of the various approaches to financial regulation, before delving into a discussion of the approach that is currently in place in Kenya. This first part of the Chapter, which discusses the various approaches to financial regulation generally, aims to define the general context within which this research is taking place. It provides an understanding of the various regulatory alternatives that states have, in deciding which approach to implement.[418] The perceived strengths and shortcomings of each of the main approaches to financial regulation are discussed, of, course, subsequent to an explanation of their defining characteristics. The approaches discussed in this Chapter are the sectoral approach and the single/unified regulator approach.[419]

While the sectoral approach is praised for ensuring specialisation and specific attention to the unique regulatory requirements of the different subjects of regulation in the financial sector, it is criticised for ignoring the blurring of boundaries – a notion that generally alludes to the fact that due to evolutions in the financial market, financial services providers begin to provide products that do not necessarily fall into one or the other sector of the financial market, at least for

[417] Norton J 'Global Financial Sector Reform: The Single Financial Regulator Model based on the UK FSA Experience – A Critical Re-evaluation' (2005) 39 *The International Lawyer* 33 available at http://heinonline.org/HOL/Licence (accessed 27 November 2016).
[418] See, generally, Chapter Two above.
[419] See, generally, Chapter Two above.

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purposes of regulation.[420] In the same vein, there is a blurring of boundaries when financial services entities merge or begin providing financial products for which they were not initially registered, for example, when banks begin offering insurance services.[421]

The other risk that comes with this model of financial regulation is that when new sectors/services that fall outside the existing framework of classification are established, they are likely to be left unregulated.[422] An example of this in Kenya would be the mobile phone based financial services, as epitomised by the M-Pesa services. That consumers will be left vulnerable in such situations is a fact that needs no emphasis. Consumer protection in this model is also undermined by the very nature of the model – the many regulators create confusion for consumers, and the fact that a regulator is responsible for both prudential and market conduct regulation in a specific sector may result in one aspect being dominant over the other.[423] It may be argued that in such cases, consumer protection is the more likely to be dominant, given the political sensitivity inherent in this function, and that consequently, if this research is about consumer protection, then this approach does not fall short in that regard.[424] However, the argument in this research that such a view would represent a myopic and piecemeal understanding of the objectives of financial regulation. While prudential regulation and consumer regulation may be viewed as different objectives of regulation, this does not mean that they are not intertwined. A failure that is a consequence of poor prudential regulation will undeniably impact on the consumer.[425]

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Most of these shortcomings still exist in the unified regulation model. As the regulatory function is the mandate of a single actor, the potential for one regulatory objective – consumer protection as already indicated above – is likely to be the more dominant one, with the ramifications for such already explained above. The efficiency of this approach to regulation has also been put

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[420] Wymeersch E 'The Structure of Financial Supervision in Europe: About Single Financial Supervisors, Twin Peaks and Multiple Financial Supervisors' (2007) *European Business Organization Law Review* 252.
[421] Wymeersch E 'The Structure of Financial Supervision in Europe: About Single Financial Supervisors, Twin Peaks and Multiple Financial Supervisors' (2007) *European Business Organization Law Review* 252.
[422] Wymeersch E 'The Structure of Financial Supervision in Europe: About Single Financial Supervisors, Twin Peaks and Multiple Financial Supervisors' (2007) *European Business Organization Law Review* 252.
[423] Taylor M 'Twin Peaks': A Regulatory Structure for The New Century (1995) *Centre for the Study of Financial Innovation*, London, at 1-3; Andrew Schmulow 'Financial Regulatory Governance in South Africa: The Move Towards Twin Peaks' (2017) 23(3) *African Journal of International and Comparative Law* 393.
[424] Taylor MW 'Twin Peaks' Revisited...a Second Chance for Regulatory Reform' (2009) Centre For the Study of Financial Innovation, London at 26.
[425] Davies H & Green D *Global Financial Regulation: The Essential Guide* (2008) 103.

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into question, having in mind the fact that the single regulator would still have to create different regulatory regimes in view of the differences between the sectors under regulation.[426] In the same vein, having to supervise a range of different institutions may result in the regulator having poorly defined objectives.[427]

The second part of Chapter Two considered the regulatory approach in Kenya. The approach in Kenya was identified as being the sectoral approach.[428] The regulatory agencies in Kenya are granted competence on the basis of the sector that they regulate. Thus, there is the Insurance Regulatory Authority for insurance, the Central Bank for banking and the Capital Markets Authority for securities.[429] The current system exhibits the general shortcomings associated with sectoral regulation. Some of these shortcomings do appear in practice.

First, since the regulatory divisions are based on certain delimitations along the lines of the financial services offered, the consequence has been that emergent areas that do not neatly collapse into the existing divisions are left unregulated. Thus, mobile phone-based financial services, the epitome of which is Safaricom's M-Pesa, exist without proper regulation.[430] The risk that this poses to consumers is pretty obvious. Other shortcomings that have been identified in the foregoing parts of this paper include the potential for regulatory overlap, and the conflict of interest and confusion for consumers as a result of the 'alphabet soup' of regulators.[431]

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The chapter also discussed current legislative developments, which have taken the form of the Financial Services Authority Bill 2016 and the Financial Markets Conduct Regulation Bill

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[426] Abrams K & Taylor MW 'Issues in the Unification of Financial Sector Supervision' IMF Working Paper, No. WP/00/213, International Monetary Fund (December 2000), at 1 available at https://www.imf.org/external/pubs/ft/wp/2000/wp00213.pdf (accessed 5 June 2018) 17.

[427] Taylor M 'Twin Peaks': A Regulatory Structure for The New Century (1995) *Centre for the Study of Financial Innovation*, London, at 1-3; Andrew Schmulow 'Financial Regulatory Governance in South Africa: The Move Towards Twin Peaks' (2017) 23(3) *African Journal of International and Comparative Law* 393.

[428] Abrams K & Taylor MW 'Issues in the Unification of Financial Sector Supervision' IMF Working Paper, No. WP/00/213, International Monetary Fund (December 2000), at 1 available at https://www.imf.org/external/pubs/ft/wp/2000/wp00213.pdf (accessed 5 June 2018) 17.

[429] Abrams K & Taylor MW 'Issues in the Unification of Financial Sector Supervision' IMF Working Paper, No. WP/00/213, International Monetary Fund (December 2000), at 1 available at https://www.imf.org/external/pubs/ft/wp/2000/wp00213.pdf (accessed 5 June 2018) 17.

[430] Abrams K & Taylor MW 'Issues in the Unification of Financial Sector Supervision' IMF Working Paper, No. WP/00/213, International Monetary Fund (December 2000), at 1 available at https://www.imf.org/external/pubs/ft/wp/2000/wp00213.pdf (accessed 5 June 2018) 17.

[431] Gakeri J 'Financial Services Regulatory Modernization in East Africa: The Search for a New Paradigm for Kenya' (2011) 1 (16) *International Journal for Humanities and Social Science* 164.

http://etd.uwc.ac.za/

2018.[432] It was pointed out in the discussion that the two bills do not seem to be properly harmonised, as they both purport to govern prudential regulation and market conduct regulation at the same time.[433] The enforcement authorities they establish, namely the Financial Services Authority and the Financial Markets Conduct Regulation Authority, would therefore have overlapping functions.

It is unclear, as things stand, if the two bills are intended to be complementary or if the latter is intended to supplant the initial legislative effort. Whichever the case, both possibilities do not portend any amelioration of the existing framework in Kenya. If the two bills were intended to be complementary, the handicap, as has been already identified, is that they both create enforcement authorities with overlapping functions. The obvious ramification of this is that there will be regulatory overlaps, creating confusion and leading to very high compliance and administrative costs.

On the other hand, if the two bills are alternatives, the ramification will be that part of the extant regulatory framework, with the weaknesses identified above, will remain. In particular, if the Financial Markets Conduct Regulation Bill 2018 is to be taken to have replaced the legislative ambition encapsulated in the Financial Services Authority Bill, by virtue of its having come later in time, the outcome will be that there shall be a single market conduct regulator working with a host of prudential regulators. In other words, there will be a single market conduct regulator, working in a context where there are several sectoral regulators.

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On the other hand, if the legislature was to go with the Financial Services Authority Bill, the result will be that Kenya would, essentially, have installed a unified regulator model of regulation, whose attendant shortcomings have already been demonstrated in the previous sections of this work. There is therefore need to review the context and legislative intent of both bills, with the aim of installing the twin peaks regulatory model, for which this work has made a case. This is suggested in the recommendations below.

[432] Abrams K & Taylor MW 'Issues in the Unification of Financial Sector Supervision' IMF Working Paper, No. WP/00/213, International Monetary Fund (December 2000), at 1 available at https://www.imf.org/external/pubs/ft/wp/2000/wp00213.pdf (accessed 5 June 2018) 17.

[433] The FSA Bill, Section 9; the Financial Markets Conduct Regulation Bill 2018 Section 11.

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Chapter Three has assessed the consumer protection framework in Kenya, identifying the essentials that the applicable law imposes. The general law on consumer protection, to wit, the Constitution, the Consumer Protection Act and the Competition Act is discussed, before the law on specific aspects of the financial sector is considered.[434] The aim of this Chapter is to evaluate whether the current regulatory framework, as represented by the specific laws on financial regulation, meets the threshold of the essentials imposed by the Constitution and the other general laws on consumer protection. The conclusion is that they do not, largely because of the shortcomings of the regulatory schemes that they author.

It is in this regard that a case has been made, in Chapter Four, for a Twin Peaks approach to financial regulation. The case for a Twin Peaks approach is made both on the strengths of the Twin Peaks model on its own, and against the backdrop of the disadvantages of the current and alternative approaches to financial regulation in Kenya. The experience of Australia as the first country to implement the Twin Peaks approach is revisited. The choice of Australia as a case study is motivated by the reason not merely that Australia was the first country to implement the Twin Peaks approach to financial regulation but that as the first country to implement this approach, Australia has the longest experience from which useful lessons may be drawn. The potential advantages of the Twin Peaks approach are discussed critically.

It has been argued that the Twin Peaks approach would ensure that a wide range of financial firms would have to be regarded as systemically important, and that the approach would avert the risks associated with multiple regulators, like the appearance of regulatory arbitrage and potential for turf battles over jurisdiction, given the proliferation and disparateness in regulatory agencies.[435] This will reduce confusion among consumers, as the same phenomenon that creates the potential for regulatory arbitrage also creates the possibility for important issues to 'disappear down the gaps', and … among consumers [confusion is created] by an alphabet soup of regulatory bodies.' [436] Furthermore, in view of the ever-increasing cases of financial conglomerates, the Twin Peaks approach would address a group-wide perspective on financial soundness, and also ensure that the rare and specialist expertise and limited supervisory

[434] See generally, Chapter Three above.

[435] Schmulow A 'Financial Regulatory Governance in South Africa: The Move Towards Twin Peaks' (2017) 23(3) *African Journal of International and Comparative Law* 396.

[436] Taylor MW 'The Road to "Twin Peaks" – and the Way Back' (2009) 16(1) *Connecticut Insurance Law Journal* 7.

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resources would be pooled and used harmoniously, instead of being utilized in a duplicating and overlapping manner, as is the case in the current institutional framework in Kenya.[437] Pooling and harmonization would result in economies of scale due to the regulatory consolidation that is involved.

The Twin Peaks approach has however been subject to some criticism. Critics doubt the possibility of a clear distinction between the various objectives of financial regulation, to wit, financial stability and consumer protection, arguing that these objectives are intertwined, and that in practice, both prudential and market conduct regulation would entail the assessment and evaluation of very similar facts and issues, that there would be significant overlaps between both, thereby negating any institutional set up that is built on an assumed separation of the two as different regulatory objectives.[438] However, it has been noted that following the GFC, there is now seemingly broad consensus that prudential regulation and market conduct regulation require different approaches to regulation, hence justifying the separation.[439]

5.2 Recommendations

As far as Kenya is concerned, the Twin Peaks approach provides an optimal regulatory model, because of its inherent strengths. It provides the most appropriate regulatory framework, in comparison to the other alternatives, that will ensure that the consumer protection essentials imposed by the applicable law are well implemented.

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The pertinent question that may arise would concern the role of the Central Bank in a Twin Peaks regulatory scheme in Kenya. It has been observed that state practice on this issue varies; while some countries place the Central Bank under the prudential peak, in others, the prudential peak is the responsibility of the Central Bank.[440] In others still, the Central Bank is a separate peak, apart from the prudential and market conduct peaks. It has been argued in this paper that the alternative, in which the Central Bank and prudential functions are discharged by the same

[437] Taylor MW 'The Road to "Twin Peaks" – and the Way Back' (2009) 16(1) *Connecticut Insurance Law Journal* 6
[438] Davies H & Green D *Global Financial Regulation: The Essential Guide* (2008) at 192.
[439] The Financial Services Authority *The Turner Review: A Regulatory Response to the Global Banking Crisis* (2009), at 87, available at http://www.fsa.gov.uk/pubs/other/turner_review.pdf (accessed 8 June 2018).
[440] Llewellyn D 'Institutional Structure of Financial Regulation and Supervision: The Basic Rules', Paper presented at a World Bank seminar Aligning Supervisory Structures with Country Needs, Washington DC, 6 and 7 June 2006, 26 (2006) 30.

http://etd.uwc.ac.za/

body, would be the best for Kenya under a Twin Peaks approach.[441] This is because, as is the case for other jurisdictions, Kenya would be able to harness the knowledge, skills and experience of the central bank in the performance of the prudential function. It would also be possible to minimise costs and personnel requirements, while averting the possibility of a complex supervisory structure that may in effect be a 'three-peak model' as is the case in Australia.

As has been indicated above, the legislative attempts that have been proposed to remedy the deficiencies in Kenya's financial regulatory engender some confusion as to whether they are complementary or alternatives. This is partly because between them, they establish enforcement authorities with overlapping functions. If both are enacted into law, there would be a semblance of twin peaks regulatory model, which will however be deficient in the sense that the regulators will not have clearly defined mandates, as they are likely to encroach in each other's terrain, especially as far as prudential regulation is concerned.

To remedy this situation, it is proposed here that both these legislative initiatives should be merged, so that there is a single bill that establishes two regulatory peaks, one for prudential regulation and the other for market conduct regulation. Having a single piece of legislation for all aspects of financial regulation would avert the risks of establishing two different entities under different laws that have the same functions. There will be room to specify and delimitate the functions of each enforcement authority even more clearly. The suggestion to merge these bills is, arguably, even the more suitable especially considering that both bills are still at the very nascent stages of the legislative process. Merging the bills at this early stage, and passing them as a single law that installs a twin peaks regulatory approach on the Kenyan financial landscape would avert the possibility of enacting different laws that would ultimately cause confusion and increase administrative and compliance costs because of the fact that they create bodies with overlapping functions.

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[441] Llewellyn D 'Institutional Structure of Financial Regulation and Supervision: The Basic Rules', Paper presented at a World Bank seminar Aligning Supervisory Structures with Country Needs, Washington DC, 6 and 7 June 2006, 26 (2006) 30.

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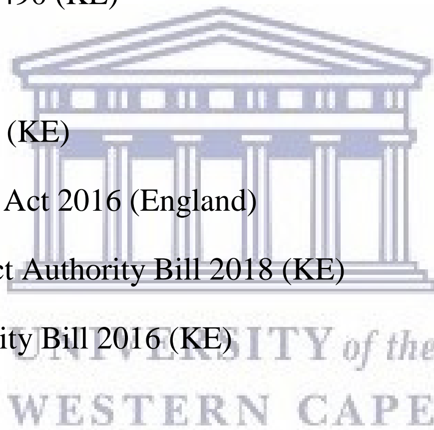
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