CAPITAL MARKETS AUTHORITY

Promoting the Integrity and Growth of the Capital Markets

The Capital Markets Soundness Report

Volume VI

Quarter 1. 2018

"Staying the course in a turbulent world of increasing protectionism"

In this issue...

SPECIAL MESSAGE FROM THE CHIEF EXECUTIVE

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

Welcome to the Sixth Edition of the Capital Markets Soundness Report (CMSR). I am happy to note that over the last six (6) quarters, the CMSR publication has served to contextualize major developments and occurrences in Kenya and beyond while highlighting the lessons and implications of those events for Kenya. The ultimate objective of the Report is to provide credible data to inform strategies on mitigating key risks affecting Capital Markets in Kenya and identifying the opportunities presented.

The Authority is honored by the growing pool of domestic and international stakeholders that are actively leveraging the data and analysis provided and proactively contributing insights to ensure the Authority provides comprehensive coverage of capital markets risk and stability issues from global, regional and domestic perspectives.

On behalf of the Authority, and our research team that drive this initiative, I wish to express my sincere gratitude for your support and engagement in enhancing the capital markets policy and legal environment towards greater efficiency in capital market operations and the impact of long term market based financing. As always, your readership and feedback on the publication is welcome.

Mr. Paul Murithi Muthaura, MBS
CHIEF EXECUTIVE

EDITORIAL

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

We welcome you to this sixth edition of the Capital Markets Soundness Report (CMSR), a publication covering the first (January-March) quarter of 2018.

This volume which is themed ***"Staying the course in a turbulent world of increasing protectionism"*** is inspired by global developments in the first quarter of 2018 that saw an increase in the threat and imposition of international trade barriers among major trading partners, particularly between the U.S. and China. Though they could be seen as bilateral tensions, these barriers could be a major risk to smaller economies as they navigate their way in international trade.

Globally, capital markets registered strong performance in the early part of Q1/2018. As the quarter progressed however, global markets tightened and became more volatile as the destabilizing potential of US inflationary pressure increased and with attendant rate adjustments, coupled with uncertainty on the risks to global trade loomed large. This reflected itself in the lower performance of global equity and bond indicators as the quarter came to a close.

Domestically, the market stabilized as it sought to shake off the "wait and see" sentiments from a pro-longed electioneering period. Equity turnover for Q1/2018 stood at KShs. 61.15 Billion, compared with KShs. 36.02 Billion registered in Q4/2017, a 69.77% increase. An 11.72% increase was also recorded in capitalization as the market rose in value to Kshs. 2,817.38 Billion in Q1/2018, compared to KShs. 2,521.77 Billion recorded in Q4/2017.

Overall, we are looking forward to a better year in 2018 as market turbulence ebbs away.

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

Q1. 2018 - Special Feature

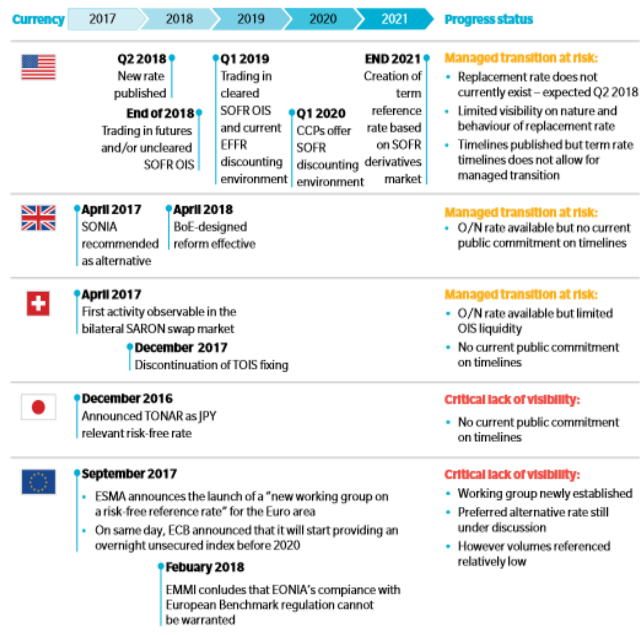
What Next after Libor?

In July 2017, the UK Financial Conduct Authority (FCA) reported that the London Interbank Offered Rate (LIBOR), will be phased out as the interest rate index used in calculating floating or adjustable rates for loans, bonds, derivatives and other financial contracts by the end of 2021.

In financial markets globally, it is estimated that the value of contracts referencing LIBOR is roughly $350 trillion[1] on a gross notional basis. LIBOR is quoted in five different currencies: Sterling; US Dollars; Euro; Swiss Francs; and Japanese Yen. Derivatives represent the largest proportion of market exposure when calculated on a gross notional basis. In the cash markets, the main financial instruments referencing LIBOR include floating rate notes, syndicated loans and bilateral corporate loans, term wholesale deposits, overdraft and trade finance facilities, covered bonds, capital securities, perpetual and securitizations, as well as retail and commercial mortgages. In this context, many of the financial instruments referencing LIBOR in the cash markets have a maturity date well beyond the 2021 transition period.

Given the outlook on LIBOR ceasing to be published[2], regulatory authorities have been working to encourage the market to move away from LIBOR to near risk-free rate benchmarks. Proactive engagement from authorities remains key noting the substantial market inertia in the use of LIBOR. So long as financial instruments referencing LIBOR benefit from a concentration of liquidity, the adoption of alternatives will be a challenging task.

LIBOR Transition Timeframe[3]



Implications

- The transition from LIBOR may result in considerable costs and risks for financial firms arising from proposed alternative asset pricing mechanisms for payments under LIBOR referenced contracts that are still in force;
- The transition will change firms' market risk profiles, requiring changes to risk models, valuation tools, product design and hedging strategies;
- LIBOR may become unavailable even though products referencing remains in force. These contracts typically include "fall-back provisions" which specify contract terms in case LIBOR is unavailable;
- Renegotiating a large volume of contracts would be difficult especially in the case when one party has a contractual right to windfall gain;
- Financial firms to work with regulators to influence the transition process and outcomes.

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[1] Bloomberg Business

[2] The Transition from LIBOR Paul Richards

[3] Libor Transition Oliver Wyman

- Transitioning away from LIBOR could create considerable conduct, reputational and legal risk.

Lessons for Kenya

Kenya's longer term sovereign and corporate syndicated as well as project financing structures, which in many cases use the LIBOR as a pricing benchmark, will likely be exposed to transition uncertainty and risk re-assessments.

Further, the choice of risk free benchmark adopted by the Kenyan Government and domestic institutions borrowing from the international financial markets will determine the level of efficiency on the cost of financing in comparison with the LIBOR and could potentially impact capacity to repay. This is likely to affect both conventional and non-conventional debt such as Sukuks.

New products being rolled out in the capital markets such as financial derivatives and hedging instruments that have traditionally relied on the LIBOR as a benchmark may also face valuation and settlement related challenges.

Other financial instruments that may be affected include Unit Trusts, Insurance Schemes and Pension Funds depending on the proportion of their portfolios allocated to their offshore investments asset classes.

In all the cases above, the Government and institutions should regularly monitor and assess the various risk-free rates available in the international market to inform decisions on which options would be optimal in terms of cost of financing, valuations and returns on investments, depending on their respective financial objectives. Providers of financial benchmarks should be monitored for compliance with International Organizations of Securities Commissions (IOSCO) Principles on Financial Benchmarks relating to governance (such as separation of roles and codes of conduct for submitters, administrators, index review oversight boards), historical market data retention policies, It may also be strategic to consider homegrown risk free asset pricing models.

Kenya has an opportunity to start building its own globally competitive benchmark rate that can stand the test of time, reliability. This can be done in consultation with key market stakeholders.

Q1/2018 Capital Markets Soundness

Overview – International Markets

i. Global Economy growth and prospects in 2018

According to the World Bank report, Global growth is projected to move up to 3.1 percent in 2018, as the cyclical momentum that picked in 2017 continues to gather pace. This growth is anticipated to slightly moderate to an average of 3 percent in the 2019-20 period.

Table 1: Real GDP growth rates for major world regions

	2015	2016	2017e	2018f	2019f	2020f
World	2.8	2.4	3.0	3.1	3.0	2.9
Advanced economies	2.2	1.6	2.3	2.2	1.9	1.7
EMs & DCs	3.6	3.7	4.3	4.5	4.7	4.7
East Asia and Pacific	6.5	6.3	6.4	6.2	6.1	6.0
Europe and Central Asia	1.0	1.7	3.8	2.9	3.0	3.0
Latin America and the Caribbean	-0.6	-1.5	0.9	2.0	2.6	2.7
Middle East and North Africa	2.8	1.5	1.8	3.0	3.2	3.2
South Asia	7.1	7.5	6.5	6.9	7.2	7.2
Sub-Saharan Africa	3.1	1.3	2.4	3.2	3.5	3.6

e – Estimate; f- forecast; EMs – Emerging Markets; DCs – Developing countries
Source: World Bank

Growth in advanced economies is expected to average 2.2 percent in 2018, as central banks gradually ease out of their post-crisis policy stance of stimulating demand. Growth in emerging market and developing economies is projected to strengthen to 4.5 percent in 2018, as activity in commodity exports continues to recover. In January 2018 for instance, commodity prices rose across-the-board, led by energy commodity prices including oil, which moved up by 9.2 percent.

Non-energy prices rose 3.3 percent. Raw materials price increased 2.8 percent, food prices 2.6 percent, and beverages 1.1 percent. Both base and precious metals prices rose more than 5 percent. The improvement in world GDP has largely been driven by rising demand from East Asia, which has been contributing to nearly half of global growth.

Opportunities for Kenya

- Being a commodity export dependent country, Kenya has an opportunity to leverage the prevailing global economic conditions to produce more and obtain favorable prices for its commodities which include coffee, tea and horticulture for higher GDP growth, better balance of trade and improved social welfare. Further, expedient enactment of the Petroleum (Exploration, Development & Production) Bill 2017, currently in the Public Participation Stage, prior to its Second Reading, may fast-track the implementation of the early oil pilot scheme project which could signal the commencement of commercial production of crude oil at improving prices. This could in the medium to long term improve Kenya's Balance of Payments deficit and lessen its debt burden.
- The Authority will continue to advocate for the speedy enactment of the Bill and facilitate the National Oil Corporation of Kenya (NOCK) in preparing for its scheduled Initial Public Offering (IPO) to be dual listed on the Nairobi Securities Exchange and the London Stock Exchange.

ii. Global Overview – Major Country-Specific Q1/2018 updates

1) The U.S.

In late March 2018, a trade war threatened to break out between U.S. and China, after the U.S. announced trade sanctions on China, including restrictions on investment and tariffs on $60bn worth of products. China reacted by indicating that it would take all legal measures to protect its interest if the US took actions that will harm both China and itself.

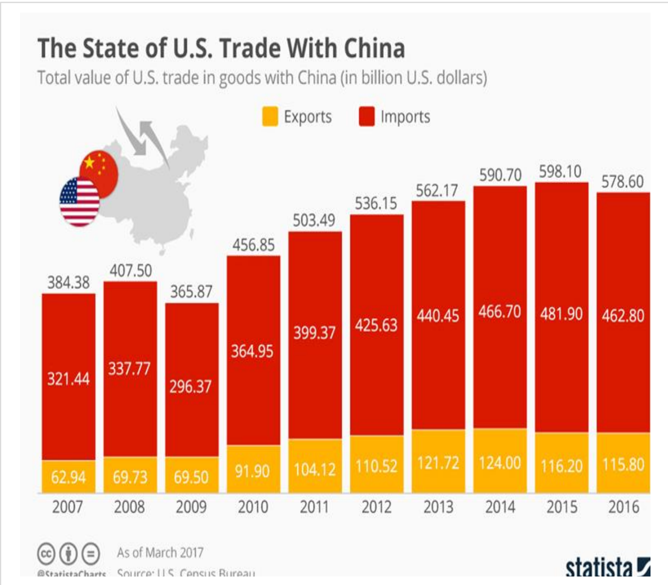
US Exports	US Imports
In 2017, China accounted for 10% of U.S. exports ranking third among all nations.	In 2017, China accounted for 22% of U.S. imports and ranked first among all nations.
Aircraft and parts - China ranked No. 1, with 13% of all U.S. exports. This is one of the export categories most often mentioned as an easy target for China, since it will affect Boeing and down-the-line manufacturers.	Cellphones. China accounted for 62% of all U.S. imports.
Motor vehicles. China ranked second, with 20% of all exports.	Computers. China accounted for 60% of all imports.
Motor vehicle parts. China ranked third, with 5.1% of the market. (Most go to Canada and Mexico).	Motor vehicle parts. China, ranked second, was responsible for 14% of the inbound total.
Computer chips. China ranked second, with 14% of all outbound shipments.	Computer chips. China, ranked third, accounted for 8.2% of the total.
Cellphones and related equipment. China ranked sixth, with 4.7% of the market. Hong Kong ranked first, with 13%.	Computer parts. China was behind 68% of the U.S. total.
Medical devices. China ranked fourth, with 9.2% of the market.	Furniture. China ranked first, with 48% of the total
Soybeans. China ranked first, with 57% of all U.S. exports.	TVs and computer monitors. China ranked first, with 47% of the total.

Source: www.forbes.com

The US sanctions were imposed after a reported seven-month investigation into China's infringement of copyright on use of technology. The U.S indicated that the imposition of tariffs was part of an effort towards fairness, noting that China imposes a 25% tariff on US cars while the US only has a 2.5% duty on Chinese cars.

During the early part of Q1/2018, the US equity market had registered a strong performance due to the country's overall strong economic performance, robust earnings and the confirmation of a major tax reform package.

As the quarter progressed however, the latter part of Q1/2018 saw a marked increase in volatility, with the Fed raising rates by 25 basis points (bps) in March 2018, to a range of 1.5% to 1.75%. Overall, the S&P 500 declined in the period. The weakest performance was in telecoms and consumer staples, although most sectors fell. Technology and consumer discretionary stocks were the only positive sectors over the quarter[4].



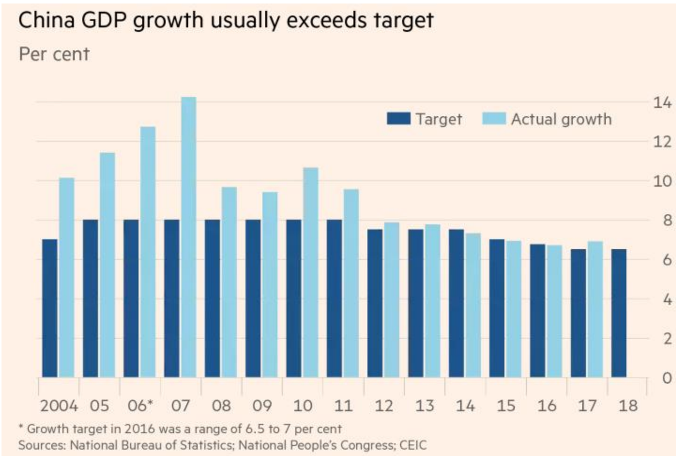
Lessons for Kenya

- The dynamic policy shift in US is likely to result in uncertainty in the trade arena if China opts to retaliate, further leading to ripple effects in world trade activities. It could impact bilateral trade between the two countries and their other existing trading partners depending on their respective decisions to review their existing foreign trading policies.
- Kenya should continue to monitor such developments and leverage opportunities while mitigating against threats. Both would be achieved through fostering increased intraregional and Pan African trade and ratification and implementation of the African Continental Free Trade Area Agreement amongst other policies.
- Noting that the increased tension between China and US may adversely impact global trade, Kenya should actively advocate for fair trade relations in line with World Trade Organization commitments.
- Policymakers need to actively work together to minimize trade barriers and resolve trade disagreements amicably thus avoiding an escalation of protectionist measures.

  In case of trade imbalances, measures that include product diversification, specialization and trade negotiations should be put in place.

2) China

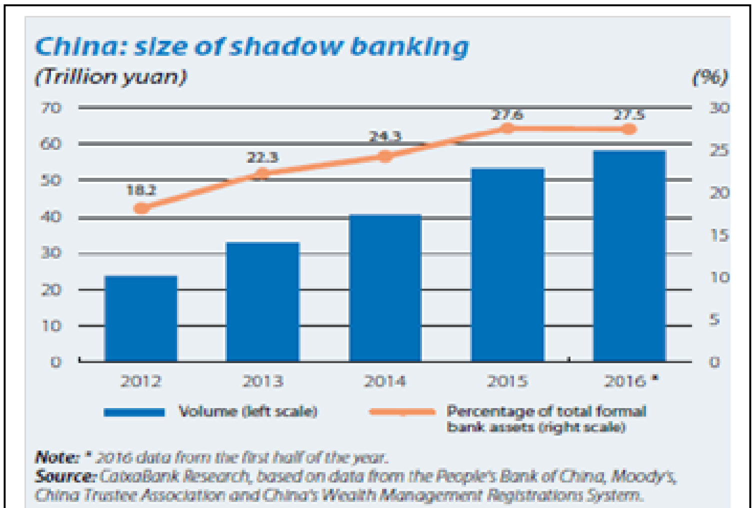
During the quarter, China announced that it is targeting an annual economic growth target of about 6.5 per cent for 2018, unchanged from last year. This signaled a policy focus on containing financial risk and economic welfare. The country also announced a lower fiscal deficit target of 2.6 per cent of gross domestic product, down from last year's 3 per cent target and the first year-on-year reduction of that goal since 2012.



[4] http://www.schroders.com/en/insights/economics/quarterly-markets-review---Q1-2018/

Shadow Banking in China and the need for reform [5]

Shadow banking refers to non-bank financial intermediation activities taking place outside the officially regulated banking system.[6] This process is done through non-bank financial intermediaries providing firms with loans in a manner similar to traditional commercial banking, but outside the traditional regulatory purview of Government. Shadow banking institutions do not receive traditional deposits like a deposit taking bank and therefore they have escaped most limits and laws imposed on the traditional banking system. Shadow banking in China emerged as a necessary alternative for Chinese businesses which were faced with Government imposed lending restrictions. These included limits on bank lending imposed by the People's Bank of China (PBOC), a cap of bank loans to deposits of 75 percent, and regulators discouraging loans to certain industries. China's shadow banking now accounts for 80 percent of its GDP, but it is far behind the United States where it is 150 percent of GDP.



In January 2018, the China Banking Regulatory Commission (CBRC) published regulations on its website that put limits on the number of commercial banks that single investors can have major holdings in. The rules are aimed at tackling "disorder" in the banking sector, including the abuse of rights by major shareholders and the prevalence of "invisible shareholders".

Also, in separate measures announced in the same month, the CBRC indicated that it would require firms to step up their risk management and disclosure around entrusted loans, a form of business-to-business financing.

Under the new commercial lender shareholding regulations, a single investor can hold 5 percent or more, of no more than two commercial banks, or a controlling stake of no more than one lender. Any stake purchase of more than 5 percent must be approved by the CBRC and major shareholders of commercial lenders cannot hold interests in the same institution via financial products.

The measures, which follow draft regulations released in November 2017, also require major shareholders to disclose their ownership structures up to the ultimate beneficial holder.

Lessons for Kenya

As institutions seek alternative sources of financing, it is critical for incumbent systems to develop innovative policy responses and interventions aimed at enhancing corporate governance, reducing costs and improving efficiencies to mitigate against the growing opaqueness and inefficiencies to remain relevant and competitive within the contemporary approaches.

3) UK

In February 2018, the European Union published the draft legal text that will form the basis for the Brexit treaty. The legal text included a fall-back option for Northern Ireland to remain in the customs union with a border between the province and the rest of the U.K. The text was rejected by

[5] Facilitating the creation of credit across the global financial system but not subject to regulatory oversight. The shadow banking system also refers to unregulated activities by regulated institutions.

[6] globalriskinsights.com

the British Prime Minister who indicated that if implemented, the provisions in the legal text would undermine the U.K. common market and threaten the constitutional integrity of the U.K. by creating a customs and regulatory border in the Irish Sea. In related developments, an initial agreement was struck on the terms of a transition period for the UK to formally exit the EU.

Economic forecasts by Bloomberg on UK's economic growth noted that Britain is set to lag all other European Union countries in 2018 and 2019, even under the assumption that Britain maintains the same trading relationship with the European Union bloc after Brexit. Growth is projected to slow to 1.4 percent in 2018 and to 1.1 percent in 2019, as reported by the European Commission in its economic forecast. The report further states that inflation is likely to squeeze incomes while uncertainty around the Brexit negotiations is weighing in on business investment.

The FTSE All-Share fell 6.9% over the period under review. Sentiment towards UK equities was relatively subdued as overseas buyers continued to shun the market amid ongoing political uncertainty and a weak outlook for economic growth. Despite these challenges, in its February inflation report, the Bank of England nudged up its growth forecast for 2018, from 1.7% to 1.8%.

Lessons for Kenya

Given Kenya's strong historical ties with the UK, decline in economic growth in the UK is likely to have adverse economic impact in Kenya, with demand for Kenya commodity exports such as coffee and tea among other exports to the UK expected to decrease, following decline in both consumer and fiscal spending. Additionally, Europe and Specifically UK ranking as one of Kenya's trading partners continues decline with China becoming the leading trade partner with Kenya as the largest source of imports.

According to the Economic Survey 2017 publication by KNBS Total exports to the United Kingdom, traditionally one of the major destinations of Kenya's exports, declined by 7.6 per cent to KShs 37.6 billion, accounting for 6.50% of the country's total exports as at the end of 2016 with Netherlands toppling the UK as the top export destination. Exports to the UK accounted for 7.00% of Kenya's total export in the previous year. Imports from the United Kingdom also recorded declines for the third year in a row to stand at KShs 33.5 billion in 2016 accounting for 2.34% of total imports compared to 2.72% in the previous year. Imports from China on the other hand accounted for 23.57% of total imports to Kenya as at the end of 2016.

The market share of trade with UK is likely to further shrink with slowed economic growth.

Against this backdrop the re-negotiation of post-Brexit trade deals should focus on devising new ways to maintain the current market share while identifying new avenues to expand trade.

4) EU

The Eurozone economy remained resilient over the three months. GDP growth for Q4 2017 was confirmed at 0.6% quarter-on-quarter. Unemployment was stable at 8.6% in January 2018. However, forward-looking surveys painted a picture of slower future growth.

Eurozone equities registered negative returns in the first quarter, with the bulk of the declines coming in March 2018. The region's stock markets began the year on a firmer footing, with concerns on US interest rates and the outlook for global trade leading to declines for the period overall. The worst performers in terms of sectors were healthcare and telecommunication services[7].

Lessons for Kenya

- There is growing contention by EAC member countries that slower expected growth in the EU is likely to further impact the EAC/EU Economic

[7] http://www.schroders.com

Partnership Agreement (EPA). The EU is the EAC's top trade partner for exports (25.3% of EAC exports go to the EU) and third partner for imports (12.5% of EAC imports). All in all, trade between both regions amounts to an estimated €6.8 bn.[8]

- Kenya should monitor and diversify its trade partnerships to cushion against any shortfalls resulting from decreased trade from EU.
- Similar to the threat of a possible US China trade war, the alternative would be to focus on intra Africa trade based on arrangements such as the African Continental Free Trade Area (AfCFTA) treaty that was signed on 21st March 2018 in Kigali, Rwanda.

Topical Global Risks

The Cryptocurrencies Risk- *Emergence of Initial Coin Offerings and Tokens*

Market excitement in cryptocurrencies has shifted to a debate on regulatory risk, given the borderless nature of transactions, the limited nature of supply, fears about the long-term value of fiat currencies in an era of quantitative easing and the allure of anonymity in conducting virtual currency transactions, among others.

As a Cryptocurrency, Bitcoin has experienced sharp value fluctuations, with its price trading at a high of about US$17,000 in early 2018, but experiencing a downward spiral thereafter with the price settling at US$6,926 at the end of March 2018. This volatility in price fluctuation remains a concern, even as regulators seek to strike a balance between managing the risks that accompany innovations and avoiding being an impediment to market led innovation. The debate is on as to the ideal regulatory perimeter within which these virtual currencies that use decentralized technology operate.

The Authority Vide a cautionary notice on 21st February,2018, warned investors against taking part in Initial Coin Offerings (ICOs), indicating that to date the Authority has not approved any ICO, taking the position that the ongoing offerings are unregulated and speculative investments with considerable risk exposure to the investor.

Some of the risks as identified by the International Organization of Securities Commissions (IOSCO) of which Kenya is a member include;

i. **Heightened potential for fraud:** While some ICOs are floated by entrepreneurs with genuine and innovative ideas for new products and services, there is a risk that some issuers could seek to perpetrate fraud against investors. Most ICOs operate solely over the internet – and the fact that the products and those selling them may in some cases not be subject to regulation, expose investors to fraud.

ii. **Cross-border distribution risks:** As the issuer may also be operating the ICO from outside the investor's jurisdiction, following the money in the event of a collapse of the ICO as well as recovering invested funds, may prove extremely difficult in practice.

iii. **Information asymmetry:** Due to their complexity and the uncertainty around the rights or interests that an investor may be acquiring, many retail investors may not be able to understand the risks, costs and expected returns and/or the drivers of risks and returns, arising from their investment. This hampers their ability to make informed investment decisions and increases the likelihood of adverse consumer outcomes.

iv. **Liquidity risks:** Like crypto-currencies in general, tokens traded on virtual currency exchanges (or

[8] The Economic Impact of the EU - East African Community Economic Partnership Agreement

over the counter) may give to opaque and volatile pricing, often coupled with insufficient liquidity to support reliable trading and market making activities. In some jurisdictions, the crypto currency exchanges may also be unregulated and operate without oversight. This can leave investors vulnerable to dramatic process changes and the possibility that they may not be able to exit their holdings.

Other risks may include;

a. Lack of proper definition of product scope.
b. Cryptocurrency do not have an attached security.
c. Lack of transparency given that some of the innovations were invented with the objective of avoiding regulation.

The Authority in the cautionary notice further noted its cognizance of the importance of FinTech and the benefits that can be derived from leveraging on Blockchain technology and indicated that its keen interest on working with interested parties through the regulatory sandbox model that is under development for the purposes of supporting innovative FinTech products in a controlled and safe environment.

Lessons for Kenya

i. There is need for regulators to devise a common approach towards handling issues revolving around Cryptocurrencies and Initial Coin Offerings. A joint work group by financial sector regulators could be put in place to tackle issues around cryptocurrencies/ICOs.

ii. An alternative approach would be creation a special unit that is an arm of all relevant regulators to deal with all issues aimed at regulating cryptocurrency.

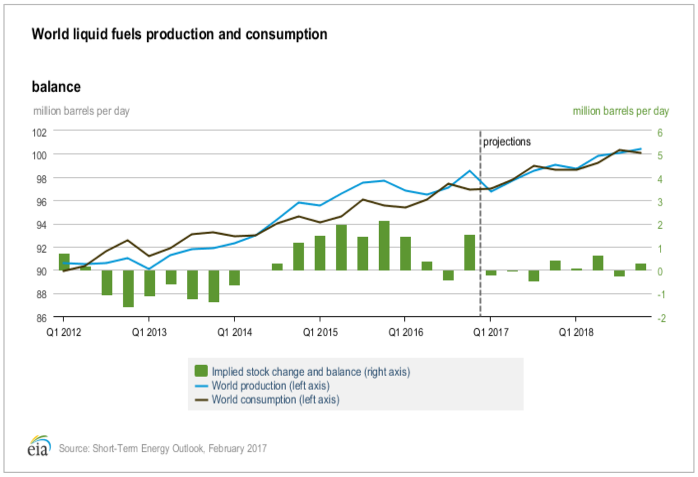
iii. Regulators need to communicate their willingness to accommodate FinTechs to the market to remove the perception that regulators are innately hesitant to appreciate new Fintech innovations.

iv. There is room to develop international regulatory principles for crypto assets including initial coin offerings (ICOs). The goal should be to harness the potential of the underlying technology, while ensuring financial stability and mitigating the risks from money laundering and terrorism financing. This has been advocated by IMF.

Surge in Global Oil Prices

Effective September 2017, global Oil prices have been on a general upward trend. The Organization of the Petroleum Exporting Countries (OPEC) led by Saudi Arabia and non-OPEC Russia reduced production during 2017-2018 to help in the recovery of oil prices. Rising U.S. shale oil production has been a drag on the OPEC's commitment to address a prolonged global oil glut, with the outcome of a meeting between U.S. shale firms and OPEC in March 2018 being awaited.

The International Energy Agency (IEA) has already indicated that the United States will overtake Russia as the world's biggest oil producer by 2019 at the latest, as the country's shale oil boom continues to alter the status quo in the global markets. The Organization of the Petroleum Exporting Countries, along with other exporters such as Russia, have agreed to maintain a joint restriction on crude supply for a second year running in 2018, to support prices.



An escalation of US military attack against Syria following its allegation of having broken international law established by the United Nations and the Geneva Conventions by deciding to use chemical weapons on rebels in the country and possible Russian and Iranian response to the strikes, could determine the direction of benchmark oil prices, but generally it is expected to maintain an upward trend.

Further, any hostility in the Middle East could restrict supplies further, with specific concern on the Strait of Hormuz in the Persian Gulf as a potential "choke point," where, if conflict occurs supply will be severely affected. Of concern too is the specific geo-political actions that the Syrian Government will take in response, these are considered high risk factors for oil traders.

Implications for Kenya

Coming into effect of the 16% VAT tax on petroleum in September 2018 in addition to persistent surge in oil prices could reduce Kenya's trade competitiveness due to increases in production and living costs.

This may lead to decline in revenues to the Government due to resultant decreases in volumes exported as well as local consumption contrary to the initial intention by the Government to increase revenues, reduce budget deficits and ultimately slow down debt accumulation.

Key Global Opportunities

Green finance

In 2016, Kenya became a signatory to the Paris Climate Agreement which became international law following the Marrakesh Climate Conference whose outcome was *The Marrakesh Action Proclamation*. This proclamation, is a call by heads of state and Government to show the highest political commitment to tackle climate change. It supports global unity and continued resolve on delivering the Paris objectives[9] and the transition to a global low-carbon economy. The proclamation is aligned to at least seven of the Sustainable Development Goals (SDGs) to which Kenya has ratified. Additionally, the Marrakech Pledge for ***"Fostering green capital Markets in Africa"*** involving 19 African capital markets regulators and exchanges (covering 23 African countries) and open to all countries from the South was launched in the conference. The pledge aims to enable the rapid, effective and efficient & innovative capital markets in Africa, with the view to allowing for a substantial increase in public savings and private capital flows towards low-carbon and climate-resilient investments, particularly in developing countries.[10]

Statistics by the Climate Bonds Initiative show that as at December 2017;

i. USD155.5bn – worth of green bonds have been issued;
ii. A record 1500+ issues have been done globally;
iii. 37 countries have participated in issuance with representation from all the 6 continents;
iv. 239 different issuers have been involved;
v. 146 new issuers entered the market in 2017
vi. There has been a rise in sovereign green bond issuance as characterized by three oversubscribed bonds in 2017 from Nigeria, Fiji and Mexico.
vii. The largest issuer was US Agency - Fannie Mae with USD24.9bn of labelled Green MBS – despite US withdrawal from the 2015 Paris Climate Agreement.

Lessons for Kenya

- Initiatives around re-forestation, improving water and waste management systems as well as

[9] An agreement within the United Nations Framework Convention on Climate Change (UNFCCC) dealing with greenhouse gas emissions mitigation, adaptation, and finance starting in the year 2020.

[10] http://marrakechpledge.com/the-pledge/

generation of sustainable energy among others aimed at tackling environmental challenges in Kenya could lend themselves well to green financing, creating an opportunity for Kenya to explore green finance issuance to attract strategic investors whose target investments meet the green criteria.

- Presently, the Authority is working in conjunction with the Nairobi Securities Exchange and the private sector to explore issuance of Green Bonds in the country as a way of tapping into a targeted class of investors, both domestic and foreign.
- Additionally, in February 9th, 2018, the Authority submitted a policy proposal to the National Treasury on tax treatment for green bonds. The proposal seeks the Government to extend the current tax exemption incentives on infrastructure bond to include the green bonds and the amendment of the Capital Markets Act to clearly define green bonds to aid the review and approval of green guidelines to be issued by the Nairobi Securities Exchange.
- The NSE has also proposed amendments to its listing rules to introduce a sub-segment for Green Bonds within the Fixed Income Securities Market Segment.

Fintech innovations in the Capital Markets Infrastructure Industry –World Federation of Exchanges (WFE) viewpoint

In a report by the World Federation Exchanges titled, "***Fintech Decoded- Capturing the Opportunity in Capital Markets Infrastructure***," a case is presented on the potential of FinTech innovations within the Capital Markets Infrastructure. The publication defines capital markets infrastructure (CMI) as an industry comprising of a global network of organizations that handle and safeguard the world's investments.

These organizations carry out the execution of trades, clear securities positions and settle payments, take custody of assets, and facilitate these functions with secure networks for transactions, communications, data analytics, and value-added services (e.g., regulatory services and corporate solutions). CMI providers (CMIPs) include traditional exchanges and alternative trading venues, interdealer brokers, broker-dealer trading platforms, providers of order management systems, central counterparties and clearing houses, securities depositories, and securities services firms.

An important opportunity, for both exchanges and independent firms, arises from information services, ranging from streams of data on market transactions and market indices via financial and economic news to advanced analytics that develop value-added information.

(a) The report identifies four FinTech themes shaping the CMI value chain, where some of the themes increase productivity and lower costs, while others generate new sources of revenue: The themes include; The use of **advanced analytics and artificial intelligence (AI)** is set for rapid growth, as the amount of available data circulating through capital markets grows, and amid increasing interest in the application of advanced analytics to market, financial, and economic data.

(b) **Distributed ledger technology (DLT)** is applied to a range of CMI operations. Use cases include clearing and settlement, alternatives to the traditional markets for access to capital (initial coin offerings [ICOs]), and new digital markets.

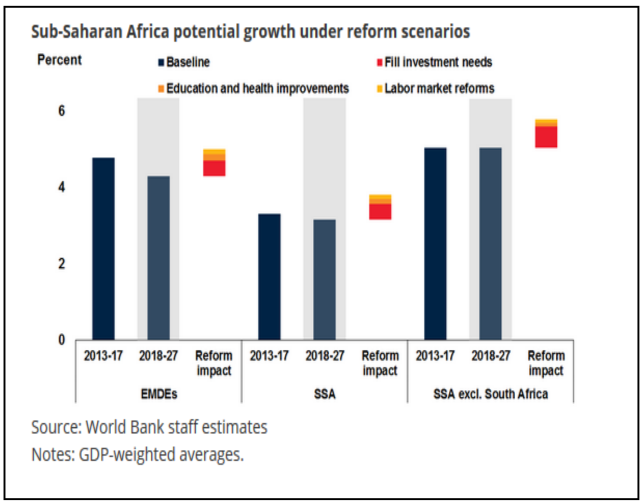
(c) FinTech will bring greater efficiency through innovative technologies such as **cloud and quantum computing**—for example, in the sphere of matching technologies—while driving depth in traded markets and expansion towards new asset classes.

(d) Post-trade services will gain in productivity through the application of **automation and**

robotics. A separate branch of regulatory tech firms (RegTech) will bring efficiency and uniformity to risk management and regulatory reporting.

Lessons for Kenya

a. There is an opportunity for Kenyan FinTech innovators to explore solutions that will provide efficient models of operation to solve limitations that characterize existing capital market infrastructure aimed at;
    - providing deeper access to capital, new assets and markets
    - providing an enabling environment/framework for issuers or interested parties to progress innovations such as crowdfunding offerings to raise debt and equity.



Source: World Bank staff estimates
Notes: GDP-weighted averages.

b. Fintech also presents a great opportunity for Capital Markets infrastructure providers to develop sophisticated systems for trade surveillance, risk and regulatory providers, fraud risk and anti-money laundering monitoring.
c. Capital Markets Infrastructure Providers locally including (NSE and CDSC) should consider the following three key elements as they embrace FinTech and formulate a Fintech Strategy for their existing business models;
    - Protect the core business from erosion
    - Modernize existing businesses
    - Capture new business opportunities through Fintech

Overview – Africa

Africa Outlook 2018

According to a recent publication by the World Bank[11], the global economic recovery will see economic conditions improving in Sub-Saharan Africa. As projected by the report, activity is expected to pick up across the region over the forecast horizon, helped by firming commodity prices and gradually strengthening domestic demand. This will be driven majorly by reforms within the investments, labor markets that is expected to drive investment trends and per capita incomes ultimately reducing poverty within the region. Downside risks abound, with the main ones being a possibility of tightening global financing conditions and fluctuating commodity prices.

On the upside, a stronger-than-expected pickup in global activity could further boost exports, investment, and growth in the region. An analysis by *Frontier Strategy Group*[12] indicates that Sub-Saharan Africa's (SSA's) growth will improve fractionally in 2018 driven majorly by greater currency stability in most markets, greater levels of investment, and the easing of drought conditions.

African Continental Free Trade Area - a new dawn

On March 20th, 2018, key leaders from the African continent signed a framework establishing the African Continental Free Trade Area - the largest free trade agreement since the creation of the World Trade Organization.

[11] World Bank

[12] A leading information and advisory services firm for emerging markets executives.

The free trade area aims to create a single market for goods and services in Africa. The Agreement envisions that by 2030 the market should have 1.7 billion people with over USD$ 6.7 trillion of cumulative consumer and business spending, should all African countries join the free trade area by then. Ten countries, including Nigeria, have yet to sign up.

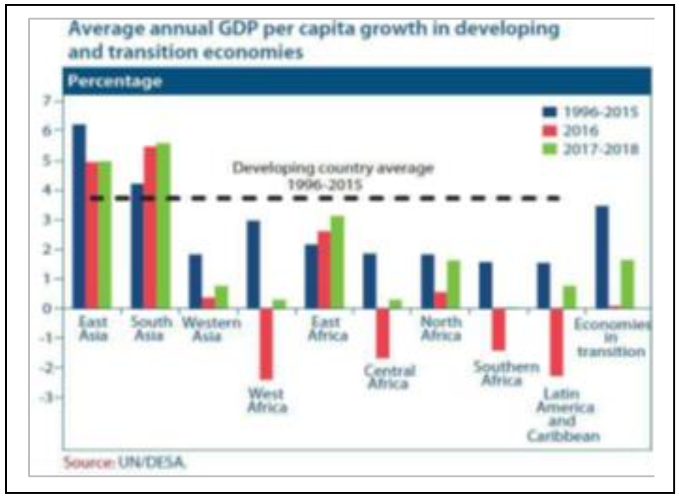
The continental free trade area is expected to offer substantial opportunities for industrialization, diversification, and high-skilled employment in Africa.

Southern Africa

In Southern Africa, growth is expected to average 2.3 per cent in 2018 and 2.5 percent in 2019, supported by increasing agricultural production. However, an infestation of armyworm might pose a substantial risk to the region's agricultural production. Additionally, investment is expected to remain subdued mainly due to political uncertainties, further constrained by a lack of reforms, an unfavorable institutional environment, and slowly addressed infrastructure gaps.

East Africa - a fast growth pace in Q1/2018

According to the World Bank, East Africa continues to host the fastest growing economies in Africa with an expected annual growth rate of 5.9 per cent in 2018 and 6.2 per cent in 2019. Ethiopia, Kenya, the United Republic of Tanzania and Uganda lead the growth performance of the sub-region with average growth of 6 per cent per annum, supported by infrastructure investments and an improving business environment. In Ethiopia, fiscal stimulus, foreign investment in infrastructure and manufacturing, diversification of the economy towards tourism and strong internal demand are anticipated to support growth.



Lessons for Kenya

i. Kenya to leverage on the Treaty to drive the achievement of the Big 4 agenda which could also widen its export market size for more rapid growth.

ii. The continental free trade area will additionally provide Kenya with a greater negotiating power to eliminate barriers to exporting its products to other African countries that are not members of EAC.

Kenya's Economy – Overview

Kenya's Growth Prospects

According to the National Treasury, Kenya's economy should rebound in 2018 after a slowdown in 2017 that was mainly caused by drought and political events during a prolonged election cycle. The National Treasury (TNT) opines that the economic growth could rise to more than 6 percent in 2018 and move towards 7 percent in the medium term. In 2017, TNT trimmed the 2017 growth forecast to 5.0 percent from a previous projection of 5.5 percent, which itself had been a reduction from an earlier projection of 5.9 percent.

Interest rate Cap review

According to International Monetary Fund, Kenya agreed to make adjustments in its economic policies including the possibility of scrapping the interest rates cap.

The issue however is undergoing debate and a formal decision is yet to be made on whether the interest rates will remain capped going forward.

Inflation rate

The Kenya National Bureau of Statistics (KNBS) released the official inflation statistics for the month of March 2018, with the rate of inflation standing at 4.18 percent, the lowest rate recorded since May 2013. This inflation rate is well within the country's target rate of 5%+/-2.2%. However, despite the favorable inflation levels, there have been public complaints on the cost of living, bringing to question, the composition of the basket of goods that make up the Consumer Price Index.

Kenya's Fiscal Consolidation

According to World Bank, Kenya should rethink its fiscal-consolidation plans to ensure that its economic growth rebounds from a five-year low reached in 2017. To achieve this the Kenyan Government should slow the rate of expansion of recurrent expenditure, improve spending efficiency, restore the potency of monetary policy and rationalize tax exemptions to ensure its resources are fiscally sustainable.

The budget deficit more than doubled to 8.9 percent of gross domestic product in the five years through June 2017. Indicatively, the National Treasury intends to trim the gap to 3 percent by 2021 by cutting spending mainly on development projects rather than recurring expenses, which took up almost 99 percent of national revenue in the fiscal first half through December. According to the World Bank, Kenya's debt is anticipated to reach 58 percent of GDP by end-June, from 40.6 percent in the 2011-12 fiscal year.

Impact on Kenya

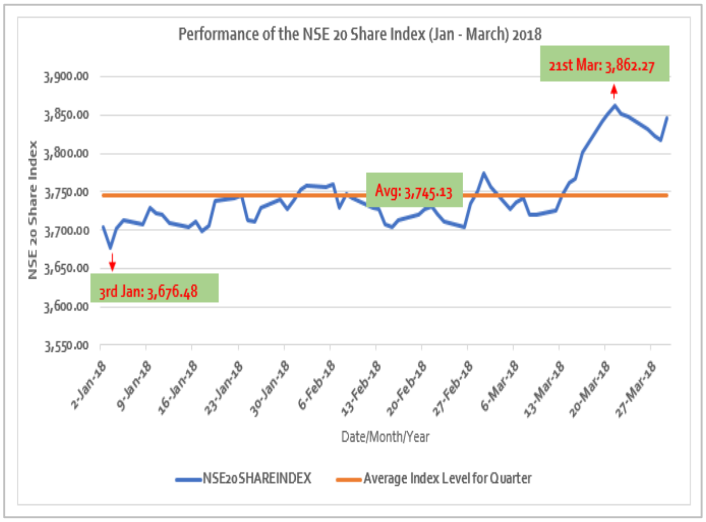
While improved economic activity is likely to push it towards the right path in realizing the Kenya Vision 2030, mechanical implementation of fiscal consolidation through expenditure cuts and tax hikes could impact adversely on public investment, ultimately economy's productive capacity and consumption negatively.

The Government should apply prudent spending and public investment management in order to stimulate the private sector's contribution to GDP even as it sets up a regulatory environment and incentive structure to facilitate the flagship infrastructure projects to achieve its Big 4 Agenda

Equity Market Performance & Stability

Domestic Market Stability

NSE 20 share index has been relatively stable, with intermittent fluctuations.



Source: NSE/CMA

Snapshot of Annual Market Performance

Year	Equity Turnover KShs. Bn	Share Volume (Mn)	NSE 20-Share Index	NSE All Share Index	Market Cap (KShs. Bn)
2013	155.75	7,665.92	4,926.97	136.65	1,920.72
2014	215.73	8,133.67	5,112.65	162.89	2,316.00
2015	209.38	6,812.14	4,040.75	145.70	2,053.52
2016	147.18	5,813.49	3,186.21	133.34	1,931.61
2017	171.61	7,065.36	3,711.94	171.20	2,521.77
2018*	61.15	2,138.45	3,845.34	191.23	2,817.36

As at March 2018

Equity turnover for Q1/2018 stood at KShs. 61.15 Billion, compared to KShs. 37.06 Billion registered in Q1/2017; a 65.00% increase confirming an increase in investor participation at the bourse. An increase of 48.73% was also recorded in end period market capitalization as Kshs. 2,817.38 Billion was recorded in Q1/2018 compared to KShs. 1,894.34 Billion recorded in Q1/2017.

Table 3: Secondary Equity Market Performance; Q1/2017/18

Month	Equity Turnover (KSHS. Bn)	Share Volume (Mn)	NSE 20-Share Index	Market Cap (KSHS. Bn)
Q1/2017				
Jan	12.04	571.27	2,789.64	1,770.30
Feb	12.57	650.01	2,994.53	1,810.39
March	12.45	636.02	3,112.52	1,894.34
End-period	**37.06**	**1,857.31**	**3,112.52**	**1,894.34**
Q1/2018				
Jan	20.34	862.16	3,737.27	2,266.047
Feb	17.92	567.98	3,750.75	2,677.81
March	22.89	703.60	3,845.34	2,817.36
End-period	**61.15**	**2,133.74**	**3,845.34**	**2,817.36**
% Change	**65.00%**	**14.88%**	**23.54%**	**48.73%**

Performance of Listed Companies

Price Gainers

Unga Group and Express Kenya: During the quarter, both companies submitted notice of intent for a takeover bid by Seaboard (US Company) and Diniz Holdings respectively.

Table 4: Top 10 Price gainers as at 31st March 2018

Counter	VWAP as at 31st Dec 2017	VWAP as at 31st March 2018	% Change
TOTAL(K)	23.50	32.75	**39.36%**
UNGA GROUP	29.00	40.00	**37.93%**
EQUITY	39.75	54.00	**35.85%**
BARCLAYS(K)	9.60	12.55	**30.73%**
EXPRESS	3.75	4.90	**30.67%**
KENOLKOBIL	14.00	17.55	**25.36%**
CO-OP	16.00	19.60	**22.50%**
NIC GROUP	33.75	41.25	**22.22%**
KCB GROUP	42.75	52.00	**21.64%**
CAR&GENERAL	21.00	25.00	**19.05%**

Source: NSE

Following official submission of the notices, trading in both counters was suspended temporarily. Trading has now resumed. The suspension of trades at the exchange as approved by the Authority is important to allow the market to respond to new information and then allow for market based price discovery in the case of uneven dissemination or leakage of information in the market giving rise to an unusual movement in the price or trading volume of the issuer's listed securities.

Total Kenya: Recently the company announced that it will take up 25 percent of Turkana oilfields, and also committed to the construction of the Lokichar - Lamu crude oil pipeline. Further, the company announced a First & Final dividend of Kes.1.30 on 29-Mar-2018.

Equity: The bank announced a number of corporate actions during the review period including; the appointment of Equity Group Chief Executive, Dr James Mwangi into the IFC Economic Advisory Board. Further, the Group recorded a 14 percent increase in profit amounting to Kshs 18.9 Billion. The Bank also embarked on an aggressive campaign of its online money transfer platform; Equitel that continued to increase its market share with transaction volumes growing by 11 percent to 251.6 million from 227.4 million Year on Year.

Price losers

Table 5: Top ten price losers as at 31st March 2018

Counter	VWAP as at 31st December 2017	VWAP as at 31st March 2018	% Change
UCHUMI	4.60	2.45	46.74%
KENYA AIRWAYS	17.15	10.85	36.73%
ARM CEMENT	13.00	8.25	36.54%
TRANSCENTURY	6.00	4.45	25.83%
NBV	3.35	2.50	25.37%
HOME AFRIKA	1.40	1.10	21.43%
DEACONS (EA)	3.50	2.85	18.57%
MUMIAS	1.10	0.90	18.18%
SAMEER	2.80	2.30	17.86%
STANDARD GROUP	37.00	30.50	17.57%

Source: NSE

Uchumi: Uchumi did not declare dividends after it declared pretax loss of Sh895 million in 2017, compared to Sh547 million previous year. The unaudited results to December 31, 2017 showed half year sales and other income at Sh527 million compared to Sh1.85 billion in 2016.

Bond Market Performance & Stability

Primary Market Performance

In the primary treasury bonds market, during Q1/2018, five (5) Treasury bonds were issued with an infrastructure bond offer of a 15-year amortized bond issue no. IFB 1/2018/15. There were five (5) tap sales during the quarter for each of the bond issuances[13].

During the quarter the Government sought to raise KShs. 120 Billion against which KShs. 131.30 Billion worth of bond applications were received with the Government only accepting KShs. 49.80 Billion worth of bonds (excluding tap sales), indicating a 37.93% acceptance rate. In addition, KShs. 55.55 Billion was raised from the five tap sales effected in the quarter resulting in a total of KShs. 105.35 Billion from the bond issuances. In a similar quarter in 2017, the Government had sought to raise KShs. 90 billion; KShs. 99.28 billion worth of bond applications were received, with the Government accepting applications worth KShs. 46.34 billion, indicating a 46.68% acceptance rate.

Table 6: Primary Treasury Bond Performance; Q4.2016/17

	BOND	Amt. Issued KSHS. Bn	Amt. Received KSHS. Bn	Amt. Accepted KSHS. Bn
Jan. 2018	IFB 1/2018/15	40.00	55.76	5.04
	Tap Sale		-	36.22
Feb 2018	FXD 1/2010/15	40.00	7.97	4.44
	Tap Sale			0.32
	FXD 2/2013/15		16.18	8.76
	Tap Sale			3.50
March 2018	FXD1/2018/5	40.00	37.65	23.07
	Tap Sale			7.74
	FXD1/2018/20		13.74	8.49
	Tap sale			7.77
Total		**120.00**	**131.30**	**105.35**

	BOND	Amt. Issued KSHS. Bn	Amt. Received KSHS. Bn	Amt. Accepted KSHS. Bn
Jan. 2017	FXD2/2007/15	30.00	-	-
Feb. 2017	IFB1/2017/12	30.00	35.03	6.00
March. 2017	FXD2/2014/5	30.00	31.33	12.96
	Tap Sale			7.65
	FXD3/2013/5		32.92	11.90
	Tap Sale			7.83
	MAB1/2017/3 (M-Akiba Bond)	0.15	0.15	0.15
Total		**90.15**	**99.43**	**46.49**

Source: CBK

During the quarter, it was noted that the Government accepted lower amounts during auction due to the receipt of bids at rates above the proposed issue coupon rates. The Government nonetheless sought to mop up the excess liquidity through tap sales in which it accepted higher amounts at lower rates than the rates at which the bonds had initially been issued.

An analysis of the Coupon rates vis-a-vis the average yield indicates that in January 2018 for instance, the average yield of the Infrastructure Bond (IFB) stood at 13.03% while that of the tap sale stood at 12.51% compared to its Coupon rate of 12.50%.

Table 7: Bond issuance and Tap Sale Rates for Q1/2018

Jan. 2018	
IFB1/2018/15	13.03%
Tap Sale	12.51%
Feb. 2018	
FXD1/2010/15	12.76%
Tap Sale	12.68%
FXD2/2013/15	13.00%

[13] A tap sale/issue allows borrowers to sell bonds or other short-term debt instruments from past issues. The bonds are issued at their original face value, maturity and coupon rate, but sold at the current market price.

Jan. 2018	
Tap Sale	12.91%
Mar.2018	
FXD1/2018/5	12.39%
Tap Sale	12.30%
FXD1/2018/20	13.42%
Tap Sale	13.34%

Source: CMA

Government has therefore managed to lower borrowing rates through leveraging tap over new issuance uptake.

Table 8: Secondary Bond market Performance; Q1: 2018/17

Month	Government Bond Turnover (KSHS. Bn)	Corporate Bond Turnover (KSHS. Bn)	Total Bond Turnover (KSHS. Bn)
Q1/2017			
Jan	31.19	0.17	31.36
Feb	20.10	0.10	20.20
March	52.07	0.36	52.43
TOTAL	**103.36**	**0.63**	**103.99**
Q1/2018			
Jan	38.72	0.04	38.76
Feb	64.49	0.33	64.81
March	37.49	0.03	37.52
TOTAL	**140.70**	**0.40**	**141.09**
Q1/2018/17 %Δ	**36.13%**	**36.15%**	**35.68%**

Source: NSE Monthly Reports

****March 2018 data as per CMA computations***

Major Market Risks

Equity Market Liquidity risk

In the quarter to March 2018, average quarterly equity market liquidity stood at 2.17 percent, compared to 1.43 percent registered in the quarter to December 2017, indicating a 0.74% increase in turnover ratio in the equities market mainly attributable to an almost double increase in turnover between Q1/2018 and Q4/2017.

Table 9: Market Liquidity Concentration in 2017/18

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

Source: CMA

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

Foreign Investor Exposure risk

Table 10: Equity Market Foreign Investor Exposure by Turnover as at March 2018

	Month	Foreign Investor Purchases	Foreign Investor Sales	Equity Turnover	
		KShs. Millions	KShs. Million	KShs. Millions	%
Q4 2017	Oct	7,042	6,556	9,390	72.41%
	Nov	8,142	8,592	14,760	56.69%
	Dec	7,575	7,793	11,867	64.75%
Q1. 2018	Jan	13,813	15,277	20,340	71.51%
	Feb	6,324	11,461	17,919	49.63%
	March	10,927	12,410	22,890	50.98%

Source: NSE

SGF Exposure Risk

SGF Ratio for the quarter to March 2018 averaged 0.84. The SGF ratio is computed as the ratio of SGF balance for the month to the average daily turnover. The quarterly average ratio therefore indicates that the balances were lower than the average daily turnover implying that the Guarantee Fund balances were insufficient to cover liabilities that would have arisen.

Table 11: Capital Market activity in East Africa

Indicator	Uganda	Tanzania	Kenya
	Q1/2018	**Q1/2018**	**Q1/2018**
Number of Shares Traded (million)	241.30	45.24	2,138.96
Turnover (USD Billion)	0.0067	0.088	0.61
Number of Deals	1,560	2,248	81,019
Market Cap (USD Billion)	8.26	10.32	27.94
Turnover Ratio	0.00081	0.0085	0.022

Indicator	Uganda	Tanzania	Kenya
All Share Index (Closing)	2,193.67	2,396.23	191.23
Exchange rate to the USD	3,645.45	2,230.07	100.85

Exchange rate as at 29th March 2018

Major Economic Developments

Kenya's Big Four Agenda and CMA's role

The Kenyan Government has already pronounced itself on the guiding policy in transforming the country's economy under the Big 4 Agenda that outlines four key sectors as priority areas for focus namely; **manufacturing, affordable housing, universal health care and improving food security**. Consequently, corporate entities - a key stakeholder in financing the Government's plan are expected to align their strategic goals with the Big 4 Agenda, as more public private partnerships are sought to ensure growth in the country's GDP.

The Authority has aligned its priority focus areas to include opportunities and potential for Government and related entities to raise funds to finance these projects through the Capital Markets.

On **affordable housing**, there is a clear opportunity for capital markets to work with the Government in leveraging on existing capital markets products such as Real Estate Investment Trusts to develop low-cost housing structures.

On **food security**, the capital markets provide an avenue through which licensed fund managers could structure funds to attract long term funds to invest in Agriculture.

On **health**, the Government could leverage capital markets to procure health equipment, build health infrastructure, procure medical supplies and purchase other infrastructure to support universal health.

Manufacturing could also be supported by capital markets through use of capital market instruments to raise capital for go-downs, seed capital for procuring manufacturing inputs and building distribution networks among others.

Proposed approach realization of Big 4 Agenda within the capital markets

Some of the specific areas to be considered in the capital markets to drive the Big 4 Agenda is through realignment of capital markets products and services. Suggested areas include:

- ✓ Tapping on Green Bonds and Financing to boost investments in Agriculture, Manufacturing and Infrastructure development;
- ✓ Repackaging Real Estate Investment Trusts and Asset Backed Securities to finance big ticket development projects touching on Agriculture, Housing and Health, while driving targeted public awareness;
- ✓ Activate use of Islamic Capital Markets Products and Services to support development projects;
- ✓ Tap on the Growth Enterprise Market Segment of the NSE through on-boarding SMEs within manufacturing and production sectors and to list.

In repackaging Capital Markets Products, focus should be on:

- ✓ Introducing the right incentives to entice commercial entities & private sector to take up the products;
- ✓ Removing of impediments to the realization of low cost housing through the capital markets such as levies & fees;
- ✓ Tapping on unused resources such as technology to reduce the cost of implementation of the Big 4 agenda items; and
- ✓ Stakeholders engaging with Ministries of Transport, Infrastructure, Housing and Urban Development; Ministry of Agriculture; and the Agriculture and Food Authority (AFA) to develop a joint facilitative environment to allow entry of capital markets players into their space

Feasibility of using block chain to spur growth agenda

During the quarter, the Ministry of ICT was directed to create a taskforce that will focus on how the country can leverage on Blockchain technology and artificial intelligence. This is seen as an opportunity for the country to further raise its profile as a leader in digital innovation in line with previous innovations such as M-Pesa and M-Akiba. The taskforce has a three-month period to come up with a 15-year roadmap and recommendations on how the Kenya Government could best leverage upcoming technologies. The roadmap will facilitate contextualization of the application of these emerging technologies in the areas of financial inclusion, cybersecurity and land registration among others.

Capital Markets Developments

i. Roundtable Discussions on Derivatives

The Derivatives Unit of the Authority has been undertaking various awareness and capacity building initiatives targeted towards key stakeholders in anticipation of successfully launching exchange traded derivative products in Kenya. To create awareness and promote coordination between regulators and policy makers, the Authority organized for a full day workshop on March 29, 2018.The workshop covered aspects relating to the following even as preparations towards a soft launch firm up;

- Legal, Regulatory & Rules framework
- Market Structure and Product Development
- Trading, Clearing, Settlement and Surveillance
- Risk Management Framework
- Compliance, Reporting, Audit & Inspection
- Derivatives Market Project Roll-Out Plan
- Role & Responsibilities of Derivatives Market Technical Advisory Committee

ii. CMA Licenses the First Online Forex Broker

During the quarter, on February 5, 2018, the Authority granted an Online Forex Broker License to Execution Point Limited. This is following from the Gazettement of the Capital Markets (Online Foreign Exchange Trading) Regulations, 2017 in 25th August 2017 compelling all Kenya's online currency traders, dealers and money managers are now compelled to obtain a license from the Authority to continue in the business. Additionally, this is line with the Authority's efforts to exercise a measure of regulatory oversight over online forex business to ensure adequate arrangements for investor protection.

Further, the Authority envisions that approximately 50,000 persons, including brokers, dealers and money managers, are in the business and are mainly using offshore platforms that are not overseen by Kenyan regulators to offer the service. The requirement for online traders, dealers and money managers to register with the Authority to conduct business are part of efforts to exercise a measure of regulatory oversight over online forex business to ensure adequate arrangements for investor protection.

iii. CMA on boards a Consultancy for implementation of the Hybrid Bond Market Kenya

With support from the World Bank under the patronage of the National Treasury, through the Financial Sector Support Project (FSSP), the Authority on-boarded Consultants to support the Authority implement the hybrid bond market model. The consultancy is expected to support in development/amendment of regulations, rules and guidelines for effective and transparent bond trading operations and oversight and to the best extent possible, develop approval/ licensing framework or requirements for recognition of an appropriate industry body to take up the role of a Self-Regulatory Organization (SRO) for Over the Counter bond transactions and act as a market coordinator/organizer.

Additionally, the consultancy will also include defining broad system requirements/ parameters for the OTC trading and reporting infrastructure / platform, including its interaction with the settlement systems and surveillance. Upon completion, the expected outcomes of the assignment include;

- Clear regulatory framework to support efficient OTC trading and reporting including a criteria and or licensing requirements for the approval of the market operators;
- Technical specifications or requirements for an appropriate e-bond trading and reporting platform including the parameters for facilitating regulatory functions of the Authority and ensuring efficient settlement;
- Capacity building programs for stakeholders, the Bond Market Steering Committee as well as the Authority;
- Support in operationalisation of the liquidity enhancing mechanisms such as Securities lending and market making; and
- A road map towards launch of the OTC market clearly detailing short, medium term to long term actions.

iv. Fintech and Regulatory Sandbox

During the quarter, with the support of Financial Sector Deepening Kenya, the Authority on boarded consultants to finalize the policy framework on a regulatory sandbox to support FinTech within the capital markets. The consultants will also be working in conjunction with the Authority's regulatory framework department to develop a policy guidance note for the introduction for a regulatory sandbox in the capital markets.

Additionally, the Authority with the facilitation of FSDK brought on board another consultant to conduct a landscaping study aimed at establishing the location and size and FinTech firms whose innovations are aligned with the Authority's regulatory sandbox initiative that aims to offer an incubating experience for firms with financial services sector innovations. These firms should have the potential to revolutionize how business is done in the country.

The findings from the study are expected to form the basis upon which the regulatory framework for the operation of the regulatory sandbox in Kenya will be developed.

Capital Markets Master Plan Implementation -

i. Business intelligence and shift to effective data collection and analysis

The Authority is currently working with a consultant to develop an information repository to enable the streamlining of the Authority's use of business intelligence through improved data collection and analysis and to strengthen internal capacity through e-learning. The contract for the consultancy was effected on 28th August 2017 and will run until 30th June 2018 aimed at developing specifications that would have Advanced Financial Analysis, Business Intelligence System, E-Learning System and Communication/IT infrastructure capability for the Authority. The consultant is currently collating inputs and suggestions from the Authority prior to recommending an implementation road map.

ii. Funding Gap Consultancy

In line with the project activities aligned to the funding gap consultancy aimed at determining Capital Markets products and services that can be used by sovereign and sub-sovereign entities in accessing funding from the Capital Markets, the Authority has made progress in the following areas;

- Review of a legal report by the consultant that identified legal gaps limiting access for funding by such entities.
- Following the successful end to the first phase that was targeting National Government Entities, the consultant has embarked on the second phase of field visits targeted at County Governments. The Authority has sampled 16 County Governments based on their historical performance on own revenue collections, expenditure patterns for both recurrent and development purposes, pending

bills as at end of financial year 2016/17 as well as alignment to the realization of the big 4 agenda as articulated by the National Government in its strategic blueprint on the same.

- Stakeholders keen on understanding ways in which the funding gap can be filled include; State Owned Enterprises, County Governments, Transaction Advisers, Investment Banks and potential issuers.

iii. Islamic Finance

Under the patronage of the National Treasury and in collaboration with the other financial sector regulators, the Authority, with the support of a consultant is in the process of laying the foundation of building a regulatory framework to support the operation of Islamic Finance in the country. Already, the initial anchoring law amendments have been done, with the outstanding deliverables now planned for the medium term.

Capital Market Stability Indicators (CMSIs)

	1.0 Stock Market Volatility							
Equity Market Depth	**Quarter/ Year**	**Statistics**				**Assessment of Risk Level (High – Medium – Low)**	**Performance Brief for the Quarter**	**Ongoing Intervention Measures**
NSE 20 Index Volatility Base Year = 2010	**Q1/2018**	**Jan**	**Feb**	**March**	**Q. Avg**	**Low (indicative - <10% high; >10% - low)**	• The NSE 20 Share Index volatility for the quarter ending March 2018 averaged **0.31%**, compared to **0.42%** recorded in quarter 4 2017, an indication of reduced volatility of the NSE 20 share index.	• To maintain low volatility, the Authority is pursuing measures aimed at increasing market liquidity introduction of market makers, Derivatives, Securities Lending and Borrowing, Direct Market Access among others.
		0.37%	0.27%	0.29%	0.31%			
	Q4/2017	**Oct**	**Nov**	**Dec**	**Q. Avg**			
		0.62%	0.36%	0.28%	0.42%			
	Q3/2017	**July**	**Aug**	**Sep**	**Q. Avg**			
		0.40%	0.58%	0.62%	0.53%			
	Q2. 2017	**April**	**May**	**June**	**Q. Avg**			
		0.49%	0.43%	0.29%	0.40%			
NASI Volatility Base Year = 2010	**Q1/2018**	**Jan**	**Feb**	**March**	**Q. Avg**	**Low (indicative - <10% high; >10% - low)**		
		0.43%	0.58%	0.37%	0.46%			
	Q4/2017	**Oct**	**Nov**	**Dec**	**Q. Avg**			
		0.39%	0.69%	0.42%	0.50%			
	Q3/2017	**July**	**Aug**	**Sep**	**Q. Avg**			
		0.27%	0.64%	0.71%	0.54%			
	Q2. 2017	**April**	**May**	**June**	**Q. Avg**			
		0.64%	0.65%	0.67%	**0.65%**			
Turnover Ratio	**Q1/2018**	**Jan**	**Feb**	**March**	**Q. Avg**	**Medium (indicative – annual: <8%-Low; >15% High)**	• A turnover ratio of **2.24%** was recorded in the reporting period compared to **1.45%** in quarter 4 2017 indicating slight increase in trading activity in the quarter. This could be	• The Authority is cognizant of the fact that despite the availability of regulation and an array of Capital Markets products and services for investments, there has been a low uptake of the said products, contributing towards the low turnover ratio.
		0.76%	0.67%	0.81%	2.24%			
	Q4/2017	**Oct**	**Nov**	**Dec**	**QTR**			
		0.40%	0.58%	0.47%	1.45%			
	Q3/2017	**July**	**Aug**	**Sep**	**QTR**			
		0.90%	0.65%	0.68%	2.23%			
	Q2. 2017	**April**	**May**	**June**	**QTR**			
		0.59%	0.70%	0.77%	2.06%			

							attributed to increased investor optimism following the conclusion of the election that heralded relative economic stability.	• As a proactive measure, the Authority is undertaking a study aimed at determining reasons behind the low uptake of Capital Markets products. This is to ensure that the Capital Markets Master Plan is aligned to meet market demands as well as seek convergence with market players on necessary interventions for deepening Kenya's Capital Markets in line with the aspirations of Vision 2030 aimed at making Nairobi an International Financial Center.
	2.0 Foreign Exposure Risk							
Foreign Investor turnover as a % of total turnover	**Q1/2017**	**Jan**	**Feb**	**March**	**Q. Avg**	**Medium (indicative – annual: <40%-Low; >90% High)**	• Average Foreign investor participation in the review period averaged at **57.37%**, a decrease of **7.25%** from **64.62%** recorded in the preceding quarter. This could be attributed to flow of funds towards Kenya's second Eurobond issuance whose yields were	• In addition to the Authority's initiatives towards increasing foreign investor activity in Kenyan markets such as introduction of inbound GDR/DN as well as scrapping off the 75% foreign investor cap on ownership of listed companies, it is also targeting retail and local investors to participate more in the markets by reaching out to the diaspora population as
		71.51%	49.63%	50.98%	**57.37%**			
	Q4/2017	**Oct**	**Nov**	**Dec**	**Q. Avg**			
		72.41%	56.69%	64.75%	**64.62%**			
	Q3/2017	**July**	**Aug**	**Sep**	**Q. Avg**			
		49.14%	57.05%	55.68%	**53.96%**			
	Q2. 2017	**April**	**May**	**June**	**Q. Avg**			
		72.41%	63.40%	57.94%	**67.91%**			

							attractive to most foreign investors.	potential investors to tap into the huge diaspora remittances earned from the diaspora community.
Net Foreign Portfolio Flow (In KES Millions)	**Q1/2017**	**Jan**	**Feb**	**March**	**Q. Sum**	**High (indicative – annual: <Kshs (50million) - High (outflow; >KShs. 50 million High inflow)**	• Net Foreign Portfolio levels for the quarter ended March 2018 amounted to a total outflow of **Kshs 8,084 Mn,** a **22,555.55%** decrease in net foreign portfolios from the previous quarter a confirmation of shift in funds from the exchange to possible investment in the second Eurobond issued by the National Treasury on 21st February 2018.	
		(1,464)	(5,137)	(1,483)	**(8,084)**			
	Q4/2017	**Oct**	**Nov**	**Dec**	**Q. Sum**			
		486	(450)	(218)	**36**			
	Q3/2017	**July**	**Aug**	**Sep**	**Q. Sum**			
		(2,054)	(3,268)	(5,799)	**(11,121)**			
	Q2. 2017	**April**	**May**	**June**	**Q. Sum**			
		433	(1,888)	(813)	**(2,268)**			
Market Concentratio n (Top 5 companies by market cap)	**Q1/2017**	**Jan**	**Feb**	**March**	**Q. Avg**	**High (indicative – annual: >50% High concentrati on)**	• During the quarter, the top five companies by market capitalization accounted for 67.21% of the market value on average, confirming the market's susceptibility to the performance	• The Authority is working with stakeholders such as the NSE, Privatization Commission and the National Treasury to promote big ticket parastatals that could be listed as a measure of diluting the influence of the top five companies by market capitalization at the NSE.
		66.45%	66.69%	68.50%	**67.21%**			
	Q4/2017	**Oct**	**Nov**	**Dec**	**Q. Avg**			
		65.94%	65.89%	64.96%	**65.60%**			
	Q3. 2017	**July**	**Aug**	**Sep**	**Q. Avg**			
		66.10%	66.19%	65.62%	**65.97%**			
	Q2. 2017	April	May	June	Q. Avg			
		66.04%	65.49%	66.04%	**65.86%**			

							of these few companies. • The top five companies include SAFARICOM, EABL, EQUITY, KCB and CO-OP being the predominant companies.	• The Authority is also working with other stakeholders including the National treasury and World Bank to build a pipeline for infrastructure and other projects through PPP to leverage the capital markets in Kenya. • The Authority is also reviewing its public offers regulations to identify regulatory roadblocks inhibiting small and medium enterprise companies from listing and raising funds from the exchange.
	3.0 Government Bond Market Exposure							
Treasury Bond market turnover Concentration	**Q1/2018**	**Jan**	**Feb**	**March**	**Q. Avg**	**High (indicative – annual: >50% High concentration)**	• The Treasury bond market remains dominant in the Kenyan bond market, accounting for an average of 99.71% during the quarter; indicating an increase of 0.93% compared to the preceding quarter.	• Despite the challenges surrounding KDIC and bond investor compensation, the Authority is, through the Bond Market Steering Committee (BMSC) actively pursuing the expansion of the Kenyan bond markets.
		99.91%	99.57%	99.66%	**99.71%**			
	Q4/2017	**Oct**	**Nov**	**Dec**	**Q. Avg**			
		98.39%	98.10%	99.95%	**98.81%**			
	Q3/2017	**July**	**Aug**	**Sep**	**Q. Avg**			
		99.97%	97.68%	99.93%	**99.19%**			
	Q2. 2017	**April**	**May**	**June**	**Q. Avg**			
		98.84%	98.40%	99.01%	**98.75%**			
Corporate Bond Market ownership	**Category**	**No of Investors**	**Amount Outstanding (Mn)**	**% of total outstanding**		**High (indicative – annual: >50% High**	• Local Corporate bond investors were the leading investors in	

	Local Investors 4,712 72,064.26 98.85% **East African Investors** 21 183.68 0.25% **Foreign Investors** 115 692.45 0.90% ***Source: CDSC Data as at September 2017***	**concentration**	corporate bonds at 99.10% of amounts outstanding, while foreign bond investors held 0.90% of total corporate bond holdings.	
	4.0 Investor Profiles - Equity Market			
Equity Market	**Type of Investor** / **2015** / **2016** / **2017** / **2018** E.A. Institutions (%) 65.68 66.38 68.36 68.43 E.A. Individuals (%) 12.84 12.49 11.47 11.64 Foreign Investors (%) 21.48 21.13 20.17 19.93 **Source: CMA- *Data as at February 2018**	**High (indicative – annual: >50% High concentration)**	• Local investors, a sum of East African institutional and individual investors accounted for **80.07%** of shares held in the equity market with **19.93%** being held by foreign investors.	• To attract local investors, the Authority is targeting corporate and retail investors by conducting investor education initiatives to demystify the capital markets as a safe investment option for long term investment as opposed to short-termism.
	5.0 Investor Compensation Coverage			
Settlement Guarantee Fund (SGF) Coverage Ratio[14]	see table below	**Medium (indicative – annual: > 1 times, implies full coverage)**	• SGF Ratio for the quarter to March 2018 averaged 0.84. This is an indication that the Guarantee Fund balances are insufficient to cover liabilities	• Through Risk-based supervision, the Authority has been monitoring the SGF figures and the financial position of the firms to ensure that they are in good standing and that investors are protected.

Q1/2018	**Jan**	**Feb**	**March**	**Q. Avg**
	0.87	**0.91**	**0.76**	**0.84**
Q4/2017	**Oct**	**Nov**	**Dec**	**Q. Avg**
	1.58	**1.12**	**1.21**	**1.30**
Q3/2017	**July**	**Aug**	**Sep**	**Q. Avg**
	0.75	1.06	1.00	0.93
Q2. 2017	**April**	**May**	**June**	**Q. Avg**
	1.15	1.03	0.87	**1.02**

[14] **Source: CDSC**

							that would arise following default by securities brokers.	
	6.0 Asset Base of Fund Managers, Stockbrokers, Investment Banks							
Assets Under Management	**As at 28th February 2018 (Amount in KShs Millions)**					**Medium (Indicative – the higher the figure, the more stable is the market)**	• The total Asset Base of Fund Managers, Stockbrokers, Investment Banks and Investment advisers as at 28th February 2018 was Kshs 7.95 Billion, 3.17 Billion, Kshs.11.64 Billion and Kshs 1.22 Billion respectively.	• The Authority continuously monitors asset levels of its licensees to ensure accurate reporting of assets and liabilities and monitoring sufficiency of liquid capital to monitor potential bankruptcy of licensees.
	CMA Licensee	**Total Assets**	**Total Liability**	**Net Assets**				
	Fund Managers	7,948.50	1,576.01	6,372.49				
	Stockbrokers	3,165.12	929.94	2,235.18				
	Investment Banks	11,637.92	3,505.56	8,132.36				
	Investment Advisors	1,221.87	83.00	1,138.87				

Source: CMA/CDSC/NSE

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