



Circular No.06/2024

June 13, 2024

TO: ALL ISSUERS OF SECURITIES TO THE PUBLIC AND CAPITAL MARKETS INTERMEDIARIES

RE: CLARIFICATION ON KEY GOVERNANCE ISSUES FOLLOWING GAZETTEMENT OF THE CAPITAL MARKETS (PUBLIC OFFERS, LISTINGS AND DISCLOSURES) REGULATIONS, 2023 AND THE CAPITAL MARKETS (COLLECTIVE INVESTMENT SCHEMES) REGULATIONS 2023.

The Authority is committed to ensuring the effective functioning of the capital markets through protection of investor interests and supporting the development of a robust and transparent securities market in Kenya.

To achieve this objective, the Capital Markets (Public Offers, Listings and Disclosures) Regulations, 2023 (hereinafter referred to as POLD Regulations, 2023) and the Capital Markets (Collective Investment Schemes) Regulations, 2023 (CIS Regulations, 2023) were gazetted on 15th December 2023 and acceded to by the Delegated Committee of the National Assembly on April 19, 2024. In line with section 23 (1) of the Statutory Instruments Act, the POLD and CIS Regulations, 2023 and became effective upon gazettelement on 15th December 2023.

Since the Regulations came into force, some provisions have been highlighted that we deem require guidance to ensure clarity in their interpretation and application.

For greater clarity, the Authority hereby offers the following guidance to ensure that stakeholders and the general public have a clear understanding, interpretation and applicability of those key provisions.

1. VALIDITY OF THE CODE OF CORPORATE GOVERNANCE PRACTICES FOR ISSUERS OF SECURITIES TO THE PUBLIC 2015.

Paragraph 8 of the Thirteenth Schedule to these Regulations states that "Every issuer shall comply with the Code of Corporate Governance Practices for Issuers of Securities to the Public, 2015 issued by the Authority and as may be amended from time to time and any other codes as may be prescribed by the Authority for specific issuers or segments."

See extract below of Paragraph 8 of 13th Schedule;

8.	Corporate Governance
8.1.	Every issuer shall comply with the Code of Corporate Governance Practices for Issuers of Securities to the Public, 2015 issued by the Authority and as may be amended from time to time and any other codes as may be prescribed by the Authority for specific issuers or segments.

In order to entrench the Code and ensure that there are no doubts as to its enforceability, the above provision is drafted in a mandatory language i.e. *shall comply*. Therefore, the debate surrounding mandatory versus voluntary requirements in the Corporate Governance Code has been settled with the coming into force of the POLD Regulations, 2023.

Further, it envisages amendment or development of specific Codes applicable to various issues for instance SME-specific Code.

This addresses the concern that Regulation 92 of the POLD Regulations, 2023, which revoked the Capital Markets (Securities) (Public Offers, Listing, and Disclosures) Regulations, 2002, automatically revoked the Code of Corporate Governance Practices for Issuers of Securities to the Public 2015.

The Authority shall review and harmonize the Code of Corporate Governance with the POLD Regulations 2023 to ensure consistency and coherence between the two frameworks. This alignment will facilitate smoother implementation, reduce potential regulatory conflicts and enhance the clarity and effectiveness of governance practices for issuers. In the interim, where there is any conflict between the POLD Regulations 2023 and the Code of Corporate Governance provisions, the POLD 2023 provisions takes precedence.

2. INDEPENDENT DIRECTORS AND NON-EXECUTIVE DIRECTORS

2.1. Independent Directors

Under the previous Capital Markets (Public Offers, Listings and Disclosures) Regulations of 2002, the definition of an independent director closely mirrored that which is outlined in the newly Gazetted Capital Markets (Public Offers, Listings and Disclosures) Regulations of 2023 as well as the provisions in the Code of Corporate Governance for Issuers of Securities, 2015.

However, Regulation 2 of The POLD Regulations, 2023 defines an independent director to mean “a member of a board of directors who is not an executive director, does not have a material or pecuniary relationship with the company or related persons, is compensated through sitting fees or allowances and does not own shares in the company, provided that after six years of continuous service as such director, such person shall no longer be considered as an independent director.”

The primary distinction between the two versions lies in the duration of service permitted for independent directors. Specifically, while under the previous regulations, independent directors were allowed a continuous tenure of nine years, the revised regulations limit this period to six years. Upon the completion of the specified term, the individual in question transitions from the role of an independent director to that of a non-executive director.

While the initial draft put on public exposure had sought to retain the maximum tenure of 9 years, stakeholders' feedback was that this should be limited to a tenure of maximum 5 years. Following further analysis, and especially considering the domestic governance dynamics, the maximum tenure of independent directors was settled at 6 years. This is fully aligned with *Mwongozo* which provides a term of 3 years renewable once for a final term of 3 years for directors in public entities.

It is however important to note that companies have the option to retain an independent director after the six-year period of service, but such a director will have to be re-designated as a non-executive director.

The Authority confirms that to ensure smooth transition of the new Regulations, the provision on term of Independent Directors shall apply prospectively to only new appointments. The existing Independent Directors whose letters of appointment indicate they shall serve for nine (9) years as per the old Regulations, shall continue to serve as such.

2.2. Non-Executive Directors

Regulation 2 of the POLD Regulations, 2023 defines a non-executive director as "a board member of a company who is not an executive director and is not an executive director or employee of a related entity".

This implies that non-executive directors cannot have a formal day-to-day responsibility in another company/entity that is closely connected or affiliated with the issuer where they serve as a non-executive director.

The rationale behind the non-involvement of a non-executive director in the day-to-day management of the company and their exclusion as an executive director or employee of any related entity is to uphold independence and objectivity. By avoiding direct involvement in operational matters or affiliations with related entities, non-executive directors are positioned to offer impartial oversight and counsel. They introduce novel viewpoints and operate in the company's and shareholders' best interests, devoid of influence from personal or professional connections within the group. This practice serves to uphold transparency, accountability and robust governance standards within the issuer.

Moreover, by excluding individuals who are executives or employees of related entities from serving as non-executive directors, the company reduces the risk of real or perceived conflicts of interest. For example, a non-executive director who also serves as an executive director or employee in a parent, sister or subsidiary company may have loyalty divided between the related company and the issuer potentially compromising their ability to act in the best interest of shareholders. In addition, this could lead to a lack of impartiality in decision-making as their allegiance might lean towards the broader corporate group rather than the specific issuer they are meant to oversee. This helps maintain the integrity of the board's decision-making process and enhances trust among shareholders and other stakeholders. This approach ensures a judicious balance between safeguarding against conflicts of interest and capitalizing on diverse expertise and perspectives within the boardroom.

It is however important to note that the definition of non-executive directors does not exclude appointment of non-executive directors who are independent non-executive directors or non-executive of related entities.

2.3. Executive Directors

Regulation 2 of the Capital Markets (Public Offers, Listings and Disclosures) Regulations 2023 defines an Executive Director as member of a board of directors of a company who also serves as a manager in the company. This implies that an Executive Director not only participates in the strategic decision-making process as part of the board but also takes on day-to-day operational responsibilities ensuring the effective management and execution of the company's business activities. Their deep involvement in the daily operations allows them to provide valuable insights and feedback to the board enhancing the overall governance of the company.

3. INDEPENDENCE OF FUND MANAGER FROM CUSTODIAN OR TRUSTEE

Regulation 12(1) (a) (i) of the CIS Regulations, 2023 requires the fund manager to maintain independence from the trustee and custodian. This stipulation necessitates the fund manager to operate autonomously from both the trustee and custodian entities, ensuring impartiality and preventing conflicts of interest in the management of investment funds.

Regulation (12) (1) (c) (i) and (ii) of the above-mentioned Regulation states that "the fund manager, trustee and custodian are each a body corporate licensed and incorporated in and with its registered office in Kenya." This stipulation underscores the necessity for the entities overseeing collective investment schemes to be distinct, legally acknowledged, and subject to The Capital Markets (Collective Investment Schemes) Regulations, 2023 all while operating within Kenya's jurisdiction. Nonetheless, Regulation (12) (3) of the aforementioned regulations incorporates a clause permitting the trustee and custodian to be a single entity, under the condition that the said entity can substantiate to the Authority that conflicts of interest are sufficiently addressed, alleviated and mitigated.

Further, please note to comply with Regulation 171 (1) and (2) of the Capital Markets (Collective Investment Schemes) Regulations, 2023 which stipulates that all collective investment schemes registered and operating under the previous regulations must undergo transition within twelve (12) months from the commencement date of the regulations.

The Authority hereby provides clarification to eliminate any ambiguity and/or uncertainty, emphasizing on the unique identity of each entity involved and the impartiality required from all stakeholders within the collective investment scheme. Emphasizing the significance of independence for each entity, the above directive underscores its pivotal role of Capital Markets Authority, Kenya in advancing equity, transparency, and compliance with legal norms in the management of investment funds within the jurisdiction of Kenya.

This guidance underscores the pivotal role of the Capital Markets Authority, Kenya in enhancing transparency, promoting compliance, fostering trust, protecting investors interests and facilitating effective and good governance practices amongst the issuers of securities to the public in Kenya.

Kindly ensure compliance and do not hesitate to contact the Authority in case of any further clarification through issuergovernance@cma.or.ke in case you require further clarification/guidance.



FCPA. Wyckliffe Shamiah,
CHIEF EXECUTIVE OFFICER

