



## REGULATORY DEVELOPMENTS

### **KENYA**

#### CMA approves Derivatives Market

The Authority approved Nairobi Securities Exchange (NSE) to operate a derivatives exchange business in Kenya in October 2015. This is a final step towards confirmation of a provisional license that the NSE had earlier been granted in January 2015. The approval was granted after a comprehensive systems audit of the NSE's Derivatives infrastructure; corporate governance requirements including the establishment of a Derivatives Oversight Unit, among other requirements.

### **UGANDA**

#### Parliament Passes the CMA Amendment Bill 2016

In February 2016 the parliament of Uganda passed the CMA Amendment Bill 2016 which was a major milestone in the history of the capital markets in Uganda. The amendments will enable CMA successfully apply to become an appendix A signatory to the International Organisation of Securities Commissions (IOSCO) Multi-lateral Memorandum of Understanding (MMoU) on information sharing. Further to that the amendments also provide for recognition of the EAC laws, regulations and Council Directives which is a critical step towards facilitating the integration of the EAC capital markets.

### **BURUNDI**

#### Development of Laws and Regulations Establishing a Capital Market

With support from the East African Community (EAC) Secretariat, Burundi has since 2004 to date received technical assistance to develop an institutional, legal and regulatory frameworks to facilitate the establishment of a capital market in Burundi. The capital markets development process in Burundi is being spearheaded by the National Steering Committee. To date various reports have been produced with a policy document for the institutional framework set up, and three bills and twelve draft regulations for the legal and regulatory framework establishment. Work is already underway to take the draft policy, laws and regulations through the legislative process before adoption. The Banque de la République du Burundi is set to be a transitional Regulator of Capital Market.

### **TANZANIA**

#### Enactment of the Commodity Exchanges Legislation

The Commodity Exchanges Act was passed by the Parliament of the United Republic of Tanzania on 29th June, 2015 and the ensuing regulations were published in March, 2016. The promulgation of the commodity exchange regulations marked the major milestone on the operationalization of the commodity exchange in Tanzania.

## FEATURED ARTICLES

### **Outsourcing Public Education: Uganda's Experience**

Recognizing the limited financial and human resources to undertake a massive and effective public education campaign, the Capital Markets Authority (CMA) in Uganda has experimented with a strategy of out-sourcing the delivery of public education to individual resource persons. Initially where all the public education was delivered by CMA staff, some of this education is now done by individuals who are not only competent but also have a passion and experience in the capital markets.

This approach has enabled CMA-Uganda reach out to a wider public audience through face to face presentations on the investment opportunities in the capital markets industry. Through the many resource persons at their disposal a number of presentations can be simultaneously held at the same time which would not be possible if it just CMA staff conducting these presentations.

CMA-Uganda adopted this approach to public education in 2014. It recruited a total of 20 resource persons and within a period of 12 months CMA-Uganda had already reached out to over 9000 potential investors. This was a major fit for CMA-Uganda because this was a first in the history of the institution. By end of March 2016 over 13000 potential investors had been reached. CMA-Uganda targets to reach out to over 15000 by the end of June 2016. CMA-Kenya also launched the same initiative in Kenya in March 2016.

#### How does it Work?

The Authority prepares a standard presentation in consultation with the resource persons. This is to ensure that all the resource persons deliver the same message. However each resource person has the liberty to employ a different approach of delivery so long as the message is not distorted. The Authority then regularly updates the presentation in tandem with the developments in the market.

Each resource person is given a one year contract which is renewable based on their performance. To ensure quality of delivery CMA inducts the newly recruited resource persons and also has its staff seated in some of the presentations of the resource persons. An evaluation of the performance of each of the resource persons is also done by CMA.

#### Emerging Challenges and Lessons Learnt

While a wider investor base can be reached through this approach, the challenge of translating these into active investors still remains. The regulator can only educate the public about opportunities in the capital markets but they cannot close the transaction deals. This is the responsibility of the licensed market intermediaries. Therefore the regulators need to explore ways in which they can encourage the market intermediaries to be more active in reaching out to retail investors.

## **PRINCIPLE-BASED REGULATION AND ITS APPLICATION FOR ISSUANCE OF NEW PRODUCTS IN KENYA**

In financial markets, principle-based regulation (PBR) is a more flexible regulatory approach that uses a broad set of principles as opposed to detailed prescriptive and enacted statute or subsidiary legislation. The regulated entities are expected to decide how to most appropriately implement them in order to achieve the desired regulatory objective of enabling them to conduct their business activities, while ensuring that they stay within a stated borderline. PBR differs from rules-based regulation (RBR) which usually has a specific 'straitjacket' approach, leaving far less room for regulated entities to decide on the letter and spirit of the law.

Principle-based regulation (PBR) are Kenya's antidote to the legislative process in Kenya, as in most countries, which are long and subject to delays. Under the rules based regulation in Kenya, the Authority has to draft Regulations that need to be passed by the Cabinet Secretary before consideration of any new product or service. The introduction of the Statutory Instruments Act that requires all legislative instrument to be laid before Parliament, further elongates this process. Given the dynamism of the capital market and with an increasing number of potential issuers, it is evident that this legislative process discourages innovation thus restricting the growth of the market. Further, as the law is enacted before the product or service is introduced, where deficiencies in the law are identified, it also takes an inordinate amount of time to amend the legislation.

It is against this background that CMA Kenya introduced principle based regulatory oversight. of the Capital Markets Act

empowers the Authority to issue guidelines and notices as the Authority considers necessary for the better carrying out of its functions under the Act for the regulation of capital markets activities and products subject to the assessment of the extent to which they appropriately cater for efficient, orderly and fair operation of the segment, product or intermediaries, adequate provisions for risk management and controls on market misfeasance, the proper protection of investor interests and appropriate level of disclosure, and a facilitative environment for transparent operations.

The Authority has identified seven key principles which in summary include-

- i) The need to have the applicant for a principle based approval have the requisite financial resources, including adequate capital and liquidity to ensure that there is no significant risk that liabilities arising from the proposed service or product cannot be met as they fall due.
- ii) The need to have a description of the broad business strategy relating to the target product or service, its view of applicable key risks and intended approaches to measuring and managing the risks.
- iii) The need to maintain an availability of an appropriate level of professional expertise and identify the entities to perform professional duties in accordance with relevant laws, regulations, and technical standards. The applicant must also set out measures to be applied to ethically mitigate actual or potential conflicts of interest

- iv) The need to have an applicant of PBR have in place adequate Corporate Governance structures.
- v) The need to have documented policies and procedures (internal controls) to be adopted by all relevant players or participants in delivering the designated product or service.
- vi) The need to ensure fairness and to ensure that an applicant of PBR undertakes to deal with the regulator in an open and co-operative manner.

Whilst the principles set out the highest level outcomes the Authority is seeking to achieve, they are underpinned with further rules/assessment criteria to aid in evaluation of applications. The relevant, more detailed requirements are developed to supplement the above broad-based principles for each new product in order to ensure that there are no gaps.

PBR and RBR differ in that PBR is flexible as the PB guidelines are general and non-prescriptive, focus more on the outcome rather than the process followed and the Regulator and the regulated both agree on the interpretation of the principles unlike RBR where if a difference in interpretation arises, it is left to the Courts to decide on the interpretation of the provision. PBR also allows the regulator to respond efficiently and effectively to any issues that may arise. Under Rules based regulation, as long as an applicant can tick the boxes on the checklist they are considered eligible. However with PBR, an applicant is required to comply with broad guidelines that are fairly less stringent and more flexible as compared to the rules and therefore the likelihood of an application being rejected is relatively low.

#### Advantages of PBR include

- i) Flexibility and greater freedom regulated entities: This is because PBR is not prescriptive and gives the entities a wider scope to apply the principle, so long as they do not over-step the stated 'borderline'.
- ii) Flexible responsiveness by Regulator: The regulator is also able to address emerging risks in a timely manner.
- iii) Productive dialogue between the regulator and the regulated: In case there are aspects of the principle that are not clear, the regulated may seek clarifications or further interpretation, thus enhancing productive dialogue.
- iv) Scalability: Provisions of PBR can be scaled-up to cover a wider scope within a shorter time and through a less bureaucratic process than revision of rules and regulations.
- v) Robustness: PBR can be resilient, responsive and proactive especially when the financial markets landscape is dynamic.
- vi) Facilitation of innovation: When new innovations are introduced detailed and stringent regulation tends to obstruct their operationalization. PBR is more ideal in such circumstances, giving room for experimentation and managed risk taking.

#### Disadvantages of PBR include:

- i) Uncertainty and unpredictability: Given that principles usually have a wide application scope, they can sometimes leave room for uncertainty. The Regulator assesses each application with an emphasis on the risk that an applicant is exposed to therefore an applicant is unable to assess from the onset what may be

required from them. Also, different applicants undertaking the same service or issuing similar products may find that they are required to comply with different requirements based on their assessed risk management capacity thereby leading to queries relating to inequitable treatment. This risk is however minimized in that extensive engagement takes place between the regulated and the regulator before approval is given and therefore the rationale for the requirements a regulated entity is subjected to will have been agreed to before approval.

- ii) Supervision and enforcement more challenging: Given the wide scope and likely interpretation of a given set of principles, there usually are challenges on supervision and enforcement. However, as the principles get a more consistent application, these challenges are minimized.
- iii) Need for more informed regulatory staff with sufficient market knowledge to exercise risk based judgment which may ultimately not be sound resulting in failures and investor losses.

It is envisaged that eventually, and after allowing these products to get a foothold in the market, a comprehensive regulatory framework shall be developed to support their full operationalization incorporating the lessons learnt at their nascent stages.

## **TANZANIA'S CAPITAL MARKETS LANDSCAPE TRANSFORMED BY MWALIMU COMMERCIAL BANK (IN FORMATION) INITIAL PUBLIC OFFER (IPO) THROUGH USE OF MOBILE PHONE TECHNOLOGY**

The Initial Public Offer (IPO) of Mwalimu Commercial Bank information (MCB) was successfully finalized on 2<sup>nd</sup> September 2015. The MCB IPO marked a historic achievement in Tanzania's capital markets landscape by being the first one to utilize mobile telephone technology in mobilizing subscription for its shares.

The use of technology enabled the bank (in formation) to raise TZS 30.91 billion which is equivalent to 23.6% oversubscription and to comply with the shareholding structure for banking institutions. The IPO targeted raising TZS 25 billion in order to comply with the capital requirements for banking institutions in Tanzania. A total of 235,496 investors subscribed to the shares and eighty three (83%) of the new subscribers were retail investors from upcountry regions. All the subscribed shares have been allotted to the subscribers as the prospectus for the Bank IPO which was approved by the regulator Capital Markets and Securities Authority (CMSA) had provisions for oversubscription of up to 40%.

This milestone is the result of the CMSA's recognizing that Brokers of the DSE and banks that facilitate payments for purchase of shares are located in towns and major cities, while the majority of Tanzanians live in different regions, districts and villages in the country. In an effort to overcome the challenge, CMSA through its Five Year Strategic Plan for 2013/2014-2017/2018 planned and instituted a mechanism to facilitate investors to participate in the capital markets by using electronic

technology. By the end of 2014, the Authority realized its plan by putting in place the Capital Markets and Securities, Electronic Trading Guidelines, (2015). These guidelines have facilitated the functioning of a mobile telephone technology gateway solution that enables the purchase of shares using mobile phones and Maxcom Africa Limited (Maxmalipo) has been authorized to provide the services.

Equally significant are the initiatives taken by the Board of Directors and Management of Mwalimu Commercial Bank in Formation who had the ultimate objectives of raising capital and having shareholding structure that meet the regulatory requirements of the Bank of Tanzania and for a company raising capital from the public. The Capital Markets and Securities Act, 1994 requires promoters of a company with more than fifty members to prepare a prospectus to be approved by the CMSA. A prospectus is a document that provides important information to potential investors in terms of disclosure of material facts about the company, its management, business outlook and the principal risks involved in their business. The Management of Mwalimu Commercial Bank in formation and Consultants for Resource Evaluation Ltd (CORE), who are the Nominated Advisors licensed by the CMSA prepared the prospectus for offering to the public 50,000,000 ordinary shares at a price of TZS 500 each subsequent to which TZS 30.912 billion was raised from the public.

In addition to the attainment of the one of the goals of National Financial Inclusion Framework, the selling of shares of Mwalimu Commercial bank (in formation) facilitates the government's objective of increasing the number of companies which raise funds through the capital markets. This also

increases the number of participants in the formal economy in a transparent manner and in turn increases government revenue. The reason for this is that the law and regulations in the capital markets require companies operating in these markets to be transparent and to adhere to principles of good corporate governance. This enables such companies to operate more efficiently and since their financial statements are subjected to continuous disclosure requirements the government is expected to collect the correct amount of taxes and thereby increasing government revenue.

The barrier for prospective investors to access the capital markets in Tanzania now remains a history. Through the use of the mobile telephone investors can subscribe to issued shares during IPOs, place orders to buy or sell shares in the secondary capital markets (listed shares at the DSE) at their convenient time and place without making physical visits to the brokerage houses by just dialing \*150\*36# and then following instructions. Plans are underway to also enable investors to utilize the mobile telephone technology to subscribe to debt securities – corporate and government bonds that are listed at the DSE.

The listing of the Mwalimu Bank (in formation) at the DSE which is planned for 27<sup>th</sup> October 2015 will increase the number of companies that have issued shares to the public and list to twenty three (23) and increase the number of participants in the equity capital markets in Tanzania to about 435,000 from the current level of about 200,000 subscribers in the equity market.

Having more companies that have issued shares through capital markets will provide more opportunities to investors to buy shares of different companies and thus diversify the risk of investment. In addition, having more

## Annex I

companies and participants in the capital markets, facilitates increase in the level of savings, investment, employment,

government revenue and this in turn increases the level of social and economic development in the country.

The interpretations and conclusions do not necessarily represent the official views of EASRA. While every care has been taken in the preparation of this Newsletter, no representation, warranty or undertaking is given and no responsibility or liability is accepted by EASRA as to the accuracy of the information contained herein.

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