CISI
CHARTERED INSTITUTE FOR
SECURITIES & INVESTMENT

CAPITAL
MARKETS AUTHORITY

fsdafrica

Regulations and Market Practice (Kenya)

Edition 1, May 2016

This learning manual relates to syllabus version 1.0 and will cover exams from **21 August 2016 to 20 August 2018**

CHARTERED INSTITUTE FOR SECURITIES & INVESTMENT

APPROVED WORKBOOK

Welcome to the Chartered Institute for Securities & Investment's Regulations and Market Practice (Kenya) study material.

This manual has been written to prepare you for the Chartered Institute for Securities & Investment's Regulations and Market Practice (Kenya) examination.

Published by:
Chartered Institute for Securities & Investment

8 Eastcheap
London
EC3M 1AE
Tel: +44 20 7645 0600
Fax: +44 20 7645 0601

Email: customersupport@cisi.org
www.cisi.org/qualifications

Author:
Kevin Rothwell, Chartered FCSI

Reviewers:
Staff at the Capital Markets Authority

A learning map, which contains the full syllabus, appears at the end of this manual. The syllabus can also be viewed on cisi.org and is also available by contacting the Customer Support Centre on +44 20 7645 0777. Please note that the examination is based upon the syllabus. Candidates are reminded to check the Candidate Update area details (cisi.org/candidateupdate) on a regular basis for updates as a result of industry change(s) that could affect their examination.

The questions contained in this manual are designed as an aid to revision of different areas of the syllabus and to help you consolidate your learning chapter by chapter.

Learning manual version: 1.3 (June 2016)

Learning and Professional Development with the CISI

The Chartered Institute for Securities & Investment is the leading professional body for those who work in, or aspire to work in, the investment sector, and we are passionately committed to enhancing knowledge, skills and integrity – the three pillars of professionalism at the heart of our Chartered body.

CISI examinations are used extensively by firms to meet the requirements of government regulators. Besides the regulators in the UK, where the CISI head office is based, CISI examinations are recognised by a wide range of governments and their regulators, from Singapore to Dubai and the US. Around 50,000 examinations are taken each year, and it is compulsory for candidates to use CISI learning manuals to prepare for CISI examinations so that they have the best chance of success. Our learning manuals are normally revised every year by experts who themselves work in the industry and also by our Accredited Training Partners, who offer training and elearning to help prepare candidates for the examinations. Information for candidates is also posted on a special area of our website: cisi.org/candidateupdate.

This learning manual not only provides a thorough preparation for the examination it refers to, it is also a valuable desktop reference for practitioners, and studying from it counts towards your Continuing Professional Development (CPD). Mock examination papers, for most of our titles, will be made available on our website, as an additional revision tool.

CISI examination candidates are automatically registered, without additional charge, as student members for one year (should they not be members of the CISI already), and this enables you to use a vast range of online resources, including CISI TV, free of any additional charge. The CISI has more than 40,000 members, and nearly half of them have already completed relevant qualifications and transferred to a core membership grade.

Completing a higher level examination enables you to progress even more quickly towards personal Chartered status, the pinnacle of professionalism in the CISI. You will find more information about the next steps for this at the end of this manual.

With best wishes for your studies.

Lydia Romero, Global Director of Learning

CISI

CHARTERED INSTITUTE FOR SECURITIES & INVESTMENT

1 2 3 4 5 6

It is estimated that this manual will require approximately 100 hours of study time.

What next?

See the back of this book for details of CISI membership.

Need more support to pass your exam?

See our section on Accredited Training Partners.

Want to leave feedback?

Please email your comments to learningresources@cisi.org

Chapter One

Legal and Regulatory Framework

This syllabus area will provide approximately 4 of the 50 examination questions

This first chapter of the workbook looks at the legal and regulatory framework that governs the capital markets in Kenya; subsequent chapters go into the detail of the regulations that affect participants in the industry.

1. Regulatory Framework

Learning Objective

1.1.1 Know the key elements of the regulatory framework in Kenya

The capital markets industry operates within a regulatory framework that market intermediaries need to adhere to in the course of offering their services. Its objective is to deepen and broaden the capital markets by facilitating the development of new financial products and institutions through research and ensuring fairness and orderliness in the capital markets industry.

1.1 Kenyan Primary Legislation and Regulations

The regulatory framework of the capital markets in Kenya comprises both primary and subsidiary legislation.

Parliament passes primary legislation, which may delegate authority to an executive branch of government to make subsidiary legislation. In this method, primary legislation consists of statutes that set out broad outlines and principles, delegating authority to an executive branch. That branch can then issue subsidiary legislation, specifying substantive and procedural provisions for implementing them.

The primary legislation governing the capital markets is the Capital Markets Act and the Central Depositories Act. The Capital Markets Act established the Capital Markets Authority (CMA) as the regulatory body for this sector of the financial services industry and it introduces secondary legislation in the form of regulations and rules.

Regulatory Framework	
Main Acts	• The Capital Markets Act • The Central Depositories Act, 2000
Regulations and Rules	• The Capital Markets (Collective Investment Schemes) Regulations, 2001 • The Capital Markets (Securities) (Public Offers, Listing and Disclosures) Regulations, 2002 • The Capital Markets (Licensing Requirements) (General) Regulations, 2002 • The Capital Markets (Takeovers and Mergers) Regulations, 2002 • The Capital Markets (Foreign Investors) Regulations, 2002 • The Capital Markets Tribunal Rules, 2002 • The Capital Markets Asset Backed Securities Regulations 2007 • The Capital Markets (Registered Venture Capital Companies) Regulations 2007. • The Capital Markets (Conduct of Business) (Market Intermediaries) Regulations 2011 • The Capital Markets (Corporate Governance) (Market Intermediaries) Regulations, 2011 • The Capital Markets (Demutualisation of the Nairobi Securities Exchange Limited) Regulations 2012 • The Capital Markets Futures Exchanges Licensing Requirements Regulations 2013 • The Capital Markets (Real Estate Investment Trusts) (Collective Investment Schemes) Regulations 2013
Guidelines	• Guidelines on Corporate Governance Practices by Public Listed Companies • Guidelines on the Approval and Registration of Credit Rating Agencies • Guidelines on Financial Resource Requirements for Market Intermediaries

The above Acts, regulations as well as the guidelines are what the CMA uses to supervise and regulate the market intermediaries. The design of the regulatory framework encourages self-regulation to the maximum practical extent.

As a statutory agency, the CMA remains accountable to Parliament. The CMA must within six months after the close of each financial year, submit to the Cabinet Secretary of the National Treasury a report of its operations and activities throughout the year together with audited accounts. The Cabinet Secretary must then table the report to Parliament within three months of its submission.

1.2 East African Community (EAC) Directives

Learning Objective

1.1.2 Know how the regulatory framework links to EAC Directives

The East African Community (EAC) has an estimated population of about 124 million and EAC member states in furtherance of the objectives of the EAC Treaty, signed the EAC Common Market Protocol to establish a Customs Union. Its purpose is to liberalise further intra-regional trade in goods based on mutually beneficial trade arrangements and the member states are working towards the creation of a Common Market as well as Monetary Union.

The EAC Common Market Protocol envisages greater integration of the capital markets of the five EAC member states. The regional stock exchange would involve the integration of the capital markets of Kenya, Uganda, Tanzania and Rwanda. Burundi currently does not have a stock market.

One of the objectives is to integrate trading, clearing and settlement infrastructures within the EAC to facilitate a faster trading system. The integration of the stock exchanges will also provide a larger pool of capital for investment and will make it more attractive to investors as liquidity should improve.

This approach can also be seen in the directives issued by the EAC. These directives are subject to public consultation in each state and once ratified, each country amends its laws to bring them into line with the terms of the directive. This is then translated into the regulatory framework through the issue of regulations and rules.

The harmonisation of the legal and regulatory framework for securities markets is seen as a priority area for the EAC Common Market. Efforts towards the integration are also being co-ordinated by the East African Securities Exchange Association (EASEA) and the East African Securities Regulatory Association (EASRA).

Regional co-operation between regulators in the EAC takes place through a forum known as the East African Member States Securities Regulatory Authorities (EASRA) established in 1997, which brings together the securities regulators and securities exchanges in Burundi, Kenya, Rwanda, Tanzania and Uganda. EASRA's objective is to harmonise the securities laws and infrastructure of capital markets in the East African region, leading to common training and conduct of business standards and cross-border listing of companies within the region.

2. Capital Markets Authority (CMA)

Learning Objective

1.1.3 Know the objectives and functions of the CMA

In the 1980s, the Government of Kenya recognised the need to design and implement policy reforms to foster sustainable economic development with an efficient and stable financial system. In particular, it set out to enhance the development of the capital markets and detailed studies led to a blueprint for structural reforms in the financial markets. This included drafting the necessary legislation for the establishment of the CMA.

The Capital Markets Act established the CMA in 1989. The CMA began operations in 1990 as a statutory agency charged with the prime responsibility of regulating the development of orderly, fair and efficient capital markets in Kenya. It licenses and supervises market intermediaries, conducts on-site and off-site market surveillance and enforces compliance, and promotes market integrity and investor confidence.

Capital Markets Authority	
Vision	• A proactive regulator of a competitive and robust capital market.
Mission	• To promote the development of Kenya's capital market to be an investment destination of choice through facilitative regulation and innovation.
Core Values	• **Responsiveness** – we are sensitive to and will deal with issues and situations affecting all our stakeholders in a proactive and timely manner, using flexible decision making processes. • **Innovation and continuous learning** – we are committed to facilitating continuous learning and innovation. • **Integrity** – we are committed to acting at all times with honesty, fairness, accountability, transparency, ethically and above board in all our operations. • **Collaboration and teamwork** – we are committed to teamwork within the Authority and collaboration with our partners in the provision of our services. • **Commitment** – we shall perform our duties with the highest level of professionalism and dedication with a view to exceeding the expectations of our clients and stakeholders.

2.1 Objectives and Regulatory Functions of the CMA

As a statutory body, the CMA has a set of objectives set by Parliament through the Capital Markets Act.

Objectives of the CMA
• The development of all aspects of the capital markets with particular emphasis on the removal of impediments to, and the creation of incentives for longer term investments in, productive enterprises. • To facilitate the existence of a nationwide system of securities market and derivatives market and brokerage services so as to enable wider participation of the general public in the securities market and derivatives market. • The creation, maintenance and regulation, of a market in which securities can be issued and traded in an orderly, fair, and efficient manner, through the implementation of a system in which the market participants are self regulatory to the maximum practicable extent. • The protection of investor interests. • The facilitation of a compensation fund to protect investors from financial loss arising from the failure of a licensed broker or dealer to meet his contractual obligations. • The development of a framework to facilitate the use of electronic commerce for the development of capital markets in Kenya.

The regulatory functions of the Authority as provided by the Act and the regulations include the following:

- licensing and supervising all the capital market intermediaries
- ensuring proper conduct of all licensed persons and market institutions
- regulating the issuance of capital market products (such as bonds and shares)
- promoting market development through research on new products and strengthening of market institutions
- promoting investor education and public awareness
- protecting investors' interests.

2.2 Powers of the CMA

To enable the CMA to undertake its objectives and functions, it has the power to:

- issue guidelines and notices to ensure the proper conduct of business
- grant licences to act as a market participant, including as a stockbroker, derivatives broker, dealer or investment adviser, authorised securities dealer, fund manager, investment bank, authorised depository (also known as custodians) or real estate investment trust (REIT) manager or trustee
- grant approval to operate as a securities exchange, derivatives exchange, a central depository credit rating agency, registered venture capital company, collective investment scheme (CIS) or other capacity
- regulate the issue of capital market instruments in primary markets and their subsequent trading in secondary markets including issuing notices or guidelines on corporate governance or other matters relating to market conduct
- approve the issue of capital market products and any associated corporate action

- undertake supervision of market intermediaries, conduct inspections or order audits and issue directions
- impose sanctions for breach of the provisions of the Act, the regulations or for non-compliance with the CMA's requirements or directions.

When it issues regulations, the CMA will assess the extent to which they appropriately provide 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
- facilitate an environment for transparent operations.

3. Licensing and Supervision of Capital Markets

Learning Objective

1.1.4 Know the approach to the licensing and supervision of the capital markets

As we saw in the previous sections, the CMA is empowered to set rules for the proper conduct of business in the capital markets. For this to be effective, it needs to license and supervise capital market intermediaries and supervise the activities taking place in the primary and secondary markets.

3.1 Capital Market Intermediaries

One of the regulatory functions of the CMA is the licensing and supervision of all capital market intermediaries. It does so through a process of licensing, setting rules and guidelines and empowering self-regulatory organisations to supervise appropriate sectors of the market.

It is a requirement of the Capital Markets Act that all capital market intermediaries must obtain approval or a licence from the Capital Markets Authority (CMA). The CMA will only grant a licence or approval if the applicant meets the licensing criteria and the Authority is satisfied that the participant is 'fit and proper' to carry on the activity.

Market Participants in the Kenyan Capital Markets	
Stockbrokers	• Stockbrokers are market professionals who buy and sell securities on behalf of clients at a stock exchange in return for a brokerage commission.
Dealer	• Dealers are people who carry on the business of buying, selling, dealing, trading, underwriting or retailing securities as principal (ie, on their own behalf).
Investment Advisers/Fund Managers	• Investment advisers and fund managers are market professionals who promulgate analysis and research on capital markets securities, and advise investors on such securities at a commission. • They also manage portfolios of securities on behalf of clients pursuant to a contract.
Authorised Securities Dealer	• These are banks licensed under the Banking Act or a financial institution approved by the Authority to deal in fixed-income securities listed on the fixed income securities market segment at a stock exchange. • Authorised securities dealers are also required to act as market makers and dealers in this market segment, facilitate deepening of the fixed-income securities market, enhance trading and liquidity in the fixed-income securities market, and minimise counterparty risk.
Investment Banks	• These are non-deposit-taking institutions that advise on offers of securities to the public or a section of the public; corporate financial restructuring; and takeovers, mergers, privatisation of companies and underwriting of securities. • They can also engage in the business of a stockbroker, dealer, and fund manager of collective investment schemes and provider of contractual portfolio management services.
Collective Investment Schemes (CIS)	• These are specialised market players licensed to mobilise savings in financial assets and to enhance access to capital markets by small investors. • They include mutual funds, unit trusts, investment trusts and other forms of specialised collective investment schemes such as REITs. • CISs offer a unique opportunity to investors in terms of professional management, economies of scale and diversification of portfolio and risk.
Custodians or Authorised Depositories	• These are banks licensed under the Banking Act or a financial institution approved by the Authority to hold in custody funds, securities, financial instruments or documents of title to assets registered in the name of local investors, East African investors, or foreign investors of an investment portfolio. • Every investment adviser and fund manager that manages discretionary funds has to appoint a custodian for the assets of the fund.

Market Participants in the Kenyan Capital Markets	
REIT Managers and Trustees	• Real estate investment trusts are collective investment schemes that specialise in investing in real estate. Property must be held in trust by REIT trustees and professionally managed by a REIT manager.

Once authorised, market participants must continue to meet the rules and ongoing obligations of the Act and the regulations set by the CMA.

Certain organisations such as a securities exchange or central securities depository require approval from the CMA and may operate as a self-regulatory organisation. This requires them to set rules for admission of members, their business conduct and to enforce rules to ensure the proper running of their segment of the capital markets.

3.2 Investor Compensation Fund (ICF)

Learning Objective

1.1.5 Know how the Investor Compensation scheme is funded and the cover provided

Stockbrokers, dealers and other firms that are trading participants of a securities exchange are required to contribute to an investor compensation fund.

The CMA is required under the Capital Markets Act to operate an ICF and it is managed by the CMA on behalf of the ICF as a separate fund and disclosed in its annual report and accounts. The accounts and records of the compensation fund are audited as part of the regular audit of the CMA's accounts.

The purpose of the fund is to grant compensation to investors who may suffer pecuniary loss resulting from the failure of a licensed intermediary carrying out broking or dealing operations to meet its contractual obligations.

Funding of the Investor Compensation Fund
It is funded by: • contributions from licensed trading participants • a transaction charge on trades undertaken on the Nairobi Securities Exchange of 0.01% on shares and 0.004% on bonds • financial penalties imposed by the CMA on operators for non-compliance with its rules and regulations • in the event of an oversubscription of securities, the interest earned on excess funds raised in a public issue between the offer closure date and the date of crediting of investor's central depository accounts with the respective securities.

Where an investor has suffered pecuniary loss, they can claim compensation firstly from the securities or bank guarantee deposited with the exchange or central depository as a condition of becoming a trading participant or from the exchange's compensation fund. Where there is a remaining net loss, the investor can apply to the compensation fund for compensation up to a maximum of Kshs 50,000. The claim is to be submitted to the statutory manager appointed to deal with the statutory management and possible winding-up of the firm within 60 days of their appointment. The statutory manager has to submit a list of the investors to be compensated and supporting documents to the CMA, and a Compensation Committee will then determine whether to allow the claims and the amount to be paid.

Where a payment is made out of the compensation fund, the licensed person is liable for that amount and in the event of liquidation, the liquidator has to pay that amount to the compensation fund.

3.3 Primary and Secondary Markets

To enable the CMA to undertake its objectives and functions, it regulates the issue of capital market instruments in the primary market and then undertakes supervision of trading in the secondary market.

3.3.1 Primary Markets

Stock exchanges are marketplaces for issuing securities and then facilitating the trading of those securities via the trading and market-making activities of their member firms. Stock exchanges provide both a primary and a secondary market.

Listing on a stock exchange is often seen as a way to grow and enhance a business. When considering the range of available financing options, the following factors are frequently cited as the key benefits of admission to a public market:

- providing access to capital for growth
- enabling companies to raise finance for further development, both at the time of admission and through further capital raisings
- creating a market for a company's shares or broadening the shareholder base
- placing an objective market value on the company's business

- encouraging employees' commitment and incentivising their long-term motivation and performance by making share schemes more attractive
- increasing the company's ability to make acquisitions by using its own quoted shares as payment.

When a company decides to seek a listing for its shares, the process is described in a number of ways:

- becoming 'listed' or 'quoted'
- floating on the stock market
- 'going public'
- making an 'initial public offer' (IPO).

When a company's shares are first listed on a stock market, this takes place in the primary market, and the trading afterwards takes place in the secondary market – on the Nairobi Securities Exchange (NSE) or other stock markets.

Public offers and listings are governed by the Capital Markets Act and the Capital Markets (Public Offers, Listings and Disclosures) Regulations.

Regulatory Framework for Primary Markets
• Under the Capital Markets Act, to offer shares to the public a company must be established as a public limited company (plc), issue annual accounts and meet requirements for their audit as well as those relating to sound corporate governance practices. • To obtain a stock market listing requires the CMA to approve the disclosure documents relating to the public issue and listing of securities, and a separate application is required to the Nairobi Securities Exchange for the actual admission for listing. (The Nairobi Securities Exchange undertakes the approval of listings on its Growth and Enterprise Market Segment.) • The listing process is regulated by the CMA which has a legal obligation to oversee the listing process and ensure that its rules are met by reviewing and approving the prospectus or listing particulars.

In parallel to the listing process, companies need to apply to the securities exchange to have securities admitted to trading on the exchange. The NSE is an approved investment exchange and has its own set of admission and disclosure standards designed to sit alongside the CMA's listing rules.

3.3.2 Secondary Markets

Trading in the secondary markets may take place either on an approved exchange or in over-the-counter (OTC) transactions.

Trading on a securities exchange must take place in accordance with the trading rules of the exchange. Under the Capital Markets Act:

- No person holding shares in a public company listed on an approved securities exchange may sell or transfer such shares except in compliance with the trading procedures adopted by the securities exchange.
- No licensed person, broker or dealer may trade in listed securities in contravention of CMA rules on the clearance, settlement, payment, transfer or delivery of securities.

The CMA may authorise the transfer of a listed security outside the securities exchange if it satisfied that the security trades over-the-counter and such trade is subject to trade reporting rules. Over-the-counter trading (or OTC trading) takes place directly between two market participants and is often used for large market orders or for illiquid securities.

A key element of the regulatory system is ensuring the efficient, orderly and fair operation of trading activity. For markets to operate efficiently and fairly, potential investors need to be able to see what is available to trade and have access to what trades have taken place and at what prices.

This is known as pre-trade transparency and post-trade transparency.

- **Pre-trade transparency** – this is the publication of information accurately indicating the size and price of prospective trading orders such as the display of the entire contents of the limit order book for a particular security.
- **Post-trade transparency** – this is the dissemination of trade price and volume of completed transactions from all market trading in that security.

The level of transparency is an essential determinant of an effective market and the regulator and exchanges work to ensure there is the greatest degree of transparency to allow the investor to make an informed investment decision.

Pre-trade transparency alone is not sufficient. Maximum transparency requires the dissemination of price quotations on a prompt, real-time basis as well as transaction reports. Although quotes may help investors decide where and when to trade, transaction reports help investors to anticipate market trends. Without trade and volume information, there are few warnings of impending market trends. Market participants cannot respond quickly to selling or buying surges because they do not see them happening.

The exchange has responsibility for market surveillance and must work closely with the CMA to monitor trading activity in order to identify and eliminate market abuse.

4. CMA Enforcement Powers

Learning Objective

1.1.6 Know the enforcement powers of the CMA

The CMA is empowered by statute to enforce the Capital Markets Act and the various regulations that have been issued.

In addition, there is also an obligation on any person who, in the course of providing services to a licensed person or a listed company, comes into possession of information indicating that such licensed person or company is engaged in any prohibited conduct, to report the matter to the CMA. Contravention of this requirement is an offence.

4.1 Enforcement Powers of the CMA

The CMA has a wide range of powers that it can use to enforce compliance with provisions of the Capital Markets Act and associated regulations including:

- investigations
- powers to demand production of documents and records
- power of entry and search
- power to intervene in the management of a licensed person
- take action against licensed or approved persons, their employees and listed companies.

4.1.1 Powers of Investigation

In order to be able to carry out its regulatory functions, the CMA can demand information and returns from market intermediaries and may conduct investigations into the affairs of any person that the CMA has approved or to which it has granted a licence and any public listed company.

It may therefore conduct inspection of the activities, books and records of any persons approved or licensed by the CMA. Alternatively, it may appoint:

- an auditor to carry out a specific audit of the financial operations of any collective investment scheme or publicly listed company if such action is deemed to be in the interest of the investors, at the expense of such collective investment scheme or company
- a suitably qualified person to conduct investigations.

The CMA may in writing appoint a suitably qualified person to conduct investigations where it has reasonable cause to believe that:

- an offence has been committed
- a licensed or approved person may have engaged in embezzlement, fraud, misfeasance or other misconduct in connection with its regulated activity, or
- the manner in which a licensed or approved person has engaged or is engaging in the regulated activity is not in the interest of the person's clients or in the public interest.

The investigator has the right to expect cooperation from any person while carrying out the investigation and failure to cooperate is an offence.

Obligation to Cooperate with Investigations
An investigator appointed may require any person whom they reasonably believe or suspect to be in possession or in control of any record or document which contains, or which is likely to contain, information relevant to an investigation under this section to: • produce to the investigator, within such time and at such place as the investigator may require in writing, any record or document specified by the investigator which is, or may be, relevant to the investigation, and which is in the possession or under the control of that person • give an explanation or further particulars in respect of any record or document produced • attend before the investigator at the time and place specified in writing by the investigator, and to the best of their ability under oath or affirmation answer any question relating to the matters under investigation as the investigator may put to them, and • assist the investigator with the investigation to the best of the person's ability.

4.1.2 Powers to Demand Production of Records and Documents

The CMA may issue a direction to a company or person to produce documents and records or demand an explanation of the content of records and failure to comply with a direction of the Authority is an offence.

To exercise its power, the CMA must have reasonable grounds to believe that:

- the business of a listed company or similar entity is being conducted with the intent to defraud creditors, was formed for unlawful purposes, is being run in a manner prejudicial to any of its members or investors or is being run by persons found guilty by a court for fraud, misfeasance or other misconduct towards the company or entity
- the members of a listed company or investors in an entity where the shares have been offered publicly have not been given all the information relating to its affairs that they might reasonably expect.

A direction may require a company or any other person to produce records or documents and includes the power to take copies or extracts, demand an explanation or provide an explanation for failing to produce the records or documents.

4.1.3 Power of Entry and Search

The Chief Executive Officer of the CMA may authorise a senior officer to inquire into the affairs of a person. Where such a person is satisfied that a person has committed or is reasonably suspected of committing an offence under the Capital Markets Act in Kenya or elsewhere, they may apply to a magistrate for a warrant to search the premises of that person.

The magistrate may issue a warrant authorising the officer to exercise all or any of the following powers to:

- enter any premises between sunrise and sunset to search for money, documents or other assets relevant to the inquiry

- seize money, documents or assets which may be necessary for the inquiry or for the purpose of civil or criminal proceedings and to retain them for as long they are so required, and
- direct any person who has control over such assets to take any action with respect to such assets as the CMA may reasonably require with a view to protecting the assets until the court determines the appropriate course of action.

In the interest of bank confidentiality, the powers in respect of any documents held by a banker are limited to making copies or extracts therefrom.

4.1.4 Powers of the Authority to Intervene in Management of a Licensee

The CMA has the power to give directions to any person that the CMA has approved or to which it has granted a licence and any public company the securities of which are publicly offered or traded on an approved securities exchange or on an OTC market.

It specifically has the power to intervene in the management of a licensee if:

- a person's licence or approval is suspended
- a petition is filed, or a resolution proposed, for the winding up of a licensed person or if any receiver or receiver manager or similar officer is appointed in respect of the licensed person or in respect of all or any part of its assets.
- the CMA discovers or becomes aware of any fact or circumstance which, in its opinion, warrants the exercise of the relevant power in the interests of investors.

The actions available to the CMA include:

- the appointment of a statutory manager to assume the management, control and conduct of the affairs and business of a licensed person to exercise all the powers of a licensed person to the exclusion of its board of directors, including the use of its corporate seal
- removal of any officer or employee of the licensed person who, in the opinion of the CMA, has caused or contributed to any contravention of any regulatory provisions or to any deterioration in the financial stability of the licensed person or has been guilty of conduct detrimental to the interests of investors
- the appointment of a competent person familiar with the business of the licensed person to its board of directors to hold office as a director who shall not be capable of being removed from office without the approval of the CMA other than by order of the High Court
- by notice in the Gazette, revoking or cancelling any existing power of attorney, mandate, appointment or other authority by the licensed person in favour of any officer or employee or any other person.

Appointment of a Statutory Manager
A statutory manager may be appointed for a period not exceeding 12 months, although this may be extended by the High Court.

The role of the statutory manager is to assume the management, control and conduct of the affairs and business of a licensed person including:

- tracing and preserving all the property and assets of the licensed person or of its customers
- recovering all debts and other sums of money due to and owing to the licensed person
- evaluating the capital structure and management of the licensed person and recommending to the CMA any restructuring or reorganisation considered necessary
- where it appears just and equitable to do so in the interest of all interested parties and after consultation with the CMA, petitioning the High Court for the winding up of the licensed person.

All costs and expenses properly incurred by the statutory manager are payable out of the assets of the licensed person in priority to all other claims.

Alternatively, the CMA may present a petition for the licensed person to be wound up or institute winding up proceedings if it appears to it that it is desirable for the protection of clients or investors.

4.1.5 Disciplinary Action

The Capital Markets Act gives the CMA powers to take action for a breach of the rules by a licensed or approved person and their employees, and against a listed company or director of a listed company.

Range of Disciplinary Actions	
Licensed persons, approved persons and listed companies	• A public reprimand. • Suspending the trading of a listed company's securities for a specified period. • Suspension of a licensed person from trading for a specified period • Restriction on the use of a licence. • Revocation of a licence. • Levying of financial penalties and recovery of any gain made or loss avoided.
Employees of licensed or approved person	• Require the licensed or approved person to take disciplinary action against the employee. • Disqualification from employment in any capacity by any licensed or approved person or listed company for a specified period. • Levying of financial penalties and recovery of any gain made or loss avoided by an employee of a licensed or approved person. • For directors of licensed or approved firms or listed companies, disqualification from directorship in addition to the imposition of fines and recovery.

The CMA in its annual report publishes the names of persons against whom action has been taken.

4.2 Sanctions

The CMA has a wide range of sanctions that it can use to enforce compliance with provisions of the Capital Market Act and associated regulations. It has power to impose sanctions for breach of the provisions of the Act, the regulations or for non-compliance with the CMA's requirements or directions including:

- levying of financial penalties, proportional to the gravity or severity of the breach, as may be prescribed
- ordering a person to remedy or mitigate the effect of the breach, make restitution or pay compensation to any person aggrieved by the breach
- publishing findings of malfeasance by any person
- suspending or cancelling the listing of any securities or exchange-traded derivative (ETD) contracts, or the trading of any securities or exchange-traded derivative contracts, for the protection of investors.

The CMA has the power to impose financial penalties on its own initiative without the need for court action.

Maximum Fines
• **Licensed persons, approved persons and listed companies** – a maximum fine of Kshs 10 million.
• **Employees of licensed or approved persons** – a maximum fine of Kshs 5 million.
• **Breach of trading rules of an exchange** – double the brokerage commission payable to the licensed person on the relevant trade, or double the annual fees, whichever is higher.
• **Failure to comply with a reporting requirement by a listed company or a licensed person** – double the prescribed annual listing fee or licence fee, whichever is higher, for every calendar quarter during which the reporting requirement remains outstanding.
• **Failure by an exchange to enforce and ensure compliance** – the annual licence fee of the exchange.

Alternatively, where it deems it appropriate, the CMA can take legal action against companies and individuals. The Director of Public Prosecutions may appoint any officer of the CMA or advocate of the High Court to be a public prosecutor for the purposes of offences under the provisions of the Capital Markets Act.

Where a person commits an offence under the Capital Markets Act and no specific penalty is provided for, that person may be liable on conviction to the penalties noted below. All financial penalties levied under the Act are payable to the Investor Compensation Fund.

Penalties	
First Offence	• **Individuals** – a fine not exceeding Kshs 5 million or to imprisonment for a term not exceeding two years and pay two times the amount of any gain made or loss avoided as a result of the contravention. • **Companies** – a fine not exceeding Kshs 10 million and pay two times the amount of any gain made or loss avoided as a result of the contravention.
Subsequent Offence	• **Individuals** – a fine not exceeding Kshs 10 million or to imprisonment for a term not exceeding five years and pay three times the amount of any gain made or loss avoided as a result of the contravention. • **Companies** – a fine not exceeding Kshs 30 million and pay three times the amount of any gain made or loss avoided as a result of the contravention.

The CMA may also seek an order for compensation or restitution. The court may make an order for the payment of compensation by a person convicted for an offence to a person who suffers loss by reason of the offence. The amount of restitution or compensation for which a person is liable is:

- the loss sustained or adverse impact of the breach on the person or persons claiming compensation or restitution
- the profits that have accrued to the person in breach, or
- where harm has been done to the market as a whole, the illegal gains received or loss averted as a result of the illegal action as may be determined by the court.

4.3 Appeals

Learning Objective

1.1.7 Know the role and powers of the Capital Markets Tribunal

The Capital Markets Act mandated the creation of a Capital Markets Tribunal to hear appeals concerning decisions of the CMA and the Investor Compensation Fund Board. All expenses of the Capital Markets Tribunal are borne by the general fund of the CMA.

For the purposes of hearing an appeal, the Tribunal has all the powers of the High Court to summon witnesses, to take evidence upon oath or affirmation and to call for the production of books and other documents. In its determination of any matter the Tribunal may take into consideration any evidence which it considers relevant to the subject of an appeal before it, notwithstanding that such evidence would not otherwise be admissible under the law relating to evidence.

Upon any appeal, the Tribunal may:

- confirm, set aside or vary the order or decision in question
- exercise any of the powers which could have been exercised by the CMA or any of its committees in the proceedings in connection with which the appeal is brought, or
- make such other order, including an order for costs, as it may deem just.

Any party to proceedings before the Tribunal who is dissatisfied with a decision or order of the Tribunal on a point of law may, within 30 days of the decision or order, appeal against such decision or order to the High Court. The High Court may:

- confirm, set aside or vary the decision or order in question
- remit the proceedings to the Tribunal with such instructions for further consideration, report, proceedings or evidence as the court may deem fit to give
- exercise any of the powers which could have been exercised by the Tribunal in the proceedings in connection with which the appeal is brought, or
- make such other order as it may deem just, including an order as to costs of the appeal of earlier proceedings in the matter before the Tribunal.

No decision or order of the Tribunal may be enforced until the time for lodging an appeal has expired or where the appeal has commenced, until the appeal has been determined.

End of Chapter Questions

1. What is the difference between primary legislation and secondary legislation?
   Answer reference: Section 1.1

2. The Capital Markets (Conduct of Business) (Market Intermediaries) Regulations 2011 are an example of what type of legislation?
   Answer reference: Section 1.1

3. Is promoting investor education and awareness an objective or a regulatory function of the CMA?
   Answer reference: Section 2.1

4. What are the main areas where powers have been granted to the CMA under the Capital Markets Act?
   Answer reference: Section 2.2

5. What is the purpose of the 'fit and proper' test?
   Answer reference: Section 3.1

6. How is the Investor Compensation scheme funded?
   Answer reference: Section 3.2

7. For an issuer to have its shares traded on a securities market, it requires approval from which bodies?
   Answer reference: Section 3.3.1

8. What is pre- and post-trade transparency and why is it important?
   Answer reference: Section 3.3.2

9. An individual has failed to cooperate with an investigator appointed by the CMA. What is the implication for the individual?
   Answer reference: Section 4.1

10. Where the CMA determines that it is necessary to seize documents for a criminal prosecution, what does it need?
    Answer reference: Section 4.1.2

11. What sanctions does the CMA have power to impose on a market intermediary for a breach of regulations?
    Answer reference: Section 4.2

12. What are the maximum penalties that a court can impose for a breach of the regulations on a first offence?
    Answer reference: Section 4.2

13. If a market intermediary disagrees with a decision of the CMA, it may appeal to which body?
    Answer reference: Section 4.3

14. An appeal to the High Court concerning a decision of the Tribunal may be made on what grounds and within what timescale?
    Answer reference: Section 4.3

Chapter Two

Licensing of Capital Market Intermediaries

This syllabus area will provide approximately 5 of the 50 examination questions

1. General Licensing Requirements

Learning Objective

2.1.1 Know which capital market activities require approval and licensing

2.1.2 Understand the criteria used to assess the suitability of applicants and the factors taken into account as part of the fit and proper test

2.1.3 Know the general licensing requirements that apply to capital market intermediaries: requirement to register details of key personnel with the CMA; ongoing obligations that licensed intermediaries must meet; requirement for approval of auditors by the CMA and their reporting obligations

It is a requirement of the Capital Markets Act that all capital market intermediaries must obtain approval or a licence from the Capital Markets Authority (CMA). Once authorised, they must continue to meet the rules and ongoing obligations of the Act and the regulations set by the CMA.

1.1 Securities Industry Licences

The Capital Markets Act and the CMA regulations require the capital market intermediaries shown in the table below to obtain authorisation.

Market Infrastructure Firms	Investment Firms	Funds	Others
Securities Exchanges	Authorised Securities Dealers	Collective Investment Schemes	Authorised Depositories
Derivatives Exchanges	Dealers	Trustees	Credit Rating Agencies
Central Depositories	Investment Banks Stockbrokers Derivatives Brokers Fund Managers Investment Advisers	REIT Managers Registered Venture Capital Companies	

The Act does not permit any person to carry on any of the above businesses unless the CMA approves them and holds a valid licence. Once approved, they must comply with all requirements of the CMA and pay an annual fee to the Authority. The licence issued is perpetual and remains valid unless revoked or suspended.

Applications received by the CMA are broadly classified into two categories for purposes of review namely applications for licence and applications for approval.

- Any firm intending to carry on the business of a stockbroker, dealer, derivatives broker, investment bank, fund manager, investment adviser, and authorised depository must hold a valid licence issued by the CMA.
- Any organisation intending to carry on the business of a securities exchange, registered venture capital company, collective investment scheme, central depository or credit rating agency has to have the approval of the CMA.

(Note: the requirements for collective investment schemes, REITs and venture capital funds are covered in Chapter 6.)

Financial services organisations that are not capital markets participants may require licensing but other agencies grant authorisation. For example, the Central Bank of Kenya is responsible for the licensing and supervision of commercial banks, mortgage finance providers, money remittance providers, microfinance institutions, forex bureaus and credit reference bureaus.

1.2 Applications for Licences

Applications for a licence have to be in the form prescribed in the CMA regulations and accompanied by the required fee. Applications can be made using the online portal for licensing and approvals.

The CMA is able to determine whether it will issue a licence and on what conditions. The CMA will grant a licence only if the applicant meets the financial and other requirements that are set out in the Act and its regulations.

Criteria for Suitability
In determining if a firm is suitable for the grant of a licence under the Act, the CMA will consider the following. • their financial status or solvency of the person • their educational or other qualifications or experiences that are relevant to the functions that the person shall perform • the status of any other licence or approval granted to the person by any financial sector regulator • their ability to carry on the regulated activity competently, honestly and fairly • the reputation, character, financial integrity and reliability of that individual or in the case of a company, its chairperson, directors, chief executive, management and all other personnel including all duly appointed agents, and any substantial shareholder of the company.

Without prejudice to the generality of the suitability test, in determining whether the person meets the criteria for suitability, the CMA will apply tests to ensure that the person is 'fit and proper' to carry on the licensed activity.

'Fit and Proper' Test	
In determining whether a person is fit and proper to hold any particular position, the CMA will take account of the following:	
Competence to undertake the role	• Their probity, competence and soundness of judgment in fulfilling the responsibilities of that position. • The diligence with which they are likely to satisfy those responsibilities.
Offences	• Any past convictions or offences, involvement in irregularities, misappropriation of funds or manipulation of securities markets transactions that will threaten the interests of customers. • Any contravention of laws designed to protect the public from financial loss when engaged in transactions in marketable securities. • Any convictions for an economic crime under the Anti-Corruption and Economic Crimes Act.
Behaviour	• Whether they have taken part in any business practice that the CMA considers fraudulent, prejudicial or otherwise improper (whether unlawful or not) or which otherwise discredited their methods of conducting business. • Whether they have taken part or been associated with any other business practice or conduct that would cast doubt on their competence and soundness of judgment.
Others	• The state of the business the applicant is carrying on. • The suitability of any employees or agents who will be conducting regulated activities. • Where the applicant is a company in a group of companies, the suitability of any group company, substantial shareholder or key personnel. • Whether they were a director of a brokerage firm that was liquidated or is in liquidation or statutory management. • Whether they have established effective internal control procedures and risk management systems to ensure their compliance with all applicable regulatory requirements.

The CMA may grant a licence on such conditions or restrictions as it thinks fit and may give written notice, at any time, to vary any condition or restriction or impose further conditions or restrictions. The CMA will not refuse to grant a licence without first giving the applicant or holder of a licence an opportunity of being heard.

A licensed intermediary must submit an application for the renewal of its licence by 30 November of each year. They must also submit management accounts for the period up to 30 November by no later than 15 December in the same year.

1.3 Key Personnel

As well as obtaining a licence, a firm must also meet requirements relating to its personnel. These include:

- registering details of its key personnel with the CMA. This includes employees and directors of a trading participant who have direct dealings with clients and carry on trading activities on behalf of clients
- appointing a Company Secretary who is qualified under the Institute of Certified Public Secretaries of Kenya Act
- designating in writing a compliance officer who will coordinate all compliance matters with the CMA.

A firm must obtain prior confirmation in writing from the CMA that it has no objection to any proposed change to its shareholders, directors, chief executives or key personnel. Where any new appointment is a person who worked at another licensee, any request for 'no objection' must include details of the reason for their departure.

The firm must provide the CMA with a list of all of its key personnel, which includes the individual's full name, national identity card number, job designation and description of responsibilities and, where they have worked with other licensees of the CMA, details of their former employers. They should submit this annually and update it within five days of any change.

1.4 Ongoing Obligations

Once the CMA grants a licence, the firm must then meet a series of ongoing obligations in addition to the above requirements.

Ongoing Obligations	
Branches	• The prior approval of the CMA is required to change the location of or to open a new place of business. • It must provide three months' written notice of its intention to close any place of business in Kenya.
Financial Structure	• It must notify any change to its capital structure within five working days from the date of the change. • It must submit details of any alteration to its memorandum or articles of association within 30 days of passing the resolution approving such alteration.
Financial Accounts	• Where necessary, amend their financial year so that their financial year consists of a 12-month period that ends on 31 December each year. • Prepare their financial statements in accordance with International Financial Reporting Standards. • Submit their annual accounts no later than the 31 March.

Ongoing Obligations	
Publication of Financial Statements	• Collective investment schemes, stockbrokers, dealers, fund managers and investment banks must publish their financial statements in at least two daily newspapers that have national circulation. • The content of the financial statements must meet the requirements set out in the licensing rules which set out the items of income and expenditure that must be included and the content of the balance sheet. • Half-year unaudited financial statements must be published within two months after the end of the first half of the financial year and full-year audited financial statements within three months after the end of the financial year.
Display of Audited Balance Sheet	• Every licensed stockbroker, fund manager and investment bank must display its audited balance sheet, profit and loss statement, auditor's report and a list of its directors. • It must display the documents throughout the year in a conspicuous position in every office and branch in Kenya.
Professional Indemnity Insurance	• Stockbrokers and investment banks must have professional indemnity insurance with cover equal to an amount not less than five times their daily average turnover for the previous year or an amount set by the CMA. • Fund managers must also have professional indemnity insurance with the amount of cover based on funds under management.

1.5 Auditors

A firm must appoint an external auditor and the auditor may serve for a maximum period of seven years. The appointment and any subsequent change requires approval in writing from the CMA at least one month beforehand. Where an auditor wishes to resign or does not seek to be appointed they must give written notice to the CMA.

The CMA may arrange trilateral meetings with a firm and its auditor to discuss matters relevant to their supervisory responsibilities including relevant aspects of the licensed person's business, its accounting and control system and its annual accounts.

Auditors are required to report any matters they identify that affect the supervision of the firm or its compliance with the rules to the CMA irrespective of any duty of confidentiality to their client. If they fail to do so, the CMA may disqualify them from appointment as auditors of its licensees and approved persons.

In particular, if the auditor identifies any of the following issues they must report these immediately to the CMA:

- a serious breach of or non-compliance with the provisions of the Act or CMA regulations, guidelines or other stipulations

- a criminal offence involving fraud or other dishonesty committed by the firm or any of its key officers or employees
- serious irregularities which may jeopardise the security of investors or creditors of the licensed person
- where the auditor is unable to confirm that the claims of investors and creditors of the firm are capable of being met out of the assets of the firm
- where the auditor includes in his report or draft report on the firm's accounts any qualification which did not appear in the accounts for the preceding financial year.

2. Exchanges and Central Securities Depository

Learning Objective

2.2.1 Know the general requirements for an exchange or central securities depository to be approved: role as a self regulatory organisation and rule making powers; CMA powers of direction and intervention

2.2.2 Know the requirements for securities and derivatives exchanges to be approved

2.2.3 Know the requirements for a central securities depository to be approved

2.1 Approval of an Exchange and Central Securities Depository

The Capital Markets Act requires a securities exchange or a derivatives exchange to be approved by the CMA before it conducts business. The Central Securities Depository Act imposes the same requirements for a central depository.

In determining whether to grant a licence, the CMA will consider the following points.

- the organisation must be structured as a limited liability company and its memorandum and articles of association restrict it to operating an exchange and incidental services or operating a central securities depository
- the board of the exchange is appropriately structured
- whether the organisation is fit and proper to undertake that role and its ability to carry on the regulated activity competently, honestly and fairly
- the suitability of the exchange or central securities depository to be registered as a self-regulatory organisation
- its proposed rule book
- the details of the trading or settlement system to be used
- for a derivatives exchange, its trading, clearing and settlement systems.

An exchange or central securities depository is required to operate as a self-regulatory organisation. A self-regulatory organisation is an organisation that exercises some degree of regulatory authority and control over an industry or profession.

Note	An effective self-regulatory organisation (SRO) needs to be able to: • set standards for membership and ensure investor protection mechanisms are in place • create and enforce its rules subject to formal government oversight • manage conflicts of interest • set standards of conduct and supervise the activities of its members • undertake surveillance of market activity and take enforcement action • maintain effective procedures to ensure fair, efficient and orderly markets and to deal with market disruptions.

2.2 Securities Exchange

A securities exchange must meet requirements surrounding its organisation, its rules and its trading system.

The rules surrounding its organisation include the following:

- There must be prior confirmation from the CMA that it has no objection to the appointment of the directors.
- The exchange will satisfy itself that its members are suitable and issue a confirmation that they shall be accepted once they secure a licence from the CMA.
- All trading participants of an exchange are to be licensees of the Authority with rights to trade at an approved exchange.
- The CMA may prescribe limits on the ownership of a securities exchange by its trading participants.
- Trading participants must not hold an interest of 15% or more of the voting shares in another trading firm unless they have been exempted by the CMA on the basis that they have adequate internal controls to address conflicts of interest.
- 20% of the total annual listing fees receivable each financial year must be directed to support the development of the securities exchange infrastructure and an investor education programme.

A securities exchange is expected to have procedures and appropriate systems to allow it to exercise self-regulation over its trading participants. It must develop rules to ensure compliance with regulations and have these approved by the CMA. It must also have a code of conduct for its trading participants, deploy adequate trading surveillance and have a procedure for dispute resolution.

A trading system adopted by a securities exchange has to be approved by the CMA in advance and should provide for pre-trade display of all open orders, automatic matching of trades and integration with a central depository system. It should also have internal controls and security measures to ensure that only authorised persons have access, provide an audit trail and trace back mechanism for all transactions and maintain records of all transactions and retrieve such records as may be necessary.

A securities exchange has to report immediately report to the CMA by telephone and in writing whenever:

- there is a delay in the opening or closing of the securities exchange
- there is a default on settlement and delivery
- trading is to be suspended in any security

- there are incidences of violation of securities exchange rules
- there is unusual activity in the market
- it receives any non-public information that could have a material effect on the market in general or on any specific securities.

An exchange has to keep detailed records for a period of seven years of its operation, its members, the securities listed on the exchange and the trading that takes place and report the details regularly to the CMA. It must also make public a daily report on the securities transacted, the price movements on each security including low, high and average prices, and the volume of transactions in each security.

2.3 Derivatives Exchange

A derivatives exchange also has to meet requirements for its organisation, its rules and its trading system. The requirements are similar in general terms but a derivatives exchange has to meet some requirements for authorisation and its clearing and settlement operation that are different.

Requirements for Derivatives Exchanges	
Organisation	• Be structured as a limited liability company that is demutualised and has a minimum authorised, issued and paid up equity share capital of Kshs 1 billion. • At least one third of the board must be made up of public interest directors. • Have a liquid net worth amount that is adequate in relation to the nature, size and complexity of the business of that futures exchange to ensure that there is no significant risk that liabilities may not be met as they fall due. The minimum liquid net worth capital requirement is equal to one half of the estimated gross operating costs of the futures exchange for the next 12-month period or such other as may be prescribed by the CMA. • Have a minimum of Kshs 100 million in the settlement guarantee fund before commencement of trading.
Trading	• Exchange-traded derivative contracts require the written approval of the CMA before trading commences and once authorised will not constitute a gaming or wagering contract under the Betting, Lotteries and Gaming Act. • In order to prevent excessive speculation in any commodity under an exchange-traded derivative contract, the CMA can fix limits on the amount of trading which may be done or held by any person.

Requirements for Derivatives Exchanges	
Clearing and Settlement	• Clearing and settlement of all trades in futures contracts by the clearing house of the futures exchange. • The performance of novation, netting and guarantee in settlement of trades. • Margining regime including daily marking to market of all open positions and variation margin calls to futures brokers and their clients. • Methodology for determining the daily and final settlement prices. • Process for deliveries through the clearing house and obligations of the brokers. • The closing-out of futures contracts in case of non-compliance with the rules of the futures exchange.
Default	• The provisions in respect of a default process and the precedence of the default process over the laws of insolvency in relation to a central depository under the Central Depositories Act also apply to a clearing house of a securities or a derivatives exchange.

2.4 Exchange Rules

An approved exchange may make rules for the carrying out of its functions and, in particular, for the regulation of its activities, products, systems and fees. The rules adopted by an exchange have to contain provisions that are in compliance with the Capital Markets Act and CMA regulations and cover some of the following areas.

Rules of an Exchange	
Membership	• Promote appropriate standards of conduct and exclude any person who is not fit and proper. • Registration of full members, associate members, their representatives, authorised clerks and dealers. • Arbitration of disputes and provision for appeal to the CMA by trading participants, investors and listed companies.
Listing	• No admission to listing unless the security has been approved for listing by the CMA. • Listing rules that cover admission to listing, suspension or delisting. • Prompt disclosure of price sensitive information.
Trading	• Ensuring trading is conducted in an orderly and fair manner and that trading is suspended where necessary for the protection of investors. • Conduct of trading business including pre- and post-trade reporting. • Market surveillance of trading and conduct.
Investor Protection	• Rules to prevent market manipulation including abuse of confidential information, misleading information, fraud, deceit, and other adverse practices in the issuing and trading of securities. • Segregation of customers' funds and securities from the business accounts of trading participants. • Safekeeping of securities in its custody.

Proposed rules made by an exchange have to be submitted to the CMA which has 30 days in which to either approve or reject them.

Where an exchange takes disciplinary action against a trading participant or a listed company, it must notify the CMA within seven days, which, after allowing the party to make representation, will either affirm or set aside the decision.

2.5 Central Securities Depository

A central securities depository has to meet the requirements for licensing as set out in the Central Securities Depository Act. It too has to demonstrate that it is fit and proper to be licensed and show that it can operate efficiently and manage its agents as a self-regulatory organisation.

A central securities depository operates facilities for the safekeeping of securities and settlement of stock market transactions. It is required do such things as are necessary to ensure orderly dealings in immobilised or dematerialised securities.

Duties of a Central Securities Depository
The duties of a central securities depository include: • Establishing and operating facilities for the handling of securities centrally and for clearing and settlement. • Ensuring the safe custody of certificates and other documents deposited with it. • Implementing security measures to prevent and mitigate fraud, guarding against falsification of records or any other system manipulation. • Maintaining accurate records that permit the verification, inspection, identification and recording of all transactions with the central depository. • Ensuring it manages the risks associated with its business and operations prudently.

It must operate as a self-regulatory organisation and have a rulebook approved by the CMA that provides for:

- deposit, registration or transfer of securities
- clearing and settlement of transactions
- its default process and the establishment of a settlement guarantee fund
- the appointment, qualifications and supervision of central depository agents (CDAs) along with a disciplinary process
- immediate notification to the CMA if any agent is unable to meet its obligations or there is evidence of financial irregularity.

As a condition of its licence, a central depository is required to establish adequate arrangements to guarantee the settlement of all transactions relating to securities through its system. As part of meeting this, a Central Depository Guarantee Fund has to be established which is funded by a variable risk based contribution payable by central depository agents and other payments such as penalties and fines imposed by the central depository.

A central securities depository needs to have a default process to deal with situations where a central depository agent has failed or is unable to meet its obligations for all of the unsettled or open market contracts to which it is a party. The process must include the settlement of all of the defaulter's contracts and settlement of any monies due.

In undertaking its functions, it may issue directions to its agents or to an issuer to take certain actions or refrain from doing a particular act. Failure to comply is an offence under the act carrying a penalty of a fine not exceeding Kshs 5 million, or to imprisonment for a term not exceeding five years, or to both.

2.6 Powers of the CMA

Although an exchange or central securities depository can make and enforce its own rules, the CMA has the power to make directions to either body or intervene in its operations where appropriate.

- The CMA may issue either general or specific directions to an exchange or central depository where it considers it necessary or expedient for the fair and efficient operation of a market or for the protection of investors or the public.
- The CMA also has the power to intervene in the operation of an exchange or central depository where there is market disruption, threatened or actual market manipulation or for the protection of investors or the public.

Powers of the CMA	
Directions	Its powers include issuing directions related to: • the manner in which an exchange or central depository carries on its business, including the reporting of off-market trades by trading participants of the securities exchange • the trading or the termination of trading on a securities or derivatives exchange • the clearing or settlement of securities or exchange-traded derivatives contracts and the making of adjustments to contractual obligations arising out of securities transactions • any other matters necessary for the effective administration of the rules.
Intervention	It can instruct action to: • modify or suspend any rules • maintain or restore fair, efficient and transparent trading • terminate, suspend or limit trading and modify the trading hours of an exchange • liquidate any position in respect of any securities or ETDs contracts • order the liquidation of derivatives positions, the fixing of the exchange settlement price and requiring additional margin.

Where an exchange or central depository fails to comply with a direction within the time specified in the notice, the CMA may set emergency margin levels, set limits on market positions or take such other action as it may consider necessary to maintain or restore fair, efficient and transparent trading, clearing and settlement.

3. Capital Market Intermediaries

Learning Objective

2.3.1 Know the requirement for capital market intermediaries to be licensed: role and authorised functions of different type of intermediary; criteria for authorisation; financial requirements and investment limits

2.3.2 Understand the following obligations of licensed intermediaries: conduct obligations; client accounts; record keeping and reporting obligations

2.3.3 Know the roles of an authorised depository and when the appointment of a custodian is required

As mentioned earlier, capital market intermediaries require authorisation from the CMA – this includes any firm intending to carry on the business of a stockbroker, dealer, investment bank, fund manager, investment adviser, authorised depository or REIT manager or trustee.

Authorised Functions	
Stockbroker	• A stockbroker is a firm that carries on the business of buying or selling of securities as an agent for investors in return for a commission. A stockbroker may apply for authorisation to act as a dealer through a subsidiary company. • A futures broker is an authorised firm that engages in the business of trading in exchange-traded derivative contracts as an agent for investors in return for a commission and on its own account.
Dealer	• A dealer is a firm that carries on the business of buying, selling, dealing, trading, underwriting or retailing of securities as principal for its own account. • An authorised securities dealer is restricted to dealing in fixed income securities and is entitled to trade on behalf of others as well as on its own account.

Authorised Functions	
Investment Bank	An investment bank is a non-deposit-taking institution that offers one or more of the following: • advisory services on public offers of securities, corporate restructuring, takeover, mergers, acquisitions and privatisation • corporate finance including the issue of equity or debt securities or loan syndication • engaging in the business of stockbroker or dealer • promoting or arranging underwriting or issuance of securities • promoting and acting as a fund manager of collective investment schemes • providing investment advisory services and contractual portfolio management.
Fund Manager	• A fund manager is the manager of a collective investment scheme or registered venture capital company or an investment adviser who manages a portfolio of securities in excess of an amount prescribed by the CMA.
Investment Adviser	• An investment adviser is a firm that carries on the business of advising others on securities for remuneration including investment advice, portfolio management and investment research reports and recommendations.
Authorised Depository	• An authorised depository is a custodian that offers safekeeping and investment administration services to investment managers and investment funds.
REIT Manager and Trustee	• The role of the REIT manager is to manage the fund's investment portfolio and administer the fund in accordance with the provisions of the incorporation documents, the information memorandum, as well as the collective investment scheme regulations. • A REIT trustee' role is to ensure that the fund is managed in accordance with the CMA rules, the incorporation documents, the information memorandum and the rules of the collective investment scheme. The trustee must therefore supervise the activities of the fund manager and ensure that the custodian safeguards the assets of the fund.

3.1 Criteria for Authorisation

Each applicant has to provide details of its capital structure, business plan, and key personnel so that the CMA can assess whether the applicant meets the criteria for suitability and is a fit and proper person to be licensed. The CMA will assess whether the applicant is fit and proper against the general licensing requirements set out in Section 1.

A stockbroker or dealer has to lodge a security of Kshs 1.5 million or a guarantee with a securities exchange or central depository of which it is a trading participant or for which it has applied for admission as a trading participant.

The maximum value of all client portfolios that can be managed under the investment adviser's licence is Kshs 10 million and if it is in excess of this, then a fund manager's licence is needed.

3.2 Financial Requirements

Each intermediary has to meet initial and ongoing financial requirements to ensure it has sufficient capital. These require them to have a minimum amount of unimpaired shareholders' funds – paid up share capital and reserves – and in some cases, a minimum amount of liquid capital.

Intermediary	Shareholders Funds	Liquid Capital
Stockbroker	Kshs 50 million	The higher of Kshs 30 million or 8% of liabilities
Dealer	Kshs 20 million	The higher of Kshs 30 million or 8% of liabilities
Investment Bank	Kshs 250 million	The higher of Kshs 30 million or 8% of liabilities
Fund Manager	Kshs 10 million	The higher of Kshs 5 million or 8% of liabilities
Investment Adviser	Kshs 2.5 million	The higher of Kshs 1 million or 8% of liabilities

A dealer also has to meet investment limits on its activities:

- It has to set aside investment capital of Kshs 20 million in cash or listed securities – if it is a subsidiary of a stockbroker the figure is Kshs 5 million.
- It has to maintain an investment portfolio with 60% invested in equities and the balance in fixed income securities.
- At least 25% of the securities held have to be turned over every quarter and 75% every year and every security has to be turned over at least once every 18 months.

3.3 Conduct Obligations

Licensed intermediaries must conduct their business efficiently, honestly, and fairly, with the integrity and professional skills appropriate to the nature and scale of their activities.

Stockbrokers are expected to abide by the stock exchange code of conduct and in addition, are expected to adhere to the following standards:

- Obtain sufficient information about a client to enable it to identify the client's investment objectives and financial needs.
- Ensure any recommendations to buy or sell securities are suitable for the client and are based on the client's investment objectives, financial situation and needs.
- Only accept written orders from clients.
- Execute an order only where the client has made sufficient arrangements to deposit funds or securities with the stockbroker to fulfil their obligations arising from the order.

- Execute clients' orders in the chronological sequence of orders received and give priority to client orders over any orders from any shareholder or employee of the stockbroker or related dealer subsidiary.
- Exercise due diligence when executing client orders and not undertake any prohibited dealings.

Prohibited Dealings
No stockbroker or dealer shall: • create a false market in any listed security • establish a corner or trade where a corner has developed in a listed security • negotiate on any issue relating to trading with any other person on the trading floor of the securities exchange • be party to any trading and price manipulative scheme or device. • make general recommendations to the public on particular securities through publications or statements • sell securities which are not registered in the name of the stockbrokers' client or central depository.

Investment banks, fund managers and investment advisers are bound by the same requirements.

3.4 Client Accounts

A stockbroker should ensure that client money is segregated from its own and take appropriate steps to protect the client's assets including:

- Deposit client funds in one or more bank accounts that are clearly designated as 'client accounts' and only allow client funds to be held in those accounts.
- Do not permit client accounts to be overdrawn for any reason.
- Maintain a separate record for each account showing the name and address of the bank, the dates, amounts of deposits and withdrawals and the exact amount of each client's beneficial interest in the account.
- Reconcile such accounts on a regular basis to ensure the amount indicated corresponds with the balances in the client account at any given time.
- Where clients have paid in advance, ensure that orders are executed according to the clients' instructions and in any event not later than one month from the date of receipt of the clients' funds. Orders not executed within one month for whatever reason should be renewed by fresh instructions from the client.

3.5 Record Keeping and Reporting Obligations

Licensed intermediaries are required to keep records of their operations for a period of seven years. Some of the rules surrounding record keeping are noted below.

Record Keeping Requirements	
Accounting Records	• Records reflecting all assets and liabilities, income, expense and capital accounts. • Detailed records of nominee accounts. • Bank statements and reconciliation accounts. • Client account records itemising all purchases, sales, receipts and deliveries of securities and all other debits and credits.
Client Accounts	• Details of the client and the identification taken and where the client is a company, certified copies of the memorandum and articles of association and the certificate of incorporation. • Copies of all written communications to and from clients including written trade instructions. • Where recommendations are made to buy or sell securities, details of the client's occupation, financial situation, investment objectives, and other information used as the basis for ensuring the recommendations made are suitable. • The signature and name of the agent who made the recommendation to the client and the date when any order was given to the stockbroker or its agent and any price limit given.
Discretionary Accounts	• For discretionary accounts, the client's written authorisation to exercise discretionary power and the reason given by the client for granting discretionary power or authority in their account. • The written approval of the stockbroker's designated supervisor for each transaction in such account indicating the exact time and date of such approval.
Dealing	• Stockbrokers and dealers must maintain a record of their daily dealing transactions that include particulars of the type of security, the value of the trade, the counterparty and the nature of the account. • For each client's order, the time of receipt, the terms and conditions of the order, the account for which the order was entered, the time of entry into the market for execution, the price at which the order was executed and, to the extent feasible, the time of execution or cancellation. • Copies of confirmation of all purchases and sales and notices of all other debits and credits for securities and other items for the account of client. • Records on all commissions earned on account of equities, bonds and others.

Stockbrokers and dealers are required to submit to the securities exchange and the CMA a report of all of their dealing transactions whether traded on-exchange or off-exchange:

- monthly reports and accounts within 15 days of the end of each calendar month
- quarterly reports and accounts within 15 days of the end of each calendar quarter
- half yearly reports and accounts within 30 days of the end of each half-year.

In addition, audited annual accounts prepared in accordance with International Financial Reporting Standards must be submitted within three months following the end of the firm's financial year. The financial year for authorised firms ends on 31 December each year and so they must be submitted by 31 March.

3.6 Custodians

Every investment adviser and fund manager that manages discretionary funds has to appoint a custodian for the assets of the fund. The same requirement applies to investment banks when they undertake similar authorised functions. Details of the fees charged for custodial services are to be disclosed to clients in the investment adviser or fund manager's annual report.

A custodian renders safekeeping and investment administration services for the investment portfolios managed by intermediaries such as an investment adviser or fund manager and for funds such as collective investment schemes. A custodian takes into its custody or under its control all of the assets of such investment portfolios and holds them in trust for the clients. In doing so, the custodian will register the assets in its name but hold them to the order of the clients.

Duties of a Custodian
• Opening an account in the name of each client for the exclusive benefit of such investment portfolio. • Keeping in safe custody title documents, securities and cash amounts of the investment portfolio. • Transferring, exchanging or delivering securities held by the custodian upon receipt of proper instructions from the investment adviser or fund manager. • Exercising subscription, purchase or other similar rights in accordance with the instructions received from the investment adviser or fund manager. • Providing details of any corporate announcement affecting the securities including annual accounts, notices of meeting, proxies and other stockholder communications.

A custodian is expected to exercise a duty of care in the safekeeping and administration of the assets and where title to investments is recorded electronically, ensure that each client's investments are separately identifiable.

A custodian may be removed with the approval of the CMA provided that some other qualified authorised depository is appointed to replace it.

A custodian must prepare and submit an annual report to the CMA demonstrating how compliance with the regulations and its service agreement has been achieved.

End of Chapter Questions

1. Which type of organisation requires approval from the CMA as opposed to a licence?
Answer reference: Section 1.1

2. What criteria will the CMA use to determine whether a person is suitable for the grant of a licence?
Answer reference: Section 1.2

3. What four factors does the CMA assess when undertaking a fit and proper test?
Answer reference: Section 1.2

4. Individuals carrying out what functions would be classed as key personnel?
Answer reference: Section 1.3

5. Within what timescale must a licensed intermediary notify the CMA of any change to its capital structure?
Answer reference: Section 1.4

6. Within what timescale must a licensed intermediary publish its annual accounts?
Answer reference: Section 1.4

7. What amount of professional indemnity insurance cover must a licensed intermediary maintain?
Answer reference: Section 1.4

8. What is the maximum number of years that an auditor can act for a licensed intermediary?
Answer reference: Section 1.5

9. What is a self regulatory organisation?
Answer reference: Section 2.1

10. In what circumstances should an exchange notify the CMA when there are disruptions to trading?
Answer reference: Section 2.2

11. Why might the CMA fix limits on the trading of a contract that can be undertaken on a derivatives exchange?
Answer reference: Section 2.3

12. What are the duties of a CSD?
Answer reference: Section 2.5

13. List three examples of the powers of the CMA to intervene in the operation of an exchange or CSD?
Answer reference: Section 2.6

14. What is the difference between a dealer and an authorised securities dealer?
Answer reference: Section 3

15. What is the maximum value of all client portfolios that can be managed under the investment adviser's licence?
Answer reference: Section 3.1

1.6 What financial requirements must a stockbroker meet?
Answer reference: Section 3.2

17. What are examples of prohibited dealings?
Answer reference: Section 3.3

18. Why is it a requirement that client money is held in a client account?
Answer reference: Section 3.4

19. How often are stockbrokers and dealers required to submit to the securities exchange and the CMA a report of all of their dealing transactions?
Answer reference: Section 3.5

20. What are the duties of a custodian?
Answer reference: Section 3.6

Chapter Three

Governance and Controls

This syllabus area will provide approximately 9 of the 50 examination questions

1. Objective of the Corporate Governance Regulations

Learning Objective

3.1.1 Know the purpose of corporate governance rules and the types of mechanisms available

The Capital Markets Authority (CMA) has issued regulations and guidelines that market intermediaries are expected to use to develop and maintain a robust corporate governance framework. The rules and recommendations are considered in the following sections. (Note: the corporate governance rules for listed companies are considered in Chapter 5.)

A company is a separate legal entity distinct from its shareholder owners and the responsibility for the day-to-day running of a company is the function of the company's executive directors.

The executive directors and other members of the board are ultimately accountable to the company's shareholders for their actions in carrying out their function. This requires a mechanism to ensure that the board runs a company in the best long-term interests of its shareholders – a mechanism known as corporate governance.

Effective governance of a capital markets company is of intrinsic interest not just to its shareholders but also to its wider stakeholders such as its customers, the public and other market participants. As a result, market intermediaries should establish a corporate governance framework that provides strategic guidance to the firm and promotes the effective monitoring of the firm's management and its accountability to the board.

The types of corporate governance mechanisms deployed will vary from firm to firm but can be looked at under two headings – mechanisms that are in place internally within a company and externally imposed controls.

Corporate Governance Mechanisms	
Internal Controls	• An independent board of directors that monitors the activities of the executive officers of the company in the exercise of their duties. • Separation of responsibilities between the chairman and chief executive. • Appointment of independent non-executive directors. • The establishment of specialist committees, such as audit and risk committees, to undertake independent assessment and oversight of risks and financial reporting.
External Controls	• Legal duties imposed on directors. • Corporate governance regulations and internal control standards. • Rules of self-regulatory organisations that have to be adhered to. • Reporting of financial performance. • Independent audit of financial, and other, statements.

Corporate governance standards are designed to set best practice standards that firms should follow. It is not possible for them to be capable of dealing with all possible scenarios; instead, they should be seen as a set of standards that need to be continually altered in the light of market experience.

2. Board of Directors and Governance

Learning Objective

3.2.1 Know the rules on the composition of the board of directors of a market intermediary

3.2.2 Know the main responsibilities of the board and the requirement for a board charter

3.2.3 Understand the main provisions of the prescribed code of conduct

The corporate governance regulations set standards for the composition of the board of directors of a market intermediary and its operation.

2.1 Board of Directors

The shareholders of a market intermediary are expected to have active involvement in the appointment of the board of directors and how it operates:

- They should only appoint persons who are fit and proper, have the relevant experience and qualifications, and can provide effective leadership and guidance to the business.
- They should ensure through general meetings and related forums that the board is constantly held accountable and responsible for the efficient and effective governance of the firm.
- They should exercise their rights of ownership by voting to change the composition of the board that does not perform to expectation or in accordance with its mandate.

Market intermediaries must not appoint a person to be a director unless that person is fit and proper to hold such position and is a certified director from an institution recognised by the CMA. They should also ensure that the director has received relevant training on corporate governance. The firm should keep a register of its directors and make this available for inspection by the public, without any charge, at its registered office.

The board must be composed of a mix of executive and non-executive directors with a non-executive director appointed as chairperson.

Composition of the Board
The board of a market intermediary must be composed of: • a minimum of three directors of whom at least two are natural persons • independent non-executive directors making up at least one third of the board • not more than one third of directors who are close relations of any director In addition, the composition of the board should meet the following requirements: • A person must not be a director of more than two separate market intermediaries. • A firm must not appoint a shareholder who holds more than a 25% shareholding in the firm as an executive director or to any senior position in its management. • The roles of the chairperson and chief executive officer should be separated and the chairperson of the board should be a non-executive director. A firm must not change the composition of its board without the prior written consent of the CMA.

2.2 Role of the Board and Codes of Conduct

The role of the board of directors is to lead, control and be collectively responsible for the conduct and governance of its securities business. It should provide this leadership within a framework of prudent and effective control that facilitates risk assessment and management.

- The board should review the management of the firm and its operations, accounts, major capital expenditure and corporate performance at least once in every three months.
- It should ensure that the firm complies with the Capital Markets Act and other relevant legislation.
- It should review its corporate governance structure annually.
- The board should document the results of the reviews.
- The board should maintain a record of all its decisions and all actions taken to comply with regulatory requirements.

This requires the board to establish a corporate governance framework that provides strategic guidance and promotes the effective monitoring of the management and accountability of the firm. The board should prepare a board charter that:

- confirms its responsibility for the adoption of strategic plans, monitoring the operational performance, and determining policies and processes that ensure the integrity of its risk management and internal controls
- clearly delineates its areas of responsibility and which matters are delegated to management
- provides a corporate code of conduct that addresses conflicts of interest relating to directors and management
- identifies key risk areas that require regular monitoring.

The board may develop its own code of conduct for directors, management and staff or adopt the code of conduct provided in the corporate governance regulations. Where a firm develops its own code of conduct and it does not address all of the issues or is inconsistent with the model code, then the model code applies to the extent of any omission or inconsistency.

2.3 Model Code of Conduct

Set out below is an abbreviated version of the model code of conduct. The full code can be read in the Capital Markets (Corporate Governance) (Market Intermediaries) Regulations 2011.

(Note: the reference to staff in the table below includes directors, management and all staff.)

<table>
<tr><th colspan="2">Prescribed Code of Conduct</th></tr>
<tr><td>Conflict of Interest</td><td>Staff should not engage directly or indirectly in any business activity that competes or conflicts with the firm's interest or those of its clients unless fully disclosed to the clients.
These activities include, although are not necessarily limited to, the following:
outside financial interest
other business interests
other employment
corporate directorship
trusteeships.</td></tr>
<tr><td>Misuse of Position</td><td>Staff must not:
use the firm's name or facilities for personal advantage in political, investment or retail purchasing transactions, or in similar types of activities
solicit or otherwise accept inducements directly or indirectly whether in cash or in kind in order to provide any favours to a client in the conduct of the firm's business
use the firm's facilities and influence for speculating in securities, whether acting personally or on behalf of friends or relatives.
engage in 'backscratching' exercises with employees and directors of other market intermediaries to provide mutually beneficial transactions in return for similar facilities, designed to circumvent these ethical guidelines.</td></tr>
<tr><td>Misuse of Information</td><td>Staff should not engage in insider dealing as this is a criminal offence. Insider dealing involves the following:
dealing in the securities of a company that is listed or pending listing on a stock exchange
when in possession of information obtained by virtue of their employment that is not generally available to shareholders and the public
where the information, if it was made public, would have a material effect on the market price of the securities.
Staff who possess insider information are also prohibited from influencing any other person to deal in the securities concerned or communicating such information to any other person, including other members of staff who do not require such information in discharging their duty.</td></tr>
</table>

Prescribed Code of Conduct	
Integrity of Records and Transactions	• Accounting records and reports must be complete and accurate. Staff should never make entries or allow entries to be made that are false and would obscure the true nature of the transaction, as well as to mislead the true authorisation limits or approval authority of such transactions. • All records and computer files or programmes of the firm including personnel files, financial statements and client information must be accessed and used only for management purposes for which they were originally intended.
Confidentiality	• Confidentiality of relations and dealings between the firm and its clients is paramount in maintaining the firm's reputation. ◦ Staff must take precaution to protect the confidentiality of client information and transactions. ◦ No member of staff should divulge or make use of any secrets, copyright material, or any correspondence, accounts of the firm or its clients. ◦ No member of staff shall in any way use information so obtained for financial gain. • Business and financial information about any client may be used or made available to third parties only with prior written consent of the client.
Fair and Equitable Treatment	• All business dealings on behalf of the firm should be conducted fairly and equitably. Staff must not be influenced by friendship or association, either in meeting a client's requirement, or in recommending that they be met. • Such decisions must be made on a strictly arm's length business basis. All preferential transactions with insiders or related interests should be avoided. • If transacted, such dealings should be in full compliance with the law, judged on normal business criteria, fully documented and duly authorised by the board of directors or any other independent party.
Insider Loans	• Staff should not use their positions to further their personal interests. A firm should not: ◦ grant any unsecured advances in respect of any of its employees or their associates ◦ grant any advances, loans or credit facilities that are not fully secured to any of its officers, significant shareholders or their associates ◦ grant any advance, loan or credit facility to any of its directors or general management unless approved by the full board of directors, made in the normal course of business and on terms similar to those offered to the firm's ordinary clients. The firm shall notify the CMA of every such approval within seven days ◦ grant any advance, undertake any transaction or conduct its business in a fraudulent or reckless manner or in a way not in compliance with the regulations.

Management of a market intermediary should ensure that all employees familiarise themselves with and adhere to the code of conduct.

3. Management and Employees

Learning Objective

3.3.1 Know the requirements to implement a recruitment policy and the specific requirements concerning compliance, risk management and internal audit

3.3.2 Know the sanctions for non-compliance with the corporate governance rules

Staff working in a market intermediary have a key role to play in ensuring compliance with capital market regulations and so there are regulations concerning employees that a firm must follow.

The board should formulate a policy for the appointment of employees and review this at least every three years. The policy and any changes to it require the approval of the CMA.

- The board should ensure that all employees are fit and proper for their roles, including having the necessary qualifications and experience for their responsibilities and there being no evidence of lack of probity and capacity in managing their own financial affairs or those of clients.
- Management should determine and document the experience and qualifications for each post that meets any relevant requirements of the CMA.
- Management should ensure and document that all employees have an appropriate training programme based on the needs of the firm and the requirements of the CMA.
- Management should maintain records for each member of staff demonstrating that it has effectively assessed all relevant qualifications, experience, fitness and propriety.

There are specific requirements concerning compliance, risk management and internal audit.

Requirements for Compliance, Risk Management and Internal Audit	
Compliance	• The board should appoint a compliance officer to monitor compliance with regulatory requirements prescribed and should not be involved with any function that is the subject of compliance. • The individual should have sufficient authority to carry out such function, have unfettered access to information and have direct access to the board. • The compliance officer should take necessary action to rectify any non-compliance, report any non-compliance issues that cannot be rectified to the board and report to the board any material breaches of the regulatory requirements. • The compliance officer should submit an annual corporate governance report to the board. • The officer in charge of compliance may be held personally liable for the failure to ensure proper compliance by the firm with regulatory requirements.

Requirements for Compliance, Risk Management and Internal Audit	
Risk Management	• The board should appoint a risk management officer to assist the board in the discharge of its duties relating to corporate accountability and risk management, assurance and reporting.
Internal Audit	• The board should appoint an internal auditor and the person responsible for that function should be a member of the Institute of Certified Public Accountants of Kenya (ICPAK). • The internal auditor should have direct access to the board, be subject to the oversight of the audit committee, develop an internal audit programme and submit quarterly reports to the audit committee.

In the event that a director or an officer is assessed and found not to be fit and proper to work, the firm should:

- terminate the officer's services
- immediately put in place mechanisms to mitigate any loss or damage to clients, the business or the market as a whole
- inform the CMA of the decision and actions being taken immediately.

A firm that contravenes a requirement of these regulations commits a disciplinary offence that may lead to sanctions and/or penalties.

- All directors of a market intermediary shall be liable jointly and severally to indemnify the firm against any loss arising from contravention of any of the provisions of the Capital Markets Act or these regulations.
- An officer of a market intermediary may be held liable for the acts or omissions of the employees under his supervision arising from his failure to adequately and effectively supervise such employees in accordance with internal controls and the code of conduct.

4. Internal Controls

Learning Objective

3.4.1 Know the purpose of the Internal Control Standards issued by the CMA

3.4.2 Know the main features of the Internal Control Standards – management and supervision; personnel and training; information management; compliance; audit

3.4.3 Know the requirements for segregation of duties and functions

3.4.4 Understand the key operational controls required by market intermediaries

The management of a firm should identify and evaluate the risks it is exposed to for consideration by the board which is to establish appropriate policies for internal controls and risk management.

Management should then design, operate and monitor a suitable system of internal control and risk management that implements the policies of the board.

Management is accountable to the board for monitoring the system of internal controls and reporting on such monitoring activities. The board should periodically review the effectiveness of internal controls and document the results and conclusions.

4.1 Internal Controls

The CMA has developed Internal Control Standards to ensure the proper conduct of a licensed or an approved business. It is important to recognise, however, that it is up to the firm to design and implement a system that will enable it to comply with the regulatory system.

The system of compliance should take into account factors such as:

- size and geographic dispersion of the firm
- types of business activities and the products offered
- the customers of the firm
- any operations, technology, legal and regulatory issues
- market conditions
- other relevant factors.

The business environment is constantly evolving so as the environment changes or as better practices emerge, firms should change their compliance systems accordingly to maintain the highest level of appropriate compliance controls.

4.2 Internal Control Standards

The CMA compiled the Internal Control Standards to assist licensed persons to understand what is expected of them to meet the required level of internal control. The key elements of these are covered below.

4.2.1 Management and Supervision

A firm should have an organisational structure and a management process that ensures it conducts its operations in a sound, efficient and effective manner.

Management should:

- assume full responsibility for the operations of the firm including the development, implementation and ongoing effectiveness of the internal controls of the firm and the adherence thereto by its directors and employees
- ensure that a timely and effective communication process keeps them apprised of the operational and financial position of the firm. This should include risks, weaknesses, regulatory non-compliance and the overall adherence to the defined business objectives of the firm
- clearly identify reporting lines with supervisory and reporting responsibilities assigned to appropriate staff

- clearly detail the authority of staff occupying key positions and ensure adherence to authorisation and approval levels
- ensure that management and supervisory functions are performed by qualified and experienced individuals.

4.2.2 Separation of Duties and Functions

Key duties and functions must be appropriately segregated, particularly those duties and functions which when performed by the same individual may result in undetected errors or may be susceptible to abuses which may expose the firm or its clients to inappropriate risks.

Segregation of Duties

The Internal Control Standards require:
 	
• Where practicable policy formulation, supervisory and other internal review or advisory functions (including compliance and internal audit) should be segregated from line operational duties.
• Compliance and internal audit functions should be effectively segregated and independent from operational and related supervisory functions and report directly to the board.
• There should be an adequate separation of employee duties particularly between:
  ◦ those responsible for incurring commitments
  ◦ from those responsible for making payments, and
  ◦ from those responsible for preparing accounts.
• Operational functions including sales, dealing, accounting and settlement should be effectively segregated where practicable.
• Sales and dealing functions should be segregated from the research function where the possibility of potential conflict of interest exists.
• Where practicable, the research and the corporate finance functions should be segregated to ensure the objectivity of the research function.
• Internal controls should restrict the flow of information between key departments and other functions as may be considered necessary.

4.2.3 Personnel

A firm should ensure that its employees, collectively, have the necessary knowledge, skills, information and authority to establish, operate and monitor the system of internal controls.

A firm should introduce and maintain procedure manuals to implement its policies and controls and its procedures should:

- set out the areas of discretion of each employee and state that each employee is subject to oversight by another employee and in the case of management, oversight by the board
- define the ability of any employee to commit the firm to expenditure, market positions or any other trading matter
- ensure there are adequate financial controls including a requirement for dual signatures for material payments.

CISI
CHARTERED INSTITUTE FOR SECURITIES & INVESTMENT

4.2.4 Training and Competence

Management should ensure that appropriate personnel recruitment and training policies are established with adequate consideration given to training needs to ensure compliance with the operational, internal control policies and procedures of the firm, and all applicable legal and regulatory requirements to which the firm and its employees are subject to.

The control standards require firms to:

- implement procedures to ensure that the firm employs persons who are fit and proper to perform the duties for which they are employed and that such persons are duly registered with all applicable regulatory bodies as required
- ensure that all staff and other persons performing services on behalf of the firm are provided with adequate and up-to-date documentation regarding the policies and procedures of the firm which should include those relating to internal controls and personal dealing
- ensure that adequate training suitable for specific duties which staff perform is provided both initially and on an ongoing basis. A training programme should ensure that staff possess or acquire appropriate and practical experience through 'on-the-job' training and, where appropriate, structured courses.

4.2.5 Information Management

The Internal Control Standards require firms to establish policies and procedures to ensure the integrity, security, availability, reliability and thoroughness of all information, including documentation and electronically stored data, relevant to the business operations of the firm.

The control standards require firms to:

- assign the management of information, both in physical and electronic form, to qualified staff
- ensure that the operating, information management and electronic data processing systems meet the needs of the firm and operate in a secure and adequately controlled environment
- clearly define information management reporting requirements to ensure the adequacy and timeliness of internal and external reports including those required by relevant regulatory and self-regulatory bodies
- document and regularly review the key components of the information management system
- implement data processing and security policies to prevent unauthorised access or change to firm operating system and data
- put in place record retention policies which ensure that all relevant legal and regulatory requirements are complied with, and which enable the firm, its auditors and other interested parties to carry out routine and ad hoc comprehensive reviews or investigations.

4.2.6 Compliance

The Internal Control Standards require firms to ensure that policies and procedures are established and maintained to ensure compliance of the firm with all applicable legal and regulatory requirements as well as with the internal policies and procedures of the firm.

A firm should establish an effective compliance function that is independent of all operational and business functions and which reports directly to management.

- Management should establish, maintain and enforce effective compliance procedures that cover legal and regulatory requirements.
- Staff performing the compliance function should possess the necessary skills, qualifications and experience to enable them to effectively execute their duties.
- Management should enforce clear policies to ensure that the compliance function covers all relevant aspects of the firm's operations, including the unfettered access to necessary records and documentation.
- The firm should put in place written complaint handling procedures and ensure the proper handling of client complaints and appropriate remedial action is promptly taken. Where possible, complaints should be investigated by compliance staff who are not directly involved in the subject matter of the complaint.
- Compliance should promptly report to management all occurrences of material non-compliance by the firm or its staff with legal and regulatory requirements, as well as with policies and procedures of the firm.
- Management should promptly notify the applicable exchanges, clearing houses and the CMA of occurrences of material non-compliance by the firm.

4.2.7 Audit

Firms should have an audit policy and internal audit function which objectively examines, evaluates and reports on the adequacy, effectiveness and efficiency of the management, operations and internal controls of the firm.

The Internal Control Standards set by CMA include:

- where practicable, internal audit should be independent and free of operating responsibilities and its personnel should have the necessary technical competence and experience
- internal audit should be separate from compliance and any other function that it is responsible for auditing
- the function should have a direct line of communication to the audit committee and the board and operate within clearly prescribed terms of reference
- the board should ensure that there is adequate planning, control and recording of all audit and review work performed; timely reporting of findings, conclusions and recommendations to the board; and matters or risks highlighted in the relevant reports are followed up and resolved satisfactorily.

4.2.8 Operational Controls

Management needs to ensure that it puts in place effective policies, operational procedures and controls in relation to the day-to-day business operations of the firm. These should provide for the:

- exchange of information between the firm and its clients including information from and required disclosures of information to clients
- integrity of the dealing practices of the firm including the treatment of all clients in a fair, honest and professional manner

- safeguarding of both the assets of the firm and the assets of its clients
- maintenance of proper records used within the firm or used for publication
- compliance by the firm and persons acting on the firm's behalf, with relevant legal and regulatory requirements.

There are extensive Internal Control Standards and guidelines that require firms to implement operational controls. Many of the key internal control practices and processes have been specifically included in the conduct of business rules that are covered in Chapter 4.

Some of the key areas covered by the standards are noted below.

Operational Control Standards	
Know Your Client	• Establish the identity of the client through the proper application of 'know your client' principles including beneficial owners and persons authorised to give instructions. • Document and understand the client's financial position, investment experience and objectives prior to the establishment of an account.
Discretionary Accounts	• The precise terms and conditions under which such authority may be exercised are effectively communicated to the client. • Only transactions consistent with the investment strategies and objectives of the relevant client are undertaken on the client's behalf. • The use of nominee accounts should be restricted to client activity and not used to mask house, directors or staff trading.
Investment Advice	• Recommendations and advice are based on thorough analysis, taking into account available alternatives and are appropriate for the client. • The firm should document and retain the reasons for the recommendations and advice given.
Conflicts of Interest	• Minimise potential conflicts of interest and where actual or apparent conflicts of interest cannot reasonably be avoided, clients are fully informed of the nature and possible ramifications of such conflicts and are treated fairly in all cases. • Whenever the firm or its staff has a material interest in a transaction, the interest is disclosed, where practicable, to the client prior to the execution of the relevant transaction.

Operational Control Standards	
Client Order Handling	• Handle client orders in a fair and equitable manner and in all cases comply with order the order handling rules. • Document clear and comprehensive audit trails to precisely record all orders from the time of origination, including the time the order was received or initiated, through to order execution and settlement, eg, through use of sequential numbering on order tickets and the use of time-stamping facilities. • Dealing processes should prevent or detect errors, omissions, fraud and other unauthorised or improper activities, ensuring fair and timely allocation of trades is effected on behalf of clients.
Price-Sensitive Information	• Prevent the firm or its staff from taking advantage of confidential price-sensitive information or executing transactions on behalf of insiders that may contravene any laws.
Client Assets	• Protect both the assets of the firm and those of its clients from theft, fraud and other acts of misappropriation. • Safeguard all assets while at the premises of the firm and promptly deposit these into appropriate accounts at banks or securities depositories. • Maintain audit trails to enable the firm to prevent, detect and investigate suspected improprieties.
Reconciliations	• Undertake regular reconciliation of internal records with reports issued by third parties, eg, clearing houses, banks, custodians, counterparties and executing brokers to identify and highlight for action any errors, omissions or misplacement of assets. • Senior staff check and approve reconciliations.

5. Risk Management

Learning Objective

3.5.1 Know the role of the various parties involved in risk management

3.5.2 Know the CMA Internal Control Standards and guidelines for a firm's risk management approach

The board is responsible for the development and implementation of a risk management process and for the regular review of its effectiveness.

The management of the firm is accountable to the board for designing, implementing, monitoring and integrating the risk management process into the day-to-day business of the organisation. A risk management process should have regard to the size and nature of the firm's operations and the extent to which the risks may affect its business.

Employees have a key role to play in the system of internal control and risk management and should actively support, report and contribute to the risk management process and maintain an awareness of the risks and opportunities that relate to their work.

5.1 Control Standards

The objective of risk management is to ensure that effective policies and procedures are established and maintained to ensure the proper management of risks to which the firm and, if applicable, its clients are exposed. This includes the identification and quantification of risks and provision of information to enable appropriate and timely action to manage them.

The CMA has published Internal Control Standards for a firm's risk management approach.

Control Standards
• Management should clearly define its risk policies and have risk measurement and reporting methodologies commensurate with its business strategies, size, complexity of its operations and risk profile. • Establish a risk management function that consists of a sufficient number of suitably qualified and experienced professionals. • Appropriate and effective procedures are established and followed to ensure that the firm's risks of suffering loss because of client defaults or changing market conditions are at acceptable and appropriate levels. • Procedures should ensure that the firm only takes positions that it has the financial and management capacity to assume. • Where the firm carries out proprietary trading, appropriate trading limits and position limits are established and monitored at appropriate intervals and reviewed as part of the end-of-day processing routine. • Appropriate exposure reports are submitted regularly to management and any significant variances are reported promptly. • Ensure that comprehensive reviews are conducted at suitable intervals, and wherever there is significant change in the business, operation or key personnel, ensure that the firm's risk of suffering losses, whether financial or otherwise, as a result of fraud, errors and omissions, interruptions or other operational or control failures is maintained at acceptable and appropriate levels.

Management should maintain back-up and contingency plans for dealing with eventualities relating to risks, including catastrophic information technology failure, the loss of records and the loss of access to its business premises. It should also make arrangements for business continuity in the event of the loss of key personnel through illness, resignation or otherwise.

5.2 Risk Control Guidelines

The risks that a market firm faces are normally classified under four main headings – credit risk, market risk, liquidity risk and operational risk. The CMA has issued guidelines for suggested control techniques and procedures that should be deployed in these areas.

5.2.1 Credit Risk

Credit risk is the potential loss of earnings or capital due to a counterparty's failure to meet its obligations. A firm should establish and maintain an effective credit rating system to evaluate client and counterparty creditworthiness.

The firm should set appropriate credit limits for all clients that take account of the client's financial position and their investment objectives, investment history, trading frequency and risk appetite. It should also take account of the client's credit rating and past record of payments and defaults.

Where a firm permits trading on margin, its procedures should define what constitutes acceptable collateral and the consequence of a failure to meet a margin call, including the actions that the firm may be entitled to take and escalation procedures where a client fails to meet successive margin calls.

Risk management should:

- specify trading and position limits for each client based on their respective credit rating and trading needs
- utilise appropriate quantitative risk measurement methodologies to effectively calculate and monitor the firm's credit exposure including pre-settlement credit exposures (eg, marking to market of outstanding trades) and settlement risk (eg, exposure caused by timing differences between deliveries versus payment)
- aggregate the credit risks of clients belonging to the same group of companies when measuring the firm's credit exposure and take into account netting arrangements that may serve to reduce the firm's exposure.

A firm should strictly enforce trading, position and margin limits.

5.2.2 Market Risk

Market risk is the risk of loss arising from changes in the value of financial instruments. The financial services industry takes advantage of the existence of market risk to make a profit. The aim of managing this risk is not to eradicate it but to understand and quantify it.

Effective risk management measures are needed to quantify the impact on the firm and its clients from changing market conditions, especially if it deals in derivative financial products. These measures should cover all risk elements associated with the products traded or services provided by the firm and include:

- **unspecified adverse market movements** – using an appropriate value-at-risk (VaR) or other methodology to estimate potential losses; this is particularly important for firms that take significant proprietary positions in derivative products

- **individual market factors** – measures the sensitivity of the firm's risk exposure to specific market risk factors eg, interest rate yield curve shifting and changes in market volatility
- **stress testing** – determining the effect of abnormal and significant changes in market conditions on the firm using various quantitative and qualitative variable assumptions.

Relevant control techniques may include regular review of the balance sheet and profit and loss accounts, records of individual traders and trading members for unauthorised investments or transactions, and confirmation of outstanding transactions with the firm's trading partners.

To discourage the firm's dealers from engaging in unauthorised trading, the firm should use risk-adjusted performance measures that may affect a dealer's remuneration where the dealer's activities expose the firm to especially high risks.

Risk management should review and enforce compliance with trading and position limits in relation to proprietary trading and open positions with respect to each authorised product the firm trades or invests in.

5.2.3 Liquidity Risk

Liquidity risk is associated with market risk and represents the risk that a firm will be unable to unwind a position in a particular financial instrument at, or near, its market value because of a lack of depth or disruption in the market for that instrument.

Relevant control techniques include setting concentration limits with respect to particular products, markets and business counterparties, taking into account their respective liquidity profile and the firm's approved liquidity risk policies.

Other measures include:

- regular monitoring of maturity mismatches between sources of funding and funding requirements
- monitoring concentration limits of individual products, markets and business counterparties
- establishing appropriate arrears and default procedures to alert staff responsible for liquidity management to potential problems and to provide them adequate time to take appropriate action to minimise the impact of client or counterparty liquidity problems.

5.2.4 Operational Risk

The Basel Committee on Banking Supervision (BCBS) defines operational risk as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. This definition covers legal risk including fines, penalties and punitive damage resulting from regulatory actions but excludes reputational risk.

Compared to credit and market risk, it is relatively difficult to identify or numerically assess levels of operational risk and its many sources. However, the importance of managing operational risk cannot be understated. There have been many examples of financial services firms failing not just because of credit or market risks, but also by various combinations of – malfunctioning internal processes, technology failure, undesirable staff behaviours such as fraud, compliance issues and financial difficulties such as deficient liquidity management processes.

Recommended CMA control techniques include:

- physical and functional segregation of incompatible duties such as trade, settlement, risk management and accounting
- maintenance and timely production of proper and adequate accounting and other records, and the ability to detect fraud, errors, omissions and other non-compliance with external and internal requirements
- security and the reliability of accounting and other information, such as exception reports which should accurately highlight unusual activities and facilitate the detection of fraud, errors and significant trends
- staffing adequacy including personnel with relevant and sufficient skills and experience to minimise the risk of loss due to the absence or departure of key staff.

A firm should implement an effective business continuity to ensure that it is protected from the risk of interruption to its business continuity. Key processes in this area include a business impact study, identification of likely scenarios involving interruptions (for example, breakdown in its data processing systems) and documentation and regular testing of the firm's disaster recovery plan.

The firm should also have adequate insurance cover for different types of exposures, including but not limited to, fidelity insurance and replacement of equipment and other business and data processing devices.

5.3 Risk Management Function

Risk management should:

- define the nature, role, responsibility and authority of the risk management function of the market intermediary
- review and assess the integrity of the risk control systems and ensure that the risk policies and strategies are effectively managed
- monitor external developments relating to the practice of corporate accountability and the reporting of associated risk, including emerging and prospective impact
- obtain such external or other independent professional advice as it considers necessary to carry out its duties
- provide independent and objective oversight and review of the information presented by management on corporate accountability and specifically associated risk, taking account of risk concerns raised by management at the audit committee meetings on financial, business and strategic risk
- prepare a report for submission to the board so that they can annually review its risk management procedures and contingency plans.

6. Audit

Learning Objective

3.6.1 Know the role of the audit committee and internal audit

The board should establish an audit committee with written terms of reference that spell out its remit and responsibilities.

Audit Committee	
General Obligations	• Review the periodical financial statements and any other financial reports or financial information. • Monitor compliance of the firm with its code of conduct and ethics. • Consider the work plan of the firm's compliance activities. • Regularly report to the board on the activities of the firm, issues and related recommendations.
External Audit	• Review the external auditors' proposed audit scope and approach. • Review with management and external auditors the audited and unaudited financial statements before they are released to the public. • Review with management and external auditors the effectiveness of the documented risk management policy.
Internal Audit	• Review regular internal audit reports prepared by the firm's internal auditor and management's response to such reports. • Review the effectiveness of the internal controls of the firm and other matters affecting its financial performance and financial reporting, including information technology security and control. • Institute and oversee special investigations when necessary.

A firm should establish an internal audit function and implement a systematic, disciplined approach, to evaluate and improve the effectiveness of risk management, control and governance processes.

The board should formulate an internal audit charter to define its role and responsibilities. The charter should require internal audit to:

- provide assurance that the management processes are adequate to identify and monitor significant risks
- provide confirmation of the effective operation of the firm's internal control system
- ensure that there are credible processes for feedback on risk management and assurance
- provide objective confirmation that the board receives the right quality of assurance and information from management and that this information is reliable.

As mentioned earlier, the internal auditor should have direct access to the board, be subject to the oversight of the audit committee, develop an internal audit programme and submit quarterly reports to the audit committee.

7. Capital Markets Authority (CMA) Audits

Learning Objective

3.7.1 Know the objectives of CMA compliance reviews

3.7.2 Know the factors that the CMA will consider when conducting compliance reviews

The CMA will periodically undertake an assessment of the way in which licensed and approved businesses operate. The objective of these reviews is to ensure firms are complying with the regulations and that such compliance provides assurance of the:

- ability of the firm to carry on its business in an orderly and efficient manner
- safeguarding of its assets and the assets of its clients
- maintenance of proper records and the reliability of financial and other information used within and published by the business
- compliance with all applicable laws and regulatory requirements
- completeness and competency of the compliance function of the firm.

The CMA will utilise a variety of resources and tools when it makes its assessments. These include assessment questionnaires, on-site and off-site inspections and third party inspections. The latter may include inspections by self-regulatory organisations, compliance teams or by independent accounting or legal firms instructed by CMA.

The review process will entail gaining an understanding of the securities-related businesses and organisational structure of the firm. Some of the factors that CMA will consider are corporate culture, the supervisory structure, how the firm fulfils its compliance responsibilities, and an evaluation of how the firm identifies and addresses compliance risks and risk management.

Review Factors	
Corporate Culture	• Board and senior management involvement in compliance setting and monitoring. • Whether the board and senior management promote a strong and proactive culture of compliance in the firm in setting overall compliance policy. • Whether the board and senior management recognise the high priority of compliance and actively work with senior compliance officers.
Supervisory Approach	• Review of the supervisory structure. • Extent and completeness of written supervisory procedures including front line supervision and branch office supervision. • Review of employee supervision including hiring, registration, licensing, continuing education, personal trading and training.

Review Factors	
Compliance Approach	• Evaluating how the firm fulfils its compliance responsibilities. • Review of the independent oversight of compliance by the firm and its employees. • Effectiveness of compliance functions including coverage, resources, systems and communications with the board and senior management. • Experience and independence of personnel with compliance responsibility.
Compliance Risks	• Evaluation of how the firm identifies and addresses compliance risks. • How it assesses its own compliance programme including branch examinations, audits, new product reviews, surveillance and attitude to whistleblowing.
Risk Management	• Review to ensure that risk (credit, market, legal and operational risks) is identified, assessed, monitored and controlled within the firm.

In addition to considering the internal controls, systems and the risk management controls deployed by the firm, the CMA will supplement such reviews by assessing other business matters, industry developments, complaints, compliance breaches and any problems that have arisen with the firm's compliance programme.

Other Factors	
Business Matters	• Has the firm: ◦ entered new lines of business, developed significant new customers or modified its investment practices or strategies? ◦ hired any new professionals whose activities should be covered by the compliance program? ◦ implemented new software or automation initiatives? ◦ acquired any new subsidiaries, has its ownership changed or have there been any other business or organisational changes?
Industry Developments	• Has there been any change in industry best practices or other standards? • Has another relevant regulator proposed or adopted any rules relating to the business of the firm?
Complaints and Breaches	• Is there a pattern of client complaints or compliance exceptions? • Were remedial actions taken promptly? • Is there a pattern in the remedial actions taken? • Were complaints or exceptions escalated properly?
Compliance Programme	• Any issue with interpretation or confusion about the application of specific policies and procedures. • Any compliance concern not anticipated by the compliance programme. • Any violations of specific policies and procedures for which a remedial process was not identified. • Any problem in enforcing the compliance programme, eg, difficulties with respect to specific individuals or matters.

End of Chapter Questions

1. What is the purpose of corporate governance?
   Answer reference: Section 1

2. What is the role of shareholders in the corporate governance of a firm?
   Answer reference: Section 2.1

3. How frequently should the board review its corporate governance structure?
   Answer reference: Section 2.2

4. What is insider dealing?
   Answer reference: Section 2.3

5. Who is responsible for submitting an annual corporate governance report to the board?
   Answer reference: Section 3

6. Which person can be held personally liable for the failure to ensure proper compliance with the regulatory requirements?
   Answer reference: Section 3

7. The dealing function should be segregated from which other functions?
   Answer reference: Section 4.2.2

8. Under the CMA Internal Control Standards who should ideally investigate complaints?
   Answer reference: Section 4.2.6

9. Why should the use of nominee accounts be restricted to clients?
   Answer reference: Section 4.2.8

10. Do employees have any role to play in risk management?
    Answer reference: Section 5

11. What are the four main headings under which risk is normally classified for market firms?
    Answer reference: Section 5.2

12. What is the difference between market risk and liquidity risk?
    Answer reference: Section 5.2.3

13. Segregation of duties is a control measure that can be used to address which type of risk?
    Answer reference: Section 5.2.4

14. How frequently should the board review its risk management procedures and contingency plans?
    Answer reference: Section 5.3

15. Who is responsible for reviewing the effectiveness of the internal controls of the firm?
    Answer reference: Section 6

16. A CMA review of a firm's supervisory approach would take into account which factors?
    Answer reference: Section 7

Chapter Four

Conduct of Business

This syllabus area will provide approximately 18 of the 50 examination questions

1. Standards of Conduct

Learning Objective

4.1.1 Know the standards of conduct that market intermediaries must apply when conducting business with the public

The conduct of business rules apply to market intermediaries who are organisations licensed by the CMA to offer services to clients within the capital markets industry which include, but are not limited to, the purchasing of shares and investment advisory services.

A market intermediary is required to apply the following principles when conducting business with the public:

- Observe a high standard of integrity and fair dealing.
- Maintain independence and objectivity in its activities.
- Act with due skill, prudence, loyalty, care and diligence.
- Observe high standards of market conduct.

A market intermediary must also have in place a code of conduct that at minimum meets the standards set out in the CMA model code of conduct (see Chapter 2). Management of a market intermediary should ensure that all employees familiarise themselves with, and adhere to the code of conduct that covers the following areas:

- conflicts of interest
- misuse of position
- misuse of information
- integrity of records and transactions
- confidentiality
- fair and equitable treatment
- insider loans
- professionalism
- investment analysis, recommendations and actions.

2. Conducting Business with Clients

Learning Objective

4.2.1 Know the purpose of the fair and clear communications rule

4.2.2 Know the rules surrounding cold calling

4.2.3 Know the rules surrounding the disclosure of charges

4.2.4 Know the required content of a client agreement

4.2.5 Understand the requirement not to exclude any rights owed to a client and the concept of fiduciary duty

4.2.6 Understand when conflicts of interest may arise and the steps that should be taken to manage them

4.2.7 Understand the rules around client confidentiality and access to client information

The conduct of business rules contain a series of requirements that market intermediaries must meet when conducting business with clients that include rules on:

- fair and clear communications
- cold calling
- disclosure of charges
- client agreements
- client rights
- conflicts of interest
- client confidentiality.

The purpose of these rules is to provide investor protection and to require market intermediaries to follow best practice standards that restrict the possibility of a client being disadvantaged either intentionally or inadvertently.

2.1 Fair and Clear Communications

There are stringent rules that firms must follow when communicating with clients. The purpose of the fair and clear communications rule is to address concerns of potential mis-selling practices that can arise where clients are not always able to understand the risks they are subject to when considering entering into a product or service.

Fair and Clear Communications Rule
When communicating with clients, a market intermediary is required to ensure that any form of written communication given or sent to its clients is presented fairly and clearly.

The principle covers a broad range of scenarios when communicating with existing or potential clients including face-to-face meetings, calls, electronic media, new issues and marketing material.

Before buying or investing in a product or instrument, clients should have key information regarding the investment that is provided at a time when they have the opportunity to consider the information and make an informed decision about whether or not to buy or invest.

Some key practical considerations when communicating with clients include ensuring:

- The style of presentation enables the intended clients to understand the material by using plain language.
- The features of the investment and any associated guarantees and rights of cancellation or withdrawal should be clearly explained.
- The charges associated with the product and any costs of investment or commissions payable should be clearly disclosed.
- Communications should not emphasise the potential benefits of an investment without also giving a fair and prominent indication of any risks.
- Communications should not disguise, obscure or hide important items, statements or warnings.
- Information on potential future performance should be based on robust and justifiable performance data and should reflect the nature and risks of the specific type of investment.
- Distinguish between fact and opinion in the presentation of investment analysis and recommendations.

Disclosure standards and associated requirements are important regulatory tools in promoting investor protection. Providing information in such a way that investors can easily understand the features, benefits and risks of an investment enables them to make better-informed decisions about their investments.

2.2 Cold Calling

A further rule on client communications relates to the practice of cold calling which again presents risks of mis-selling as clients may be persuaded into entering into contracts or buying investments that are not suitable for their needs.

Cold calling is the practice of market intermediaries contacting people without a prior appointment with a view to communicating a financial product or service to them.

Cold Calling Rules
A market intermediary should not make unsolicited telephone calls or attend at any property, unless it has established and monitors the implementation of operational procedures to: • maintain a Do-Not-Call list which is updated whenever any contacted person requests not to be called again • train staff on the use of the Do-Not-Call list • limit the making of calls to between 8.00am and 5.00pm • at the commencement of the call, oblige the callers to state their first and last names, the firm's name and address and that it is licensed by the CMA • oblige the caller to provide a detailed overview of any product being marketed prior to soliciting any offers • record and provide copies of all recordings to the CMA for inspection.

2.3 Disclosure of Charges

A further measure of investor protection is the requirement for disclosure of charges so that an investor is fully aware of the nature of any charges they might incur in the provision of investment services.

There are rules surrounding the charges that a market intermediary may impose and a requirement for disclosure to clients of its charges before services are provided and subsequently once charges are actually incurred.

Disclosure of Charges Rules
Market intermediaries should disclose the charges it makes for the provision of services and any remuneration it might receive before providing services to clients and provide statements of fees charged.

A market intermediary's fee should be in line with its agreement with the client or in line with the fees prescribed by the CMA. It is required to disclose its charges for the provision of the services and the nature and amount of any other remuneration payable before providing the services to the client.

Subsequently, a market intermediary should provide the client with a monthly statement of fees or charges for each transaction undertaken.

2.4 Client Agreements

Standard best practice is for market intermediaries to enter into a legal contract when providing services to clients, as there is a need to agree what services are to be provided and the rights and obligations of the firm to the client.

The regulatory requirements build on this best practice by specifying the requirement for a client agreement and some of its content as noted below.

Client Agreement Rules
A market intermediary should not provide services in respect of a regulated activity unless it has entered into a written agreement with the client detailing the service to be provided.

The client agreement should set out the basis on which the market intermediary's services are provided and include the factors noted below.

Required Content of a Client Agreement	
General Information	• Essential information about the market intermediary, including its name, address and contact information.
Services	• The services to be provided. • The obligations of the market intermediary. • The obligations of the client, including how instructions are to be given.
Charges	• The fees to be charged or the way the fees will be calculated. • Any commissions to be received from third parties in relation to the services provided to the client.
Rights of the Client	The right to: • Receive title for any securities purchased. • Receive payment for securities sold within a specified period. • Receive a statement of all fees and charges. • Information on the remuneration received by the market intermediary from third parties. • Ask for information on the experience, qualifications and disciplinary history of the market intermediary. • Receive interest on funds held by the market intermediary on the client's behalf. • See the market intermediary's conflict of interest policy. • Complain and to have that complaint dealt with fairly and promptly.
Client Assets	• The arrangements made for securing the title to, and for the custody of securities including the use of nominee accounts and a custodian, where appropriate.
Conflicts of Interest	• Any conflicts of interest relating to the market intermediary and its dealings with the client. • Any connections with third parties that could affect the services being provided, including a requirement that the market intermediary deals through certain third parties or recommends certain investment products.
Other Items	• Any other terms and conditions of the agreement, including the notice to be given in respect of any changes to it or its termination. • The fact that the CMA regulates the market intermediary.

A market intermediary should keep the signed written agreement and provide the client with a copy.

2.5 Client Rights

Market intermediaries occupy a fiduciary position with respect to their clients so it is unacceptable that they should attempt to exclude any obligation that they owe to the client.

Client Rights Rules
A market intermediary should not, in any written communication or agreement exclude or restrict any duty or liability that it owes to a client.

The rules require that a market intermediary should not, in any written communication or agreement exclude or restrict the following:

- any duty or liability to a client that it has under any law or under any regulations made by the CMA
- any other duty to act with skill, care and diligence that is owed to a client
- any liability owed to a client for failure to exercise the degree of skill, care and diligence that may reasonably be expected.

Key to understanding this regulatory requirement is the concept of fiduciary duties. A fiduciary is someone who has the power and obligation to act for another under circumstances that require total trust, good faith and honesty. A fiduciary duty is a legal duty to act solely in another party's interests and is the strictest duty of care recognised by the legal system.

Typically, a fiduciary is responsible for taking care of money or other assets on behalf of someone else; examples include a lawyer and their client, a banker and a depositor, a director and the company's shareholders, a broker and their client, and an investment adviser and their client. The fiduciary will typically have greater knowledge and expertise about the matters being handled.

Fiduciaries have a duty not to put their personal interests before those of their client and a duty not to profit from his fiduciary position without knowledge and consent. Fiduciaries have a duty to avoid any conflicts of interest between themselves and their clients or between their clients and the fiduciaries' other clients. For example, a stockbroker must consider the best investment for the client, and not buy or sell based on what generates the highest commission or favour one client over another when executing trades.

2.6 Conflicts of Interest

Conflicts of interest affect firms of all types and sizes. A conflict of interest may arise where there is conflict between the interests of the firm and the duty it owes to a client or where it has a conflict between its duties to act in the best interests of two or more different clients.

It encompasses all situations where acting in a firm's own interests or the best interests of just one client would result in prejudice to another client in that matter or a related matter. They can lead to decisions that are invalid or open to challenge.

Conflicts of interest can also damage a firm's reputation or public trust and confidence in market intermediaries generally. The rules require that firms identify conflicts of interest and act to prevent them from affecting their decision-making.

Conflict of Interest Rules
A market intermediary should take appropriate steps to manage and minimise the scope for any conflicts and where conflicts arise refuse to act.

Managing conflicts of interest requires a market intermediary to identify and document the conflicts of interest that are likely to occur in the course of its business. This means that they must consider the issue of conflict of interests so that any potential effect on decision-making is eliminated; how they do this will depend on the circumstances.

- In cases of serious conflicts of interest, it may mean the firm deciding to remove the conflict by declining to act.
- Where firms have decided against removal of the conflict of interest they must prevent it from affecting their decision in a different way. They should disclose the conflict to the client if it can be managed and follow the policies developed to minimise damage to the client and to put the client's interests ahead of their own.

A firm should adopt and document appropriate policies to minimise any conflicts by identifying the instances where it would refuse to act and, where this is not necessary, making arrangements to minimise the risk of any loss to the client. The market intermediary should:

- adopt and document procedures, including the erection of information barriers, barriers between information technology systems, physical barriers or even separate office locations, to minimise the possibility of information from one client being used for the benefit of another client, its employees or the market intermediary
- train employees in matters relating to the conflict of interest and the procedures developed to avoid them
- obtain undertakings from employees that they will not use information gained from the clients for their personal benefit
- not take advantage of information it obtained from providing services to a client for its own benefit or the benefit of its employees or for the benefit of another client
- take reasonable steps to ensure that neither it nor any of its employees or agents offers or gives, or solicits or accepts, any inducement that is likely to conflict with any of the duties owed to clients.

2.7 Client Confidentiality

Client confidentiality is the principle that an institution or individual should not reveal information about their clients to a third party without the consent of the client or a clear legal reason.

Client Confidentiality Rules
A market intermediary should keep all information in its possession, relating to a client, whether obtained from the client or third parties, confidential.

The rules require that a market intermediary should adopt and document policies and procedures designed to ensure that it keeps information obtained from clients and third parties confidential and secure. The policies and procedures adopted should include:

- a requirement that employees undertake to maintain confidentiality, in their contract of employment
- how to determine the employees who may have access to confidential information
- procedures that effectively restrict access to confidential information by employees through the use of secure document management
- storage systems and encryption protected information, within the market intermediary's information technology system
- systems designed to safeguard the integrity of any electronic record or transaction recording system.

A market intermediary may, however, disclose information relating to a client to the CMA or an approved securities exchange on request, or if it is ordered to do so by a court of competent jurisdiction.

3. Suitability of Advice

Learning Objectives

4.3.1 Know the definition of 'client's best interest', the rules on independence and the implications of this rule for a market intermediary

4.3.2 Understand the 'know your customer' rules and their impact on investment advice and management

4.3.3 Understand the key stages in investment advice and determining investment objectives and strategy

4.3.4 Understand how to assess a client's risk tolerance, capacity for loss, investment experience and the impact of these factors on the selection of suitable investments

4.3.5 Understand the suitability of advice rules

4.3.6 Understand the rules surrounding presentation of investment recommendations and the standards that must be met

The suitability rules exist to ensure that market intermediaries take reasonable steps to ensure that investment recommendations or decisions to trade are suitable for their clients' needs. It is essential therefore that market intermediaries adopt a structured approach to how investment advice is provided and investment decisions are made.

3.1 Client's Best Interest

As we saw earlier, a fiduciary relationship is one in which one person places special trust, confidence and reliance in, and is influenced by, another who has a fiduciary duty to act for the benefit of that person. In discharging their responsibilities, the fiduciary must be absolutely open and fair and act with loyalty, honesty and in a manner consistent with the best interests of the beneficiary of the fiduciary relationship.

Market intermediaries occupy a fiduciary position and have a duty to put the client's best interests first. Always acting in the client's best interest has to be a fundamental principle for all advisers.

Acting in the client's best interest may take many forms, from ensuring that the adviser has sufficient information to be able to properly advise the client, through selecting suitable investments to meet the client's needs, to undertaking transactions. What it demands as an overriding requirement from the advisers is that they conduct themselves in such a way that they put the interests of the client first and the demands of their firm and their own interests second.

A market intermediary may sell the products of one or a limited number of firms only, or ones from across the whole marketplace. For example, a financial institution could choose to sell either its own range of mutual funds to its customers or ones it selects from across the marketplace. It may do either, but it must make clear to its customer the basis on which it is operating.

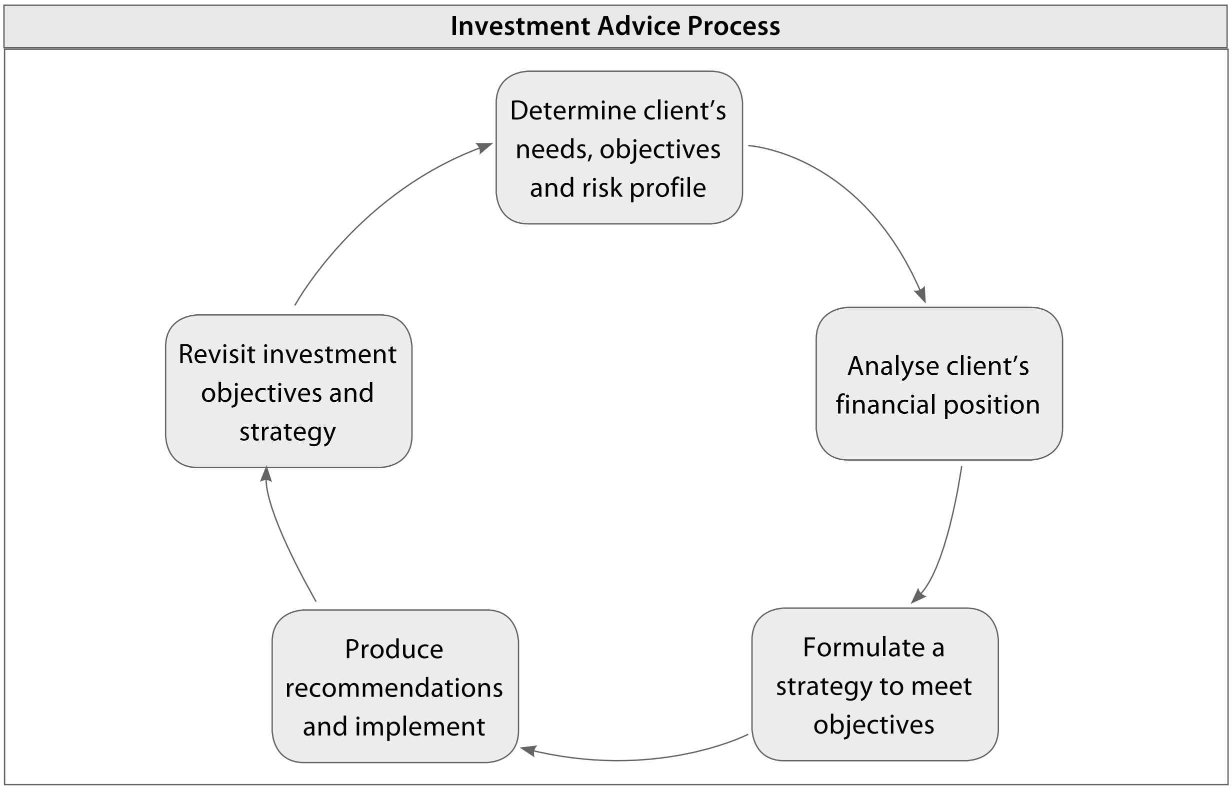
Before providing services, a firm should therefore disclose the scope of its advice and whether its recommendations will be based on products from the whole of the market – independent advice – or will be limited to a single or several product providers – restricted advice.

Independence Rule
A market intermediary advising or acting on behalf of a client is required to ensure that any claim it makes relating to its independence or impartiality includes any limitation that there may be on its capacity.

An investment firm which offers only its own products, or those of a limited number of other companies, should advise only on those products and must disclose this to the client. A firm that selects products from across the market must ensure that it selects the best products and does not enter into any commercial arrangements that might adversely affect its ability to give independent advice.

3.2 Investment Advice Process

Adopting a structured and disciplined approach to investment advice is essential in these days of increasing professionalism and regulatory scrutiny. The investment advice process can be divided into five distinct stages as shown in the following diagram but the key principle is the need to fully understand the client's needs and attitude to risk so that suitable recommendations can be formulated.



Trust is at a premium today in the financial services industry and being able to show clients that a firm has a rigorous process to understand their needs and control risks can go a long way to building trust and having a long-term profitable relationship with a client.

Having a structured investment advice process helps a firm to bring consistency to its advice process. Consistency means that each client should get the same service and outcome no matter which adviser they see. Inconsistency leads to regulatory and reputational risk, while consistency leads to trust and solid, long-term and profitable client relationships.

Clearly, once a relationship is established then the requirement to ensure ongoing suitability of the recommended solution and individual investment decisions continues.

3.2.1 Know Your Customer

A firm should obtain sufficient information about its customers to enable it to meet its responsibility to give suitable advice. Similarly, a firm acting as a discretionary investment manager for a customer should ensure that it has sufficient information to enable it to select suitable investments for the customer's portfolio.

Individuals have varying objectives and expectations and before advising the client an adviser must be aware of these various needs, preferences, expectations and the financial situation of the client.

This requirement to gather sufficient information about the customer is generally referred to as the 'know your customer' requirement or a fact find. The purpose of gathering information about the client is so that financial plans can be devised and appropriate recommendations made. The types of information that should be gathered include:

- **personal details** – name; address; age; health; family and dependants
- **financial details** – income; outgoings; assets; liabilities; insurance and protection arrangements
- **objectives** – growth; protecting real value of capital; generating income; protecting against future events
- **risk tolerance** – cautious; balanced; adventurous
- **liquidity and time horizons** – immediate needs; known future liabilities; need for an emergency reserve
- **tax status** – income; capital gains; inheritance taxes; available allowances
- **investment preferences** – restrictions; ethical considerations.

Know Your Customer's Needs Rule
A market intermediary should request sufficient information about the client to ensure that the services provided are consistent with the client's needs.

The fact find process will need to go beyond just hard facts and elicit views and opinions from the client which will allow the adviser to assess the level of risk the client is comfortable with and the extent to which family values such as ethical or religious beliefs will affect investment decisions.

3.2.2 Client Information

It is necessary to establish and capture extensive amounts of data about a client. It is a time consuming process and so it is important to understand why certain types of personal and financial details are needed so that the correct amount of information is obtained and the reason for its need can be explained to clients.

Below, we consider some of the key client information that an adviser needs to establish and some examples of why information about the client's personal and financial position is needed.

Personal and Financial Details	
Information Needed	**Why Needed**
Personal Details	• Details of the client's name and address will need to be verified to comply with anti-money laundering requirements. • The client's stage of life they have reached may have implications for any asset allocation strategy. It will also give an indication of their potential viewpoint on long-term investments.

Personal and Financial Details	
Information Needed	**Why Needed**
Health Status	• The client's health may influence the investment strategy and allocations to cash, bonds and equities. • If they are in good health, it may indicate a need to generate a growing level of income for many years. If they are in poor health, it may drive an investment strategy to produce a more immediate income. • A client's health may also influence their attitude to risk.
Details of Family and Dependants	• This may equally impact the client's investment objectives and attitude to risk. • It may also indicate a need to fund immediate or future spending on areas such as schooling or weddings.
Details of Their Occupation, Earnings and Other Income Sources	• Existing income will impact the level of income that needs to be generated from a portfolio and the level of risk that the client is able to tolerate. • The client's occupation or business will give a good indication of their experience in business matters which may be relevant when judging the suitability of a particular type of investment that carries greater risk and where the firm is required to assess the client's experience before recommending it.
Estimates of Their Present and Anticipated Outgoings	• This will be needed in conjunction with their income, where it is necessary to look at budgeting, planning to meet certain liabilities or generating a specific income return.
Assets and Liabilities	• Full details of the client's assets and liabilities are clearly needed. • In addition, details will be needed of where assets are held, their tax treatment, acquisition costs and details of any early encashment penalties.
Any Pension Arrangements	• The pension arrangements the client has made will need to be closely linked to the investment strategy that is adopted both for retirement and other financial objectives.
Potential Inheritances and any Estate Planning Arrangements, such as a Will	• This will be relevant if the amounts due to be inherited might influence the investment strategy adopted. • The adviser should also check whether the client has left any specific gifts of shares in their will and, if so, whether this would prevent any sale of such a holding.

3.2.3 Investment Objectives and Strategy

Having collected all of the core information needed about the client, the adviser can then turn to agreeing their investment objectives and risk profile.

Given the wide range of available investment opportunities that might be suitable for a client, an adviser needs to understand what the client's investment or financial objectives are. This requires the client to consider what they are trying to achieve. The answer will determine the overall investment strategy that will drive the investment planning process. Typical financial objectives include:

- maximising future growth
- protecting the real value of capital
- generating an essential level of income
- protecting against future events.

It is also important to remember that a client may have more than one financial objective, such as funding a known liability while at the same time maximising the growth of their investments to provide the funds needed in retirement.

Once the client's investment objectives have been agreed, the adviser needs to look at developing an investment strategy that can be used to achieve these objectives. In developing an investment strategy, the adviser will need to take account of the following constraints:

- risk profile
- liquidity requirements
- time horizons
- tax status
- investment preferences.

Risk Profile

A client's risk profile is made up of a combination of attitudes and risk capacity – that is the client's ability to absorb any financial losses that might arise from making a particular investment. These allow a risk classification or profile to be determined that can be agreed with the client and this is examined further in the next section.

Liquidity Requirements

It is also essential to understand a client's liquidity requirements as this will also have a clear impact on the selection and construction of any investments. Liquidity refers to the amount of funds a client might need both in the short and long term.

- When constructing an investment portfolio, it is essential that an emergency cash reserve is put to one side which the client can access without having to disturb longer-term investments.
- If there are known liabilities that may arise in future years, consideration should also be given as to how funds will be realised at that time.
- Consideration needs to be given as to whether it is sensible to plan on realising profits from equities as market conditions may be such as to require losses to be established unnecessarily. Instead, conservative standards suggest investing an appropriate amount in bonds that are due to mature near the time needed so that there is certainty of the availability of funds.

The lower the client's liquidity requirements and the longer their timescale, the greater will be the choice of assets available to meet the client's investment objective. The need for high liquidity allied to a short timescale demands that the client should invest in lower-risk assets such as cash and short-dated bonds, which offer a potentially lower return than equities; if the opposite is true, the portfolio can be more proportionately weighted towards equities.

Whatever their requirements, it is important, however, that the client maintains sufficient liquidity to meet both known commitments and possible contingencies.

Time Horizons

Time horizon refers to the period over which a client can consider investing their funds. Definitions of time horizons vary, but short term is usually considered to be from one to four years, while medium term refers to a period from five to ten years and long term is considered to be for a period of ten years or more.

Time horizon is very relevant when selecting the types of investment that may be suitable for a client. It is generally stated that an investor should only invest in equities if they can do so for a minimum period of five years. This is to make the point that growth from equities comes about from long-term investment and the need to have the time perspective that can allow an investor to ride out periods of market volatility.

Tax Status

Establishing the client's tax position is essential so that their investments can be organised in such a way that the returns attract the least tax possible.

This requires the firm to be aware of what taxes may affect the investor, such as taxes on any income arising or on any capital gains, how these are calculated and what allowances may be available. An adviser will also need to establish the client's residence and domicile status as these may impact how any investments are structured.

Investment Preferences

Some investors prefer to either exclude certain areas of the investment spectrum from their portfolios or concentrate solely on a particular investment theme, such as socially responsible investment or the construction of the portfolio in accordance with Islamic principles.

3.2.4 Risk Profile

Firms must ensure that any recommendations they make are both suitable and appropriate. In order to do so, a firm should ensure that the information it gathers also includes details about:

- a client's knowledge and experience in relation to the investment or service that will be considered for recommendation
- the level of investment risk that the client can bear financially and whether that is consistent with their investment objectives.

Clients' Understanding of Risk Rule
A market intermediary is prohibited from recommending or executing a transaction to or for a client unless it has taken all the reasonable steps to ensure that the client understands the risks involved.

Investment always involves a trade-off between risk and return. However, different people are prepared to tolerate different levels of investment risk and investment risk means different things to different investors. Variations in attitude arise because of individual differences in circumstances, experiences and psychological make-up.

A client's risk profile is made up of three components:

- **Risk tolerance** – this is the client's willingness to accept a certain level of fluctuation in the value of their investments without feeling an immediate need to sell.
- **Attitude to risk** – this represents their personal opinion on the risks associated with making an investment based on their prior knowledge and experience.
- **Risk capacity** – this is the client's ability to absorb any financial losses that might arise from making a particular investment.

Taken together, these three elements should allow a risk classification or profile to be determined that can be agreed with the client.

The risk assessment process usually starts with investigation of attitudes; consideration of risk capacity usually follows later since it requires knowledge of the client's objectives and the particular investments that are being considered.

Risk Attitudes

Risk attitudes help to identify the degree of uncertainty that an investor can handle with regard to a negative change in the value of their portfolio. These attitudes may be influenced by both objective and subjective factors.

Objective and Subjective Factors	
Objective Factors	• The timescale over which a client may be able to invest will determine both what products are suitable and what risk can be adopted. • Family commitments are likely to have a significant impact on a client's risk profile as they will want to meet their obligations, which may make higher-risk investments less suitable. • Wealth will clearly be an important influence on the risk that can be assumed. A client with few assets can little afford to lose them, while ones whose immediate financial priorities are covered may be able to accept greater risk. • Stage of life is equally important as it will impact the level of risk that can be adopted and the time horizon over which the client invests. • The age of the client will often be used in conjunction with the above factors to determine acceptable levels of risk.
Subjective Factors	• Investors who are more knowledgeable about financial matters are more willing to accept investment risk. • Some individuals have a psychological make-up that enables them to take risks more freely than others, and see such risks as an opportunity. • A client's preferred investment choice such as a client's normal preferences for the relative safety of a bank account versus the potential risk of stocks and shares. • A client's approach to bad decisions. Some clients can take the view that they assessed the opportunity fully and therefore any loss is just a cost of investing. Others regret their wrong decisions and therefore avoid similar scenarios in the future.

Establishing objective factors is clearly a preferable and more accurate way to help define a client's risk tolerance, but subjective factors clearly have a part to play. Subjective factors allow an adviser to try and establish a client's attitude to taking risks.

A client's attitudes and experiences must also play a large part in the decision-making process. A client may well be financially able to invest in higher-risk products and these may well suit their needs, but if they are by nature cautious, they may well find the uncertainties of holding volatile investments unsettling, and both the firm and the client may have to accept that lower-risk investments and returns must be selected.

Risk Capacity

Risk capacity is the client's ability to absorb any losses that may arise from making a particular investment.

Risk tolerance and risk perception are partly subjective, but risk capacity is largely a matter of fact. While subjective factors largely determine risk perception and attitude, the key question in assessing risk capacity is more what would be the consequences for the client if losses were incurred.

In some cases, risk capacity will play the most important role in determining the client's overall risk profile. The client's capacity for risk will also be affected by the level of investment being considered.

If the amount at risk represents a significant portion of the overall portfolio, risk capacity may be diminished. Risk capacity will be greater when the amount at risk is a small fraction of available capital.

3.3 Suitability

Once having gathered sufficient information about the customer, the steps expected of a firm to ensure its recommendations are suitable and appropriate for the client will vary depending upon the needs and priorities of the customer, the types of investment or service being offered and the nature of the relationship between the firm and the customer.

In general terms, the process that is involved can be broken down into a series of steps that include:

- agreeing the client's investment objectives
- investigating and agreeing the client's attitudes to risk and risk capacity
- analysing the client's financial situation and synthesising this information to create understandable summaries of the client's financial position, asset allocation and cash flow
- from this analysis, identifying the key areas that need action recognising that many clients have multiple objectives and may have different risk attitudes for each
- determining the best investments, solutions or combinations of both that meet the client's needs and are suitable for their purposes.

When considering whether a particular investment is suitable, it is necessary to look at the features of the recommended investment including:

- its terms and conditions
- its flexibility
- the inherent risks including asset allocation and structural risks such as counterparty risk
- the term or duration of the investment
- the expected return
- the charges applied by the product provider.

This involves going beyond a product's description to analyse its underlying components and characteristics.

When a firm proposes to offer investment advisory services or discretionary portfolio management, it should first assess whether such services are suitable for the client. If the firm intends to offer other investment services, eg, trading futures and options or more exotic investments, then it should go further and ensure that they are not just suitable but also appropriate for the client's financial position and their attitude to risk.

In assessing whether the investment services are suitable for the client, the firm should gather information on:

- the client's knowledge and experience
- the types of services and transactions with which the client is familiar
- the nature, volume, frequency and time that the client has been involved in such services and transactions
- the client's level of education, profession or relevant former profession.

The general principle behind this is that the firm must take reasonable steps to ensure it makes no recommendation to a customer unless it is suitable for that customer and that the client understand the risks involved. Suitability will have regard to the facts disclosed by the customer and other facts that the firm should reasonably be aware of.

Know Your Customer's Needs Rule
A market intermediary: • should only recommend investments that are suitable for their client • should not recommend investments that are unsuitable to the client regardless of the commission • may execute an order of a client without satisfying itself as to its suitability only where the client agreement makes clear that the client is acting without the advice of the market intermediary • is required to take all reasonable steps to ensure that it does not give advice or effect a transaction on behalf of a client unless the advice or transaction is suitable for the client.

If the firm determines after assessment that the service or product is not appropriate for the client, then it should issue a risk warning to the client. If the client still wishes to proceed despite the warning then it is up to the firm to decide whether it will do so.

If the firm is acting as investment manager for a client, there is an ongoing requirement that it must ensure that the portfolio remains suitable. Equally, if a customer has agreed to the firm pooling his or her funds with others, the firm must take reasonable steps to ensure that any discretionary decisions are suitable for the stated objectives of the fund.

3.4 Providing Recommendations

Having assessed what services and products are suitable and appropriate, the firm should provide the client with a report which should set out, among other things, why the firm has concluded that a recommended transaction is suitable for the client.

Clients' Understanding of Risk Rule
A market intermediary is prohibited from: • recommending or executing a transaction to or for a client unless it has taken all the reasonable steps to ensure that the client understands the risks involved • knowingly misleading a client on any advantages or disadvantages of a transaction • promising a return unless the return is contractually guaranteed.

A key regulatory principle is that a market intermediary is required to give sufficient information to the client to ensure that the client's decisions are informed. This requires a market intermediary to provide all explanations to the client in writing and retain a copy of the explanation in the client's file if the explanation was given to the client orally. The market intermediary should also document any opinion that an explanation is not required due to a client's existing knowledge. A copy of this information should be retained for record purposes.

Clients' Understanding of Risk Rule
A market intermediary should take all reasonable steps to ensure that the client has a full understanding of the: • nature of the investment • fees and charges associated with the investment • risks of the investment • factors likely to affect the performance of the investment • terms and conditions of the investment • consequences of departing from the terms and conditions of the investment.

Clear documentation directed at the client personally such as a 'reason why' letter or a suitability report can be a useful means of demonstrating that the recommendation was suitable for the consumer. In preparing suitability reports, it is important to remember that they need to serve two purposes:

- Suitability reports need to meet regulatory standards that require them to be fair, clear and not misleading.
- They also need to be understandable to the client and provide a clear summary of their objectives, needs, priorities and relevant existing investments, demonstrating how the adviser has taken account of these.

In particular, firms should consider whether their suitability report:

- is tailored to the client and uses clear and plain language
- explains the reasons for all recommendations and how they relate to the client's objectives
- provides a balanced view and highlights the risks associated with the recommendations
- explains the costs, charges and potential penalties attached to the recommendations
- identifies why the selected investments are suitable to meet the client's needs and objectives.

4. Anti-Money Laundering (AML) Requirements

Learning Objective

4.4.1 Know the stages of money laundering and when capital market firms are most at risk

4.4.2 Know the obligations placed on senior management to develop AML/CFT processes and procedures

4.4.3 Understand what factors might indicate whether a client poses a higher or lower AML risk

4.4.4 Understand what is involved in customer due diligence and when enhanced due diligence is required

4.4.5 Understand what constitutes acceptable customer identification and when additional verification measures should be undertaken

4.4.6 Know the requirements for capital markets staff to make suspicious transaction reports

4.4.7 Know the other obligations associated with AML/CTF – exchange surveillance; staff training; record keeping

Money laundering or, more specifically laundering the proceeds of crime, is a criminal act. In essence, the objective of money laundering is to take criminal proceeds and disguise their illegal source in anticipation of ultimately using the criminal proceeds to perform legal and illegal activities. Simply put, money laundering is the process of making dirty money look clean.

The regulatory framework for anti-money laundering (AML) and countering the financing of terrorism is contained in the provisions of the:

- Proceeds of Crime and Anti-Money Laundering (Amendment) Act 2015
- Prevention of Terrorism Act 2012
- Prevention of Terrorism (Implementation of the United Nations Security Council Resolutions on Suppression of Terrorism) Regulations 2013.

The CMA has issued guidelines that market intermediaries should comply with.

4.1 Stages of Money Laundering

Money laundering is generally described as comprising a three-stage process, the purpose of which is to remove the proceeds of a criminal activity from the predicate offence through a series of stages that disguise the audit trail. The result is the transformation of the proceeds of illegal or criminal activity into apparently legitimately acquired funds. The appearance of legitimacy is achieved through exploitation of normal finance transactions and can involve moving money across different jurisdictions as well as across different types of financial instrument.

Money laundering essentially seeks to separate assets from their illegal origin, so they can be used legitimately in the economy. The mechanics of money laundering are usually described as comprising a three-stage process, which may comprise numerous transactions by the persons engaged in money laundering that could alert an institution of the criminal activity.

Stages of Money Laundering	
Placement	• This is the physical disposal of cash or other assets derived from criminal activity. A person engaged in money laundering introduces his or her illegal profits into the financial system.
Layering	• In this phase, the person engaged in money laundering engages in a series of conversions or movements of the funds to distance them from their source. The separation of illicit proceeds from their source by layers of financial transactions is intended to conceal the origin of the proceeds. • This second phase involves converting the proceeds of the crime into another form and creating complex layers of financial transactions to disguise the audit trail, source and ownership of funds. The funds might be channelled through the purchase and sales of investment instruments.
Integration	• This is the provision of apparent legitimacy to criminally derived wealth. If the layering process has succeeded, an integration scheme places the laundered proceeds back into the legitimate economy in such a way that they re-enter the financial system appearing as normal business funds or personal transactions.

The three basic steps may occur as separate and distinct phases. Alternatively, they may occur simultaneously or, more commonly, they may overlap.

Capital markets are more likely to be used in the layering stage rather than in the placement stage of money laundering as they offer a vast array of opportunities for transforming money into a diverse range of assets. For liquid assets, they allow a high frequency of transactions which aids the layering process.

4.2 AML Obligations

The international nature of money laundering and terrorist financing has led to international co-ordination to ensure that countries have similar legislation and regulatory processes in place to enable the identification and prosecution of those involved in money laundering and terrorism financing.

The approach in Kenya follows international best practice where the key elements of the anti-money laundering and combating the financing of terrorism regime (AML/CFT) are set out in legislation, leaving financial institutions a measure of discretion as to how these should be implemented using a risk-based approach.

This means that firms are expected to form a view on the level of risk presented by prospective customers and by particular situations and to determine, on the strength of this assessment, the extent of the measures needed to manage and mitigate those risks.

The CMA guidelines emphasise the responsibility of the board of directors in the establishment of appropriate policies and procedures. Market intermediaries are required to identify, assess and take effective action to mitigate money laundering risks and adopt a holistic approach to the risk-based approach and should avoid a silo approach when assessing the relationship between risks. It sets out a standard approach to the identification and verification of customers, outlines customer due diligence (CDD) measures as well as giving guidance on the obligation to monitor customer activity.

Responsibility of the Board and Management
• Establish and approve appropriate policies and procedures for the detection and prevention of money laundering and terrorist financing and ensure their effectiveness. • Formulate and implement internal controls and other procedures that will deter criminals from using its facilities for money laundering and terrorist financing. • Ensure that business is conducted in conformity with the law and high ethical standards and that service is not provided where there is good reason to suppose that transactions are associated with money laundering activities or terrorist financing. • Co-operate fully with law enforcement agencies and relevant regulatory bodies, including taking appropriate measures to disclose information to the Financial Reporting Centre (FRC) and other enforcement agencies. • Review its policies, procedures and controls at least once in every two years to ensure their effectiveness as required by the regulations.

4.3 Risk-Based Approach

Market intermediaries must ensure that they have appropriate systems and controls in place to manage the risks associated with the business and its customers. This requires them to assess their money laundering/terrorist financing risk and decide how they will manage it.

A market intermediary should identify, assess and take effective action to mitigate money laundering risks and may assess the risks of individual customers by assigning a risk rating to their customers. While there is no internationally agreed set of risk factors or one single methodology, a market intermediary should consider the factors shown in the table below.

Risk Factors	
Country Risk	Customers with residence in or connection with high risk jurisdictions such as: • those identified by the Financial Action Taskforce as jurisdictions with strategic AML deficiencies • countries subject to sanctions, embargos or similar measures issued by, for example, the United Nations • countries that are vulnerable to corruption • countries that are believed to have strong links to terrorist activities.

<table>
<tr><th colspan="2">Risk Factors</th></tr>
<tr><td rowspan="2">Customer Risk</td><td>The following are examples of customers who might be considered to carry lower money laundering risks:
• customers who are in employment or with a regular source of income from a known legitimate source which supports the activity being undertaken
• customers with a positive reputation, eg, a well-known, reputable public or private company, with a long history that is well documented by independent sources, including information regarding its ownership and control
• a public entity.</td></tr>
<tr><td>Some customers, by their nature or behaviour might present a higher risk of money laundering. Factors might include:
• a politically exposed person, or the public profile of the customer indicating involvement with, or connection to, politically exposed persons
• complexity of the relationship, including use of corporate structures, trusts and the use of nominee accounts where there is no legitimate commercial rationale
• a request to use numbered accounts or undue levels of secrecy with a transaction
• involvement in cash-intensive businesses
• nature, scope and location of business activities generating the funds or assets, having regard to sensitive or high-risk activities
• where the origin of wealth cannot be easily verified.</td></tr>
</table>

Retail participants tend to have a greater level of money laundering risk associated with them in contrast to wholesale customers who will usually have a regulatory status and an established business. Persons engaged in money laundering will tend to avoid licensing obligations and regulatory scrutiny, preferring the opacity of private corporations and trusts.

The end product of this assessment is to determine appropriate customer due diligence measures to be undertaken to ensure that customer identification and acceptance procedures reflect the risk characteristics of customers, based on the type of customer and the business relationship, product or transaction.

4.4 Due Diligence

A key element of the money laundering requirements is the identification of the customer who it is proposed to do business with, a process known as due diligence.

Customer due diligence (CDD) involves:

- identifying the customer and verifying their identity
- identifying the beneficial owner, where relevant, and verifying their identity
- obtaining information on the purpose and intended nature of the business relationship.

The evidence should be verified by reliable documents or other verifiable and independent means. A market intermediary must not engage in any business transactions with a client who fails to provide evidence of their identity, nor should it permit anonymous accounts or accounts in fictitious names of their clients.

In the absence of satisfactory evidence, the firm should not open the account and should consider reporting the matter to the authorities if appropriate.

Firms must also conduct ongoing monitoring of the business relationship with their customers to identify any unusual activity. For customers that require additional caution to be exercised when transacting with them, such customers activities should be monitored on a regular basis for suspicious transactions.

In certain circumstances, either less or more due diligence is required:

- Simplified due diligence can be carried out where the firm is satisfied that they present little or no risk to the anti-money laundering objectives.
- Enhanced due diligence (EDD) is required in cases of higher risk or where customers are not physically present when their identities are verified.

Where customers are classified as high risk, the market intermediary should undertake EDD processes on the customer that should include:

- enquiring into the purpose for opening an account
- enquiring into the level and nature of trading activities intended
- enquiring into the ultimate beneficial owners
- enquiring into the source of funds
- obtaining senior management's approval for opening an account
- conducting enhanced ongoing monitoring of the business relationship.

EDD should also be carried out when:

- there is a transaction that is significant having regard to the manner in which the account is ordinarily operated
- there is a substantial change in the market intermediary's own customer documentation standards
- there is a material change in the way that business relations with the customer are conducted
- the market intermediary becomes aware that it may lack adequate identification information on a customer
- the market intermediary becomes aware that there may be a change in the ownership or constitution of the customer, or the person(s) authorised to act on behalf of the customer in its business relations with the market intermediary.

4.5 Customer Identification

A firm should obtain satisfactory evidence of the identity and legal existence of the persons applying to do business with it. The evidence should be verified by reliable documents or other verifiable and independent means.

Where the market intermediary obtains information or documents from the customer or a third party, it should take reasonable steps to assure itself that such information or documents are reliable and where appropriate, are reasonably up to date at the time provided to the firm. Where the customer is unable to produce original documents, the market intermediary may consider accepting documents that are certified to be true copies by the originators of the documents, or if this is not possible, certified by magistrates, advocates, commissioners for oaths or notaries public.

The CDD measures should include reasonable actions to understand whether the customer is acting as an agent or a beneficial owner, as well as the business nature and the purpose of trade. Difficulties can be encountered in identifying beneficial ownership due to the complexity of the organisations and structures that may be encountered so the measures noted below should be taken.

Customer Identification Measures	
Companies	• Particular care should be taken to verify the legal existence of the applicant (ie, legal entity) and to ensure that any person purporting to act on behalf of the applicant is fully authorised. • The principal requirement is to look behind the corporate entity to identify those who have ultimate control over the business and the company's assets, with particular attention paid to any shareholders or others who inject a significant proportion of the capital or financial support. • Enquiries should be made to confirm that the company exists for a legitimate trading or economic purpose and that it is not merely a 'shell company' where the controlling principals cannot be identified. • Before a business relationship is established, measures should be taken by way of a company search or other commercial enquiries to ensure that the applicant company has not been, or is not in the process of being, dissolved, struck off, wound up or terminated. • Ongoing monitoring is required so if changes to the company structure or ownership occur subsequently or if suspicions are aroused by a change in the nature of the business transacted or the profile of payments through a company account, further checks should be carried out to ascertain the reason for the changes. • In addition, enquiries should be made from time to time to establish whether there have been any changes to directors or shareholders or to the original nature of the business or activity. Such changes could be significant in relation to potential money laundering activity even though authorised signatories have not changed.

Customer Identification Measures	
Partnerships, Unit Trusts and Unincorporated Businesses	• The identity of all partners and signatories to the account should be verified. • Additionally, the partnership agreement, the trust deed or other relevant documentation should be obtained. • In cases where a formal partnership arrangement exists, a mandate from the partnership authorising the opening of an account and conferring authority on those who will operate it should be obtained.
Trust, Nominee and Fiduciary Accounts	• These are a popular vehicle for criminals wishing to avoid the identification procedures and mask the origin of the money accrued from criminal activities they wish to launder. Particular care needs to be exercised when the accounts are set up in locations with strict bank secrecy or confidentiality rules. • Verification of the identity of the trustees should be undertaken in line with the normal procedures. • In cases where a nominee is opening the account on behalf of another whose identity has not been previously identified by the market intermediary, the identity of that nominee or any other person who will have control of the account must be verified. • When the market intermediary opens a nominee account for a customer who is an institution supervised by the CMA, the AML risk is generally lower and the firm may consider performing simplified CDD measures so that there is no need to identify and verify the underlying clients of the market intermediary. • When the market intermediary opens a nominee account for a foreign financial institution, the risks associated may be considered to be potentially higher and enhanced CDD measures may be appropriate.

4.6 Suspicious Transaction Reporting

Policies and procedures must be put in place to minimise the risk of the firm being used for money laundering/terrorist financing purposes and a Money Laundering Reporting Officer (MLRO) must be appointed to act as a central point for reporting of suspicious transaction reports to the Financial Reporting Centre. Staff within the business must report such matters, in confidence, to the MLRO.

The MLRO will then decide whether to report those suspicions to the Financial Reporting Centre immediately or in any case, within seven days of the date of the transaction or occurrence of the activity considered suspicious. A market intermediary should also report to the Financial Reporting Centre all cash transactions carried out by it, equivalent to or exceeding USD10,000 or its equivalent in any other currency whether or not the transaction appears to be suspicious.

Failure to report a suspicion to the MLRO (or failure on the part of the MLRO to report to the FRC where appropriate) is a criminal offence, as is releasing information that might ‘tip off’ the person to whom the report relates that a disclosure has been made or an investigation may be underway.

4.7 Other Money Laundering Requirements

Among the other controls not already covered are the obligations on exchanges and the need for staff training and record-keeping.

Other Requirements	
Obligations on Exchanges	• A securities or derivatives exchange should have surveillance systems and mechanisms that are designed to detect activities that might be a result of market manipulation, eg, wash selling, ‘pump and dump’ or insider trading which are predicate offences to money laundering. • They should alert the market intermediary to cross-check on whether the transaction can be classified as suspicious thus requiring further investigation and reporting to the Financial Reporting Centre as a suspicious transaction.
Staff Training	The firm is required to meet the following training requirements: • Provide appropriate training to make staff aware of money laundering and terrorist financing issues, and how these crimes might take place through the firm. • The training provided should reflect the role carried out by individuals and range from a general appreciation for new employees to in depth training. • Staff involved with the general public should be trained on recognising factors that may give rise to suspicions, while those involved in account opening should fully understand the customer verification procedures.
Record-keeping	The firm is required to carry out the following: • Maintain and keep records of all transactions for a minimum period of seven years from the date the relevant business or transaction was completed or following the termination of an account or business relationship. • Retention may be by way of original documents, stored on computer disk or in other electronic form. • Keep a record of all transactions referred to the FRC together with all internal findings and analysis done in relation to them.

4.8 Combating Financing of Terrorism

Terrorists or terrorist organisations require financial support in order to achieve their aims. There is often a need for them to obscure or disguise links between them and their funding sources. It follows then that terrorist groups must similarly find ways to launder funds, regardless of whether the funds are from a legitimate or illegitimate source, in order to be able to use them without attracting the attention of the authorities.

Market intermediaries are required to keep updated the various resolutions passed by the United Nations Security Council (UNSC) on counter terrorism measures, in particular the UNSC Resolutions 1267 (1999), 1373 (2001), 1718 (2006), 1988 (2011) and such other relevant Resolutions which require sanctions against individuals and entities belonging or related to the Taliban and the Al-Qaida organisation among others. Market intermediaries are required to ensure that the information contained in the database is updated and relevant, and made easily accessible to its employees at the head office, branch or subsidiary.

Upon receipt of the designations or sanctions list from the Capital Markets Authority, market intermediaries are to conduct regular checks on the names of new customers, as well as regular checks on the names of existing customers and potential customers, against the names in the database. If there is any name match, market intermediaries are required to take reasonable and appropriate measures to verify and confirm the identity of the respective customer(s), freeze the customer's funds or block the transaction and file a suspicious transactions report with the FRC within 24 hours of detection.

5. Dealing

Learning Objective

4.5.1 Understand the rules surrounding execution of trades – necessary funds and securities; money laundering checks; timely and best execution; timely and fair allocation; contract notes; private transactions

4.5.2 Understand what constitutes unacceptable trading practices – front running; churning; insider dealing

When undertaking trades for clients there is the potential for conflicts of interest to arise and so is the subject of a number of conduct of business rules that revolve around the duties of market intermediaries when executing orders on behalf of clients and the requirement to avoid unacceptable trading practices.

5.1 Order Execution

Before accepting an order for a client to execute a trade, the market intermediary must ensure that the client has sufficient funds to settle the cost of a purchase or has the securities available to deliver to settle a sale.

Execution of Client Orders Rule
A market intermediary should not execute an order unless the client has made sufficient arrangements for the necessary funds or securities.

If an order is placed and the client has insufficient funds or securities to settle a trade, the trade will fail and automatic buy-in\sell out procedures will be instigated. Delivery settlement failure is subject to fines and penalties.

5.1.2 Money Laundering Checks

Before a market intermediary places a client order they should carry out money laundering checks and retain records in accordance with record keeping rules in the money laundering regulations.

Prevention of Money Laundering Rule
A market intermediary should obtain the following from the client on each occasion that a client places an investment order: • details relating to the origin and source of the money or funds used or to be used for the investment • where the money or funds originate from outside Kenya, a confirmation from the remitting entity of the nature of the client's business and details relating to the source of the money or funds • a written declaration by the client confirming the origin and source of the funds and that the money or funds used for the investment in securities does not arise from the proceeds of any money laundering or other illicit activities.

5.1.3 Best Execution

The best execution rule requires that firms, when executing orders, take all reasonable steps to obtain the best possible result for their clients.

Best Execution Rule
A market intermediary should deal for a client on the best terms available for the client.

In many cases, it is possible to judge achievement of best execution by total consideration less the costs of dealing. In some cases, however, other factors will be important such as:

- type of order
- order size
- liquidity of the instrument
- market impact of the trade, and
- any other transaction costs.

The best execution requirements are an important component of investor protection standards as they are designed to both promote the best possible execution results for investors individually and market efficiency generally.

The best execution principle applies to investment firms when they execute orders on behalf of their clients and covers all financial instruments. Investment firms that transmit orders to brokers for execution on behalf of their clients also owe a duty to their clients to ensure best execution.

Firms should put in place policies and procedures around how they will take and execute orders so that best execution is achieved. Firms should monitor the effectiveness of their policy on a regular basis and be able to demonstrate to the CMA how they have achieved this objective.

Notwithstanding this obligation, whenever there is a specific instruction from the client, the investment firm must execute the order in accordance with that instruction and so the rules do not then apply. Firms must not induce a client to give them particular instructions in order to avoid these obligations.

5.1.4 Timely Execution

Timely execution refers to the need for prompt, fair and expeditious execution of client orders.

Timely Execution Rule
A market intermediary should execute client orders in the chronological sequence in which the orders were received and give priority to outstanding orders.

Firms should have procedures and arrangements that provide for the timely execution of client orders, relative to the other orders or trading interests of the firm.

- Client orders should be executed in the order in which they are received.
- Comparable orders are executed sequentially and promptly, unless this is impracticable or client interests require otherwise.
- Clients are informed of any material difficulty in the prompt execution of their order.
- Executed client orders are promptly and accurately recorded and allocated.

Market practice is for orders to be time-stamped so that the timeliness of execution can be demonstrated. What constitutes a reasonable time depends on the type of order and the market circumstances at the time. If there is any delay, the broker should refer back to the client and explain the reason for the delay and request further instructions.

5.1.4 Timely and Fair Allocations

From time to time, market intermediaries will aggregate orders from clients into one larger buy or sell order. For example, a firm may aggregate similar client orders to ensure that it can execute trades for all of its discretionary clients at the same time.

Where the firm aggregates orders, they must ensure that they have policies and procedures to ensure that clients are treated fairly and that the firm avoids a conflict of interest if any of the firm's order is included in the aggregated order.

When an aggregated order is placed, a record of the underlying clients must be retained. If the order is fully executed, then the order should be allocated on a pro rata basis among the underlying clients to ensure each client receives the fairest possible outcome and to ensure best execution in line with the firm's best execution policy.

Timely Allocation Rule
A market intermediary should ensure that the transactions it executes are allocated to the clients who gave the orders in a timely and equitable manner.

Where an order may not be fully executed, a firm must have an allocation policy that drives how it will allocate the executed part of the order among the participating clients in such a way that it represents a fair and equitable treatment for each client.

Fair Allocation Rule
Where a market intermediary has aggregated an order for a client's transaction with an order for its own account transaction, or with an order for another client's transaction, the market intermediary should in the subsequent allocation: • not give unfair preference to itself or to any of the clients • give priority to satisfying orders for client transactions, if all orders cannot be satisfied.

In the event that a market intermediary's own account order is aggregated with an order for one or more clients, a record of the intended basis of allocation should be made before the transaction is executed. In the subsequent allocation procedure, unfair preference must not be given to own account orders and priority must be given to satisfying the customer order if the aggregate total of all orders cannot be satisfied.

When allocating an aggregated transaction, a record must also be made of the date and time of allocation, the relevant instrument, the identity of each customer and the amount allocated to each respective customer.

5.1.5 Contract Notes

When trades are undertaken for clients, details of the transaction need to be sent to the client in the form of a contract note or written statement.

After a broker has executed a deal, they should issue a contract note to the person who instructed the order. Where the market intermediary entered into the contract as principal, it should retain the contract for itself.

Contract Note Rule
A market intermediary should, in respect of every contract for the purchase or sale of securities it has entered into, no later than the end of the next trading day after the contract was entered into, make out a contract note.

Contract notes need to be issued to the client as soon as possible and no later than the business day following execution of the trade. If the investment manager executes the trade through a third party, ie, a broker, then the contract note needs to be issued by the investment manager to its client no later than the business day following receipt.

Required Content of a Contract Note
The contract note should state: • whether it is in respect of a purchase or sale of securities • whether a specific or limit price has been specified or whether the market rate should be applied in addition to the ultimate price, per unit of the securities • the name and address of the market intermediary and the principal place at which it carries on its business • that the market intermediary is acting as principal or agent, where it is so acting • the name and address of the person, to whom the market intermediary is required to give the contract note and, where different, the name of the person for whom the transaction was undertaken • the date of the contract, and the date on which the contract note is made • the quantity and description of the securities that are the subject of the contract • the rate or amount of commission payable in respect of the contract • the amount of stamp duty, if any, payable in connection with the contract and, where applicable, in respect of the transfer • the date of settlement • any other information as may be prescribed by the CMA to ensure that there should be a complete audit trail in respect of the execution of client instructions and the settlement of market transactions.

5.1.6 Off-Market Transactions

Private transactions involving transfers by way of gift, settlement of a will or estate, or where there is no change in beneficial ownership require approval by the CMA.

Off-Market Transactions Rule
A market intermediary should report all trades in securities dealt with otherwise than at a licensed securities exchange in such manner as may be prescribed by the Authority.

Where it is intended to effect a private transaction, a stockbroker representing the proposed transferee should assess, endorse and submit a written application stating reasons why the proposed transaction is eligible to be transferred in a private transaction.

5.2 Unacceptable Trading Practices

Market integrity is essential to the smooth operation of the market and to the trust that is necessary for the market to operate in a fair and transparent manner. Market abuse such as front running and insider dealing is a serious offence that damages investor confidence and undermines the integrity of financial markets.

Capital Markets Act Provisions
No person shall, directly or indirectly, in connection with the purchase or sale of any security: • employ any device, scheme or artifice to defraud • engage in any act, practice or course of business that operates as a fraud or deceit upon any person • make any untrue statement of a material fact • omit to state a material fact needed to make statements not misleading A person who contravenes this section commits an offence.

Market abuse may arise in circumstances where investors have been unreasonably disadvantaged, directly or indirectly, by others who have:

- used information which is not publicly available (insider dealing)
- distorted the price-setting mechanism of financial instruments
- disseminated false or misleading information.

Investors should be protected from misleading, manipulative or fraudulent practices, including insider trading, front running or trading ahead of customers. Market intermediaries should have policies and procedures in place to manage the risk of improper trading including restrictions on personal account dealing and pre- and post-trade checks on dealing patterns.

Front Running

Front running is buying or selling shares for a trader's own benefit on the basis of, and ahead of, orders from investors, in order to benefit from an anticipated impact on prices.

Front Running Rule
A market intermediary shall not engage in front running. Front running is an illegal practice, where a market intermediary executes orders on a security for its own account before filling orders previously submitted by its client.

Front running is unethical since the broker is making a profit at the direct expense of its own customers and so is expressly forbidden. Traders are not allowed to act on non-public information to trade ahead of customers lacking that knowledge.

Churning

Churning is the practice of entering into transactions with unnecessary frequency having regard to the customer's agreed investment strategy. Such practices are not in the interests of the client and are a breach of the requirement to act in the client's best interest and only recommend suitable investments.

Churning Rule
A market intermediary shall not engage in churning. Churning is an unethical practice employed by market intermediaries to increase their commission by excessive trading in a client's Central Depository System (CDS) account.

Churning occurs when a broker engages in excessive buying and selling of securities in a customer's account chiefly to generate commissions that benefit the broker. For churning to occur, the broker must exercise control over the investment decisions in the customer's account, such as through a formal written discretionary agreement.

Frequent in-and-out purchases and sales of securities that do not appear necessary to fulfil the customer's investment goals may be evidence of churning. It is also important to recognise that a series of transactions that are each suitable when viewed in isolation may be unsuitable if the recommendation or the decisions to trade are made with a frequency that is not in the best interests of the client.

Insider Dealing

Inside information is information that relates to particular securities or a particular issuer of securities (and not to securities or securities issuers generally) and which:

- is specific or precise, and
- has not been made public, and
- if it were made public, would be likely to have a significant effect on the price of the securities.

This is generally referred to as 'unpublished price-sensitive information', and the securities are referred to as 'price-affected securities'.

The offence of insider dealing is committed when an insider acquires or disposes of price-affected securities while in possession of unpublished price-sensitive information. It is also an offence to encourage another person to deal in price-affected securities, or to disclose the information to another person other than in the proper performance of employment.

Insider Dealing Rule
A market intermediary should take reasonable steps to ascertain if any of its clients are insiders and maintain records that assist it in monitoring insider dealing.

Market Abuse

The offence of market abuse includes the following offences:

- market manipulation
- false trading and market rigging
- fraudulently inducing trading
- using manipulative devices
- issuing false or misleading statements.

Penalties

The maximum penalty for a first offence of insider dealing is:

- for an individual, a fine of Kshs 2.5 million or imprisonment for a term of two years and payment of the amount of the gain made or loss avoided
- for a company, a fine of Kshs 5 million and payment of the amount of the gain made or loss avoided.

For a contravention of the market abuse rules or a subsequent offence of insider dealing, the maximum penalty is doubled to:

- for an individual, a fine of Kshs 5 million or imprisonment for a term of two years and payment of twice the amount of the gain made or loss avoided
- for a company, a fine of Kshs 10 million and payment of twice the amount of the gain made or loss avoided.

6. Client Assets

Learning Objective

4.6.1 Know the purpose of the client asset rules

4.6.2 Know why client bank accounts are used, the importance of trust status and the need for reconciliation

4.6.3 Know how title to client assets may be held and the difference between omnibus and designated accounts

---

Protection of client assets is a key regulatory concern and the conduct of business rules require that firms hold client money and assets separately from their own so that they minimise any risk to clients in the event of their insolvency.

Protection of Client Assets Rules
The Conduct of Business rules require a market intermediary to take all reasonable steps to protect client assets. • A market intermediary should hold its clients' funds in trust for and on behalf of its clients. • All securities and other property held or received by a market intermediary on behalf of a client in connection with its regulated activity should be segregated and accounted for separately. • Clients' funds should not form part of the assets of the market intermediary for any purpose and should not be available in any circumstances for payment of any debt of the market intermediary.

6.1 Client Money

Client money is any money that a firm holds on behalf of its clients in the course of carrying on investment business.

6.1.1 Segregation

The key principle is that money belonging to clients is kept separate from that of the firm in such a way that in the event of the firm going into liquidation, clients' money can be readily identified and returned to them without them suffering loss. This basic rule is known as segregation and requires firms to hold client money in bank accounts that are separate from those of the firm and which are identified as holding client money.

Segregation Rules
A market intermediary should segregate its client bank accounts from any account holding funds belonging to the market intermediary.

6.1.2 Client Money Bank Accounts

A key feature of the client money rules is that client money must be held separately from the firm's own money. This is achieved by the firm operating one or more client bank accounts.

Client Bank Accounts Rule
A market intermediary that receives or holds clients' funds should open one or more client bank account.

Firms should undertake due diligence on the choice of bank before opening the account and on a regular basis thereafter. This due diligence should extend to considering how many bank accounts it is appropriate to hold as well as assessing the bank's market reputation, its credit ratings and any legal requirements or market practices that could adversely affect clients' rights. The rules do not specify how many accounts should be opened but a firm should consider what level of diversification is appropriate.

Trust Status
A market intermediary should obtain and maintain, in its records, written acknowledgement from the bank confirming that the clients' funds deposited with the bank are held in trust for the clients and are not available to offset any obligation of the market intermediary.

When a client money account is opened, it is essential that the correct procedures are followed and that the trust status of the account is established. When a client money account is opened it is essential that the bank accepts that the client money is held in trust by the firm for its clients. In practice, the account opening process should ensure that:

- the title of the account clearly shows that it is client money and does not belong to the firm
- the bank provides written confirmation that it recognises the account is a client account and will not combine the account with any other account or exercise any right of set-off or counterclaim against money held in that account against money owed by the firm.

Importantly, records of the trust status must be both complete and comprehensive and be retained; otherwise on insolvency a liquidator may challenge the validity of the arrangements and delay the return of money to clients.

6.1.3 Operating Client Money Accounts

A firm should deposit clients' funds in one or more bank accounts which contain only clients' funds and are clearly marked as 'clients' accounts'. Such client accounts should not be overdrawn for any reason.

Operational Rules
A market intermediary should: • establish and implement systems that ensure that all funds to be received on behalf of clients are deposited directly in the intermediary's client bank account to ensure employees avoid the receipt of cash • deposit into a client bank account all funds received on behalf of or from a client upon receipt • ensure it can at all times ascertain the amount of clients' funds standing to the credit of each client • ensure funds held on behalf of a client are not used for the benefit of another client • not withdraw money deposited in a client's bank account unless the money is required for the purposes of settling a trade, paying authorised charges or making a payment authorised by the client.

Firms should maintain a separate record for each account showing the name and address of the bank where the account is maintained, the dates, amounts of deposits and withdrawals and also the exact amount of each client's beneficial interest in the account. Accounting records should record details of:

- the amount of clients' funds paid into or out of a client bank account
- receipts and payments of clients' funds that are not paid into or out of a client bank account, identifying the persons to whom each receipt or payment relates

- the aggregate balances on client bank accounts
- individual client balances allocated against the names of the client
- details of any credit extended or loans made in respect of margin or otherwise

6.1.4 Reconciliation and Accounting Records

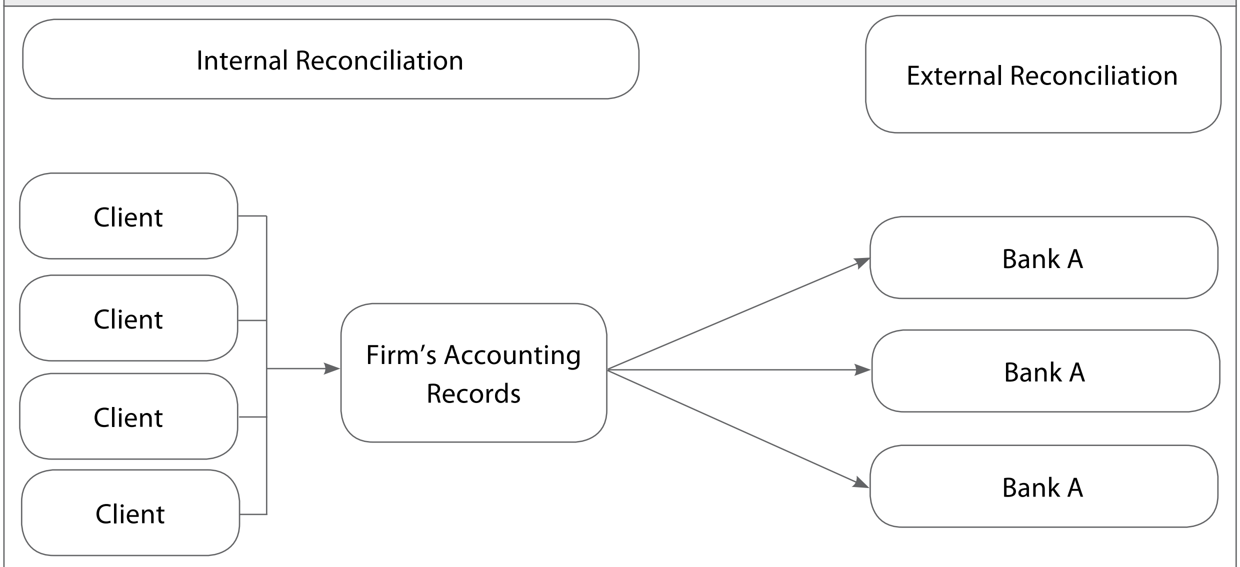
Records must be held that enable the firm at any time and without delay to distinguish client money held for one client from client money held for any other client and from its own money.

Regular reconciliations need to be undertaken of client money. A market intermediary should on a daily basis reconcile its records showing the amounts held on behalf of each client and the aggregate of clients' money held with the balances held in the client money bank accounts.

Segregation of Duties Rule
The officer who is responsible for authorising payments into and out of the client accounts should not carry out the reconciliation.

Reconciliation involves both internal reconciliation and external reconciliation. A firm may have many clients and the total of individual balances held for each client will be shown in its accounting records in some form of electronic cashbook. Internal reconciliation involves reconciling the aggregated amount shown in its cashbook with the individual balances held at client account level. A firm may hold multiple accounts with banks so external reconciliation involves reconciling what is shown in the firm's cashbook with the actual balances held in the bank accounts it uses to hold client money.

Reconciliation Process



Reconciliation issues may arise for a number of reasons including timing differences, errors in posting transactions and a variety of other reasons. These need to be identified and resolved promptly.

The fundamental purpose of the client money rules is to ensure that client's money is safeguarded in the event of either the firm or one of the banks it uses going into liquidation. This is achieved in part by ensuring the trust status of the accounts and then by ensuring that there are always sufficient funds in the client bank accounts to repay clients in full. To ensure this occurs, the rules require a daily calculation to be carried out to ensure that the total of the money held for clients is at least equal to the total of the client bank accounts.

6.2 Client Assets

Investment firms hold client assets as part of the overall investment service provided to clients and will either hold the assets themselves or outsource some or all of this function to a custodian. To hold client assets, the firm or the custodian requires the necessary licence from the CMA.

6.2.1 Segregation

As with client money, a firm is expected to implement segregation to keep client assets separate from its own and to protect the assets of the client in the event of the firm going into liquidation. A firm must not use a client's asset for its own account without the client's prior written consent. Neither must the firm use, for the account of one client, the assets of any other client unless that other client has given prior written consent to the firm.

Client Asset Segregation Rule
A market intermediary should keep such books and accounts as are necessary to show all its dealings with a client's securities and other property held or received by it on behalf of a client. In addition, it should distinguish securities and other property it holds or has received on behalf of each client from its own securities and property and other securities and property held or received by the market intermediary.

A firm should not dispose of client assets unless the client has instructed it in writing and should ensure that its internal systems and controls do not permit its officers to dispose of, pledge, lend or otherwise deal with client assets except in accordance with the rules.

6.2.2 Registration of Assets

Investments held on behalf of clients must be registered in such a way that they can be segregated from those of the firm and suitably safeguarded. This requires that a firm should organise appropriate registration or recording of legal title to client assets in the name of:

- the client, or
- a nominee company controlled by the firm, an investment exchange or a third party such as a custodian.

A firm should avoid registering the assets in its own name to reduce the risk of misappropriation and to increase the likelihood that on insolvency, a liquidator would be able to transfer client assets promptly before or after the failure of a firm to another entity.

One of the most common methods is to register the investment in the name of a nominee company. Many investment firms insist that a client's assets are held in this way to enable it to efficiently administer the portfolio, use automation, settle trades quickly and avoid late settlement. It is a company that is formed by a bank, broker or custodian to hold shares in its name on behalf of the beneficial owner, the investor. Its employees carry out all the paperwork and other tasks associated with the documentation of shareholding and arrange for necessary transfers when a share is purchased or sold.

Nominee Companies
A nominee company is used solely for holding and administering safe custody assets for clients. It does not trade and so is described as bankruptcy-remote as the chances of it going into liquidation are low.

Assets held on behalf of clients by a nominee company will be registered in the name of the nominee and so its name will appear in the records held by the Central Depository & Settlement Corporation (CDSC) and on the company's share register. The nominee is therefore the legal owner of the asset but the investor retains beneficial ownership and can instruct the nominee or its parent to sell or transfer their shareholding.

Where assets are held in a nominee's name, they will typically be held either in an omnibus or a designated account.

Accounts	
Omnibus	• An omnibus or pooled account is where all client assets are held in one nominee designation. • Its advantage is that it provides the ability to aggregate client orders and then settle one transaction for potentially many underlying clients. • Its drawback is that in the event of default of the nominee, the investor only has a claim on the pool of assets and so could be affected by any shortfall.
Designated	• A designated account is where the assets of a client are kept in a nominee designation separately from any other client. • Its advantage is that beneficial ownership is more easily identified, the risk of using one investor's holding to settle the trades of another is reduced and in case of default by the nominee it is obvious which holding belongs to which beneficial owner. • Its drawback is that achieving greater levels of automation and therefore administrative efficiency is made more difficult.

6.2.3 Reconciliation and Accounting Records

A firm needs to maintain comprehensive records of the securities that it holds and of each transaction undertaken.

Securities Reconciliation Rule
A market intermediary should on a monthly basis reconcile the records of assets held on behalf of clients, both individually and in aggregate.

This may involve reconciling the records that the market intermediary holds with those of the CDSC or where a custodian is used with its records; in the latter case the custodian would be responsible for reconciliation with the CDSC.

Where a firm operates an omnibus account structure, it will need to reconcile the individual holdings for each client with its records of what it holds at an omnibus level. The aggregate portfolio held in the firm's records should agree with the portfolio held by the custodian which itself should agree with the securities held in its CDSC stock accounts. Issues will obviously arise so the positions will need to be reconciled and any discrepancies investigated.

7. Other Conduct of Business Rules

Learning Objective

4.7.1 Know the complaint handling rules

4.7.2 Know the standard expected of accounting records and the checks required on an external audit

4.7.3 Know what matters must be reported to the CMA and within what timescales

7.1 Complaint Handling

It is almost inevitable that at some time customers will raise complaints against a firm providing financial services. The CMA requires authorised firms to deal with complaints promptly and fairly and notify clients of its complaint handling procedures.

Complaint Handling Rule
A market intermediary should handle complaints in a fair, appropriate and timely manner, and should inform the client of the outcome. It should adopt, document and disclose to a client its procedures for the proper handling of complaints from clients and ensure that appropriate remedial action is taken on the complaints promptly.

The CMA requires firms to have appropriate written procedures for handling expressions of dissatisfaction from complainants. These internal complaints handling procedures should provide for the receiving of complaints, acknowledgement of complaints in a timely manner, responding to those complaints, appropriately investigating the complaints and notifying the complainants of their right to appeal to the chief executive where relevant. The firm must take reasonable steps to ensure that all relevant employees are aware of the firm's complaints handling procedures and endeavour to act in accordance with these.

Complaints Procedure Rule
The complaints procedure should set out the process for dealing with complaints, including: • the apportionment of responsibility for the actions that led to the complaint including to persons not specifically named in the complaint • the timeframe for dealing with a complaint • the timeframe within which to inform the complainant of progress in dealing with the complaint, which should not be more than three months • the right to appeal to the chief executive of the market intermediary or another appropriately senior officer nominated by the chief executive, where the complaint cannot otherwise be resolved.

The procedures must make provision for the complaints to be investigated by an employee of sufficient competence who was not directly involved in the matter that is the subject of the complaint. The person charged with responding to the complaints must have the authority to settle the complaint, including offering redress where appropriate, or should have access to someone with the necessary authority.

Complaint Investigation Rule
A market intermediary should designate an officer to review and investigate all complaints lodged by clients and recommend appropriate remedial action to the management of the market intermediary.

The responses should adequately address the subject matter of the complaint and, where a complaint is upheld, offer appropriate redress. Where the firm decides that redress is appropriate, the firm must provide the complainant with fair compensation for any acts or omissions for which it was responsible and comply with any offer of redress the complainant accepts.

Complaint Restitution Rule
A market intermediary should, depending on the nature of the complaint, provide where a complaint is justified, appropriate restitution and address the weaknesses in its internal systems that led to the action causing the complaint.

The time frame for resolving the complaint should not be more than three months and in the event that a complaint is still unresolved three months after it was received, a market intermediary should immediately inform the CMA within 24 hours.

A market intermediary should maintain a register of complaints and keep detailed records of the complaints received and how they have been managed and resolved.

Record Keeping Rule
A market intermediary should maintain a record of complaints showing: • the client or any other person from whom a complaint was received • the nature of the complaint • the officer handling the complaint • the officer against whom the complaint was made or who was responsible for the action that led to the complaint • the progress in handling the complaint • the way the complaint was resolved • the time it took to resolve the complaint.

7.2 Accounting Records

A market intermediary should keep its accounting records in accordance with the International Financial Reporting Standards, retain records for seven years and make them available for inspection by the CMA or other authorised person.

7.2.1 Accounting Records

A market intermediary should keep proper accounts and records that show the transactions effected on its behalf or on behalf of others and the financial position of its regulated activity.

The records and accounts of the financial position of the firm should:

- disclose with reasonable accuracy the financial position of a market intermediary at any given time
- enable a market intermediary to prepare a statement of financial position and a statement of comprehensive income at any given time
- show whether a market intermediary is maintaining adequate financial resources to meet its business commitments and withstand the risks to which its business is exposed.

The client information should be recorded in a way that identifies all transactions and allows for the tracing of transactions, from the initiation of the order to its final settlement. The records should enable the easy reconciliation of client funds and assets.

7.2.2 External Audit

A market intermediary should appoint an external auditor using an engagement letter that sets out their powers and duties and seek approval from the CMA of the appointment or any subsequent change. A market intermediary should ensure that it rotates its external auditor at least once in every seven years.

An external auditor should have access at all reasonable times to accounting and other records and may request such information or explanations as necessary for the performance of their duties. As part of their audit, the external auditor should determine whether:

- the annual financial statements of the market intermediary were prepared in accordance with the regulations and give a true and fair view of the profit or loss and the financial state of affairs of the market intermediary as at the end of the financial year
- the market intermediary kept proper accounting records throughout the financial year and the statement of financial position and the statement of comprehensive income are in agreement with their accounting records
- the market intermediary kept clients' funds and other client's assets properly segregated and maintained systems to enable the identification of the securities held in safekeeping for their clients
- they have obtained all the information and explanations which, to the best of their knowledge and belief, are necessary for the purposes of its audit
- the market intermediary complied with these regulations throughout the financial year.

The external auditor should submit a report on the above to the Authority after carrying out an examination.

7.3 Regulatory Compliance

A market intermediary should comply at all times with the Capital Markets Act, regulations made under the Act and with any other regulatory requirements prescribed by the CMA. They should cooperate with the CMA and provide all the reasonable assistance it requires to discharge its functions under the Act.

A market intermediary is required to notify the CMA of certain occurrences within specified timescales.

Regulatory Notifications	
Notifications Within 24 Hours	• Any event that could affect the CMA's assessment of its fitness and propriety or that of its management and staff. • A material breach of the regulatory requirements applicable to the market intermediary or a material change in any information provided in support of the licence application. • A reduction in working capital or financial resource to below 120% of the specified minimum or a reduction of 50% in the working capital or financial resource since the previous report to the CMA. • Any concern of the market intermediary that it may not be able to meet its obligations to clients when they fall due. • Any shortfall in the funds held in the client account below the total obligations to clients. • Any inability to comply with any instruction or direction of the CMA. • Any misstatement in any return previously submitted to the CMA. • Any fraud on the market intermediary or by any of its employees. • Any disciplinary action against any of its key personnel. • Any investigation, finding or conviction relating to the market intermediary or any of the key personnel of the market intermediary by a law enforcement agency, regulatory authority, or professional association. • Any civil claim against the market intermediary that exceeds 25% of the minimum financial resource requirement of the market intermediary. • Any action against it that may lead to its insolvency.
Not Less than 28 Calendar Days	• Changes its name, business name (if different), business address and nature of business of the market intermediary. • Appoints a new chief executive, director or compliance officer. • Appoints a new auditor. • Decides to seek a licence from another regulatory authority in Kenya or abroad. • Changes its financial year and its annual reporting date. • Changes its capital structure substantially. • Changes its ownership or substantial shareholding. • Makes a substantial acquisition. • Decides to surrender its licence.

When a market intermediary contravenes any measures or administrative provisions of the Capital Markets Act or the regulations:

- the officers of the market intermediary will be jointly and severally liable to indemnify the market intermediary against any loss arising from the contravention
- the market intermediary may be liable to the sanctions or penalties prescribed in the Act.

End of Chapter Questions

1. What are the four principles that a market intermediary is required to follow when conducting business with the public?
   Answer reference: Section 1

2. What key features should be present in order for marketing material to be fair and clear?
   Answer reference: Section 2.1.1

3. What are the main cold calling rules contained in the conduct of business rules?
   Answer reference: Section 2.2

4. How would you explain fiduciary duty to a client?
   Answer reference: Section 2.5

5. What are the key stages of the investment advice process?
   Answer reference: Section 3.2

6. How does investment strategy differ from investment objectives?
   Answer reference: Section 3.2.3

7. How might an investor's time horizon affect the choice of investments?
   Answer reference: Section 3.2.3

8. Which of the three components of a client's risk profile is normally established last?
   Answer reference: Section 3.2.4

9. In what scenario might it be acceptable to execute a client's instruction without assessing suitability?
   Answer reference: Section 3.3

10. Capital markets are most likely to be exploited at which stage of the money laundering process?
    Answer reference: Section 4.1

11. A client is unable to be present at an account opening interview and conducts the arrangements by phone and email. What due diligence process should be utilised?
    Answer reference: Section 4.4

12. How would you explain the concept of best execution to a client?
    Answer reference: Section 5.1.3

13. When might the rules surrounding timely and fair allocations be relevant?
    Answer reference: Section 5.1.4

14. What is front running and why is it unacceptable?
    Answer reference: Section 5.2

15. What is the main thrust of the client asset rules?
    Answer reference: Section 6

16. Why is trust status important for a client money bank account?
    Answer reference: Section 6.1.2

17. What are the main differences, advantages and disadvantages of omnibus and designated accounts?
Answer reference: Section 6.2.2

18. Who should investigate a complaint from a client?
Answer reference: Section 7.1

19. What type of event requires immediate notification to the CMA as opposed to within 28 calendar days?
Answer reference: Section 7.3

Chapter Five

Markets and Trading Rules

This syllabus area will provide approximately 9 of the 50 examination questions

A stock exchange provides a marketplace for issuing securities and then facilitating the trading of those securities via the trading and market making activities of their member firms. All stock exchanges provide both a primary and a secondary market.

Primary and Secondary Market	
Primary Market	• The primary market, or the new issues market, is where securities are issued for the first time. • Primary markets exist to enable issuers of securities, such as companies, to raise capital and enable the surplus funds held by potential investors to be matched with investment opportunities the issuers offer. This is a crucial source of funding.
Secondary Market	• The secondary market is where existing securities are traded between investors. • Secondary issues or secondary public offerings of shares are often referred to as a 'follow-on offering' as they refer to an issue of stock subsequent to the company's initial public offering (IPO).

In this chapter, we look firstly at the rules surrounding how new issues are brought to the market and then at how they are traded and settled.

1. Stock Market Listings

Learning Objective

5.1.1 Know the main stages of the listing process and the role of the advisers in a listing

5.1.2 Know the main eligibility requirements for a listing and the continuing obligations that a listed company must follow

5.1.3 Know the purpose of the corporate governance guidelines

5.1.4 Know the general provisions applying to takeovers and mergers

5.1.5 Know the impact of the foreign investor rules

1.1 Listing and Disclosure Rules

Obtaining a stock market listing is known by various names such as a flotation, going public, becoming listed or an IPO. Companies can use a variety of ways to achieve flotation including an offer for sale, an IPO and an introduction.

The CMA and the Nairobi Securities Exchange (NSE) have rules and regulations for companies seeking a listing and continuing obligations for those already listed.

1.1.1 Listing Process

The Official List is categorised into different market segments that have different eligibility, trading restrictions and disclosure requirements prescribed by the CMA under the Capital Markets (Securities) (Public Offers, Listing and Disclosures) Regulations and in the case of REITs, the REIT Regulations. These market segments are:

- Main Investment Market Segment (MIMS)
- Alternative Investment Market Segment (AIMS)
- Growth Enterprise Market Segment (GEMS)
- Fixed Income Securities Market Segment (FISMS).

For an issuer to be listed on one of these market segments, the issuer has to comply with the eligibility criteria and disclosure requirements set out in the listing rules.

A listing on the NSE involves two applications.

- Companies seeking a listing have to satisfy the entry criteria contained in the Capital Markets (Securities) (Public Offers, Listing and Disclosures) Regulations. These regulations are administered by the CMA which determines whether to approve the prospectus and authorise the listing.
- It is then up to the NSE to approve them for trading on their exchange, a process known as 'admitted to listing'.

Listing Procedure

- An issuer submits its application and prospectus for approval to the CMA with a copy to the exchange through the sponsoring stockbroker.
- The exchange submits its comments, if any, to the CMA within ten working days of receipt of the copy of the application, which then considers these when determining whether to grant approval to list.
- On receipt of a letter of approval to list from the CMA, the exchange approves the listing without any other conditions except:
  - attainment of the prescribed minimum shareholding following a public offering or offer for sale
  - attainment of minimum subscriptions if any as disclosed in the information memorandum or prospectus
  - payment of listing fees
  - signing of the memorandum of listing.

Once the necessary authorisation procedures have been completed, the offer of securities to the public must then comply with the following timetable.

Offer Timetable	
Offer Period	• Not more than ten working days.
Announcement of Results of Allotment	• Not more than seven days after the closing date of the offer.
Allotment	• Within seven days of the announcement of results of allotment.
Crediting the CDS account on Allotment	• Within five days of allotment.
Refund Monies to Unsuccessful Applicants	• From three days of the allotment.
Commencement of Trading	• From the date of crediting the CDS account

An issuer may seek to list securities on the NSE that are already listed on a securities exchange outside Kenya using a process known as an 'introduction'. These cross-border listings also need to comply with the eligibility and disclosure requirements.

Once listed, a company may seek a listing of additional securities by undertaking a rights issue, a bonus issue, a scrip dividend or other issue. These also require the approval of the CMA and must meet the disclosure rules.

1.1.2 Role of Advisers

To undertake a listing or public offer, a company will appoint a lead transaction adviser (which are mainly investment banks) to advise on the transaction. In conjunction with a team of advisers, the lead transaction adviser will advise on the best method for the capital raising and undertake due diligence on the company's financial and legal position.

When a company is undertaking an equity issue, it has to appoint a lead transaction adviser and a sponsoring stockbroker when seeking a listing on any market segment other than GEMS. It needs to advise the CMA and the exchange of their appointment and of any subsequent changes. The lead stockbroker should, in consultation with the issuer, appoint up to five co-sponsoring stockbrokers on an equitable basis subject to the size of the issue, at no extra cost to the issuer other than the agreed sponsoring stockbroker's fee.

Responsibilities of the Sponsoring Stockbroker and Lead Transaction Adviser	
Sponsoring Stockbroker	• Guide the issuer on the application for listing and relevant regulations and discharge its duties with professional skill and due care. • Facilitate communications with the CMA and exchange. • Ensure the accuracy and completeness of all necessary documentation submitted to the exchange. • Present the application for admission to listing or the listing statement to the exchange.
Lead Transaction Adviser	• Prepare the information memorandum for listing and other relevant documents. • Manage the process for approval of the information memorandum and acting as the CMA contact for the transaction. • Co-ordinate the activities of the other advisers appointed for purposes of the listing. • Prepare the issuer on how to meet the continuous listing requirements post listing.

Where a company is seeking a listing on the GEMS, the process is different and it is required to appoint a nominated advisor. The role of the nominated adviser is to assess whether a company is suitable for listing and oversee the due diligence process. Listings on GEMS are reviewed and approved by the NSE.

1.1.3 Eligibility and Disclosure Requirements

The Capital Markets (Securities) (Public Offers, Listing and Disclosures) Regulations set out eligibility requirements and disclosure requirements for an issuer to be listed on one of the market segments.

The main requirements for an equity listing on the main investment market or the alternative investment market are summarised in the following table.

Eligibility Requirements
• A listed company must be a public company limited by shares and registered under the Companies Act. • An issuer should have a minimum authorised issued and fully paid up share capital of Kshs 50 million for a listing on MIMS and Kshs 10 million for a listing on AIMS. • A company should have net assets of more than Kshs 100 million immediately before the public offering for a listing on the MIMS and Kshs 20 million for a listing on AIMS. • Shares to be listed are to be freely transferable and not subject to any restrictions on marketability or any pre-emptive rights. • Up to date audited financial accounts must be available and there should be no doubt about the company's financial soundness. • The directors and management of the company must suitable and competent to undertake their roles. • An issuer seeking a listing on MIMS should have declared positive after tax profits in at least three of the last five years. For AIMS, the issuer must have been in existence in the same line of business for a minimum of two years, one of which should reflect a profit with good growth potential. • The issuer must have a clear future dividend policy. • The issuer should not be insolvent and should have adequate working capital. • Following the listing, a company listed on MIMS should have at least 25% of its shares held by the public with a minimum of 1,000 shareholders excluding employees. For AIMS, at least 20% of shares should be in public hands and held by not less than 100 shareholders excluding employees and family members of the controlling shareholders and no investor should hold more than 3% of the publicly held shares.

There are similar requirements for listings on the Growth Enterprise Market Segment and the Fixed Income Securities Market Segment.

1.1.4 Continuing Obligations

Once a listing has taken place, an issuer must comply with the continuing obligations which are essential to the maintenance of an orderly market in securities and to ensure that all users of the market have simultaneous access to the same information. A REIT manager and the REIT trustee are also required to comply with the continuing listing obligations in respect of listed REIT securities.

The continuing obligations cover the following:

- general obligations of disclosure
- disclosure of periodic financial information, and
- miscellaneous provisions.

General Continuing Obligations

These obligations require listed companies to release information in a controlled fashion to ensure orderly trading and to ensure that a false market in their shares is not created.

The information to be disclosed includes major developments that may lead to a significant movement in the share price or for an issuer of debt securities, a development that might affect the price or its ability to meet its commitments. The information should be disclosed as soon as possible but no later than 24 hours.

Where it is proposed to announce a development at a shareholder's meeting that might lead to a substantial movement in price, arrangements must be made for a public announcement to be made so that the announcement at the meeting is made no earlier than the time at which the information is published to the market and forwarded to the CMA.

Should a situation arise where information may become public because the necessary degree of confidentiality cannot be maintained, or that confidentiality has or may have been breached, an issuer must submit details of the price-sensitive information to the CMA and exchange and publish a cautionary announcement.

Disclosure of Periodic Financial Information

Listed companies are expected to meet standards in terms of content and timeliness around disclosure of financial and other information.

- Financial statements should be prepared in accordance with International Financial Reporting Standards and meet the minimum standards set out in the listing rules.
- Interim reports should be published within 60 days of the interim reporting date and annual reports within four months of the company's financial year end.
- Dividend announcements should be made within 24 hours of the resolution approving the payment. The books' closed date should be at least 21 days after the approval of the resolution and the dividend payment made within 90 days of the books closed date.
- Announcements of changes to an issuer's capital structure should be made to the CMA, exchange and investors.
- Issuers should provide details of their share ownership. At the end of each quarter, an issuer should provide details to the CMA and to the exchange of shareholders holding 3% or more of the issuer's ordinary shares. It should immediately notify the CMA and the exchange if the proportion held in public hands falls below the required minimum level. Its annual report should show the percentage of shareholders owning shares within set bands and provide details of the ten largest shareholders.
- Shareholder meetings should be called by giving 21 days notice in writing and the company should make arrangements for shareholders to vote in person or through a proxy. The issuer must provide to the CMA and to the exchange copies of all circulars and notices as they are issued and give notification of all resolutions passed at general meetings within ten days.
- A company should disclose in its annual reports a statement as to whether the issuer is complying with the CMA corporate governance guidelines.

Miscellaneous Obligations

There are a number of other continuing obligations including:

- No further securities of the same class as securities already listed may be issued or allotted to any person or listed, without the CMA's approval.
- There must be appropriate transfer and registration arrangements in place for listed securities.
- All directors of an issuer, other than the managing director, must retire by rotation at least once in every three years. At least one third of the directors should be appointed as non-executive directors.
- Any material information – such as significant changes to articles of association, profit warnings, material discrepancies in financial statements and appointment of a receiver – should be disclosed within 24 hours of the event.
- Shareholder approval is required for the acquisition or sale of shares in another company that is a subsidiary or related company and for a substantial sale of assets involving 25% or more of the value of the total assets of the issuer.

1.2 Corporate Governance Rules

As a company is a separate legal entity distinct from its shareholder owners, the day-to-day running of a company is the responsibility of the company's board and executive directors. A mechanism is therefore needed to ensure that companies are run in the best long-term interests of their shareholders. This mechanism is known as corporate governance.

The board and its directors are ultimately accountable to the company's shareholders for their actions in carrying out their stewardship function. Therefore, corporate governance is concerned with the creation of shareholder value through the transparent disclosure of a company's activities to its shareholders, director accountability and two-way communication between the board and the company's shareholders.

Effective governance of a company is of intrinsic interest to its shareholders, as how well companies are run affects market confidence as well as company performance. If companies are well run, they will generally prosper which, in turn, will enable them to attract investors whose support can help to finance faster growth. On the other hand, poor corporate governance can weaken a company's potential and, at worst, pave the way for financial difficulties and even fraud.

The CMA has issued guidelines for good corporate governance practices by public listed companies in Kenya in response to the growing importance of governance issues and in recognition of the role that good governance has in corporate performance, capital formation and maximisation of shareholders value as well as protection of investors' rights.

The CMA corporate governance guidelines contain a set of principles that are essential for good corporate governance and best practices that companies should endeavour to achieve. It is not possible for corporate governance standards to be capable of dealing with all possible scenarios; instead, they should be seen as best practice that a company builds into the culture of an organisation and that continually evolve in the light of experience.

Some of the corporate governance principles are highlighted below.

Corporate Governance Principles	
Board of Directors	• Every public listed company should be headed by an effective board to offer strategic guidance, lead and control the company and be accountable to its shareholders. • The board should delegate specific mandates to committees and specifically establish an audit and nominating committee. • The board should be composed of a balance of executive directors and non-executive directors (including at least one third independent and non-executive directors) of diverse skills or expertise in order to ensure that no individual or small group of individuals can dominate the board's decision-making processes. • The board should maintain control and monitor management in implementing its plans and strategies.
Chairman and Chief Executive	• There should be a clear separation of the role and responsibilities of the chairman and chief executive, which will ensure a balance of power and provide for checks and balances such that no one individual has unfettered powers of decision-making. • Where such roles are combined a rationale should be disclosed to the shareholders in the annual report.
Shareholders	• Shareholders should participate in major decisions of the company.
Annual Report and Accounts	• The board should present an objective and understandable assessment of the company's operating position and prospects.
General	• There should be public disclosure in respect of any management or business agreements which may result in a conflict of interest.

Every public listed company is required to disclose in its annual report a statement as to whether the company is complying with these guidelines and where it is not fully compliant disclose the reasons for non-compliance and indicate the steps being taken to become compliant.

1.3 Takeover and Merger Regulations

No person is permitted to acquire shares or enter into arrangements that would allow them to take effective control of a listed company without complying with the takeover procedures.

Effective Control
A person is presumed to have a firm intention to make a takeover of a listed company and is required to comply with the takeover procedures where they and any connected or persons: • hold more than 25% but less than 50% of the voting shares and acquire more than a further 5% of the shares • holds more than 50% of the voting shares and acquire additional voting shares • acquires a company that holds effective control in the listed company which results in it having effective control • acquires 25% or more of a subsidiary of a listed company that has contributed at least 50% of the listed company's average annual turnover in the latest three financial years.

The company that is intending or is treated as intending to make a takeover must serve a notice of intention within 24 hours on the offeree company and notify the CMA, the exchange and the Competition Authority where appropriate. Once it notifies the offeree company, it must also make its intentions public within the same time period by issuing a press notice that sets out details of the offer.

The offeror is required to issue a takeover offer document that has been approved by the CMA. Upon receiving the takeover document, the company on the receiving end of the takeover bid must appoint an independent adviser and circulate details of their recommendations its shareholders and make a public announcement of the details.

The takeover bid must remain open for 30 days and cannot be withdrawn without the approval of the CMA.

1.4 Foreign Investor Regulations

In normal circumstances, a foreign investor may hold any percentage of an issuer providing that it is permitted within the takeover and merger regulations. The Cabinet Secretary may, however, prescribe a maximum limit in circumstances such as government privatisations, strategic industries and if it is in the national interest.

This places an obligation on stockbrokers who must on every application for shares or transfer provide a declaration and supporting documentation showing whether the applicant or transferee is a foreign investor, a local individual investor or a local institutional investor. A company registrar will reject a transfer where it would result in the percentage held by local investors falling below the minimum required level.

As a result of these rules:

- all shareholdings for foreign investors must be registered in the name of the foreign investor and held by an authorised depositary
- a listed company must maintain its shareholder register so that it can distinguish local individual and institutional investors and foreign investors. It must provide monthly reports of its share ownership to the CMA and the exchange
- no offer of shares may be made outside of Kenya without the specific approval of the CMA

- where a foreign investor held shares beyond the prescribed limits before the issue of the regulations they are not required to dispose of the shares but no foreign investor will be eligible to purchase shares that exceed the limits
- a foreign investor may not subscribe for further shares under a rights issue or scrip dividend issue if that would exceed the percentage shareholding limits.

2. Nairobi Securities Exchange (NSE)

Learning Objective

5.2.1 Know the requirements for authorisation as a participant at the Nairobi Securities Exchange

5.2.2 Understand the NSE business conduct principles

5.2.3 Understand the standards of conduct expected from the NSE business conduct rules

5.2.4 Know the rules of the NSE surrounding trading access and trading sessions

5.2.5 Know the trading rules of the NSE

5.2.6 Know the enforcement powers of the exchange and the sanctions available

In 2012, the Cabinet Secretary of the National Treasury issued regulations authorising the demutualisation of the NSE which enabled its subsequent listing on the stock market.

As part of its application for demutualisation, the NSE was required to establish itself as a self-regulatory organisation that would set rules on eligibility of market participants, introduce conduct rules for how participants undertake business and establish how it would enforce its rules to ensure compliance by participants.

2.1 NSE Participants Rules

The board of the Nairobi Securities Exchange as a SRO has responsibility for putting in place procedures to assess whether applicants are suitable and fit and proper to become participants.

To become a participant at the NSE, an applicant must be a corporate body and be licensed by the CMA as a stockbroker, dealer, investment bank, authorised securities dealer or other license category that is eligible to be a trading participant or an authorised securities dealer. It must also confirm that it has made, or is in the process of making, satisfactory arrangements to comply with the requirements of the Central Depository & Settlement Corporation (CDSC).

If the board approves the application, the firm must then agree to be bound by and comply with the exchange's continuous obligations. To ensure compliance with these rule s a firm must, at all times, have:

- adequate trade execution, recording, reporting and settlement procedures and if relevant, order and quote management procedures and systems that are compliant with the exchange trading platform
- sufficient staff with adequate knowledge, experience, training and competence
- adequate internal procedures and controls
- a compliance officer appointed in accordance with the Capital Markets (Corporate Governance) (Market Intermediaries) Regulations 2011, who will be the primary point of contact between the firm and the Exchange.

In addition, a participant must at all times comply with the capital and financial requirements imposed on it by the CMA, and provide evidence of such compliance to the exchange on a quarterly basis within 15 days from the end of each quarter.

A market participant is also responsible for ensuring that its employees and authorised representatives are suitable persons to conduct capital market business. The firm must ensure that authorised representatives have the appropriate licence from the CMA to deal in securities and are registered as users with the exchange. It is the firm's responsibility to ensure that they are fit and proper, abide by the exchange rules and complete any prescribed examinations. The firm is liable for all transactions carried out on its behalf by employees and authorised representatives.

2.2 Business Conduct Rules

As part of its obligation as a SRO, the Nairobi Securities Exchange has issued business conduct rules that its trading participants must follow – the Nairobi Securities Exchange Trading Participants Business Conduct and Enforcement Rules.

2.2.1 Business Conduct Principles

The objective of the rules is to promote uniform standards of business conduct by participants in order to achieve an ethical, fair, transparent, orderly and efficient securities market. The rules are based on ten principles that set the high level standards that market participants should follow in conducting business.

NSE Business Conduct Principles		
1	Act with Integrity and Professionalism	Act at all times with integrity and in a professional manner towards clients, the exchange, the CMA and the general public.
2	Exercise Diligence and Due Care	Act diligently and exercise due care in performance of duties to clients.
3	Disclose or Avoid Conflicts of Interest	Make full and unambiguous disclosure of any situation that gives rise to a conflict of interest or avoid the situation giving rise to the conflict of interest.
4	Act in the Best Interest of the Client and the Securities Market	Act at all times in the best interest of the client and the securities market.
5	Uphold Securities Market Laws	Uphold the Laws and Regulations governing the securities markets and its principles.
6	Acquire and Enhance Relevant Knowledge and Skills	Endeavour to acquire the requisite knowledge and skills for effective performance of responsibilities and use such knowledge and skills for the betterment of the securities market and their peers.
7	Act in a Financially Responsible Manner	Conduct business in a financially responsible manner and maintain adequate financial resources to service liabilities as they fall due.
8	Protect Client Assets	Make sufficient arrangements for protection of assets held on behalf of the client.
9	Practice Free and Fair Competition	Exercise free and fair trade practices.
10	Communicate Important and Relevant Information to Stakeholders	Communicate information of a non-confidential nature that may be important and relevant to stakeholders.

2.2.2 Business Conduct Rules

The business conduct rules further emphasise the thrust of the principles to conduct business in an ethical manner that is compliant with the Capital Markets Act and the regulations and guidelines issued by the CMA. The rules cover the following areas:

- general rules
- know your client rules
- know your employee/agent rules
- record keeping
- notification of material information
- financial records and controls
- dealing with material infringements by employees and agents.

The General Rules require firms and individuals to act with integrity and professionalism and to avoid areas where conflicts of interests arise. Participants should ensure that they know the principles and detailed rules by which they should conduct business; ignorance of the capital markets laws and regulations is not an acceptable defence. A summarised version of the general rules is noted below.

General Rules	
Professional Standards	• Act in good faith in all dealings with clients, investors, the exchange, the CMA and other market participants. • Do not engage in any professional conduct involving dishonesty, fraud or deceit or commit any act that reflects adversely on their professional reputation, integrity and competence. • Possess the necessary knowledge and skills to perform the services offered to clients. • Where not qualified to perform a service for a client, decline to act or refer the client to another qualified person. • Remain continuously up to date on the requirements of capital markets laws and regulations.
Conflicts of Interest	• Disclose to clients in writing all circumstances that may give rise to a conflict of interest and use best efforts to place clients' interests ahead of those of the firm where conflict is unavoidable. • In all research reports or other representations to clients, disclose all possible conflicts of interest with respect to each of the researchers, key personnel or the firm itself. • Decline to act where a conflict of interest is likely to affect their independence and objectivity.
Clients	• Exercise prudence when acting on behalf of a client. • Ensure recommendations are suitable based on the client's investment objectives, financial situation and needs, and upon a reasonable examination of the client's financial records. • Do not knowingly or negligently make a misrepresentation by giving a false statement or omitting relevant information when presenting investment analysis, recommendations or advice. • Keep client details confidential except where authorised to disclose the information.
Dealing	• Place all client instructions for purchase or sale of securities before the instructions of the firm or any of its directors or employees. • Inform a client of any situation where it is likely to take an opposite transaction or position to that of the client before undertaking either trade.

General Rules	
Market Abuse	• Do not prejudice the client in order to directly or indirectly benefit the firm or any of its directors or employees. • Do not act in a way that may prejudice the fair, orderly and efficient operations of the securities market. • Do not engage in insider trading activities or other market manipulative activity. • Do not engage in any practice intended to manipulate the price of a security or investor behaviour.

The other conduct rules are summarised below:

Other Conduct Rules	
Know Your Client	• Take sufficient client details to ensure the 'know your client' process required for anti-money laundering purposes is undertaken. • Only accept verified written instructions and ensure sufficient controls to prevent unauthorised transactions. • Report any transactions or activities suspected to be a potential breach of the rules to the exchange and the CMA.
Know Your Employee/ Agent	• Conduct background checks on employees and agents with the aim of avoiding persons with previous criminal convictions for financial crimes or fraud and persons with a background which points to a lack of ethics and proper practices. • Require directors and employees to disclose all CDSC accounts and all transactions.
Record-Keeping	• Retain all records for the required seven year period and make them available to the exchange and the CMA on request. • Do not remove any document from Kenya to a foreign jurisdiction without the consent of the Exchange.
Notification of Material Information	• Inform the Exchange and the CMA in writing of any new material information or development with respect to its business.
Financial Records and Controls	• Prepare accounts in accordance with International Financial Reporting Standards (IFRS) and submit to the CMA and the exchange copies of interim financial reports and annual audited accounts. • Do not use client creditor balances to fund transactions of clients who fail to remit payment for the purchase of securities by the settlement date.

Other Conduct Rules	
Material infringements	• Document and take appropriate action for each instance of a material infringement by the firm's employee or agent and make records available to the exchange or the CMA on request or during an inspection or investigation. • Where the services of an employee or agent are terminated for a suspected material infringement, immediately notify the exchange and the CMA.

2.3 Trading Rules

A primary role of a stock exchange is to provide an organised market for the issue of subsequent trading of shares. To be able to trade on an exchange, a firm must be a member and it will then use the trading systems of the exchange. The Nairobi Securities Exchange operates an order driven trading system and has rules around its use to ensure there is a transparent, fair and efficient market.

2.3.1 Trading Access

Access to trading systems can be undertaken on the trading floor or through remote trading. When using the trading systems, each trading participant must at all times strictly comply with the rules of the exchange and any guidelines or other instructions issued.

Each trading participant is expected to appoint automated trading system (ATS) operators who can access the trading system and notify their details to the exchange. Each operator is allocated a unique personal identification user name and code to access the ATS by the exchange and access may be achieved either through terminals on the trading floor or remotely from their offices using the remote broker server.

Firms should ensure that only their designated ATS operators access the trading system for order input and executing transactions. They should not permit any form of electronic device or system capable of routing orders directly from their clients into the ATS and remain responsible for any loss that might arise in the event of unauthorised access. Notwithstanding this, a trading participant may request the exchange to give sponsored users direct access to the ATS to enable them to conduct direct trading activity, providing that the firm remains fully responsible, and will indemnify the exchange, for all activity of the sponsored users in the ATS.

All persons permitted access to the trading floor are expected to conduct themselves in a respectable and responsible manner and to follow the exchange's dress code. No unauthorised persons are permitted onto the trading floor. While on the trading floor:

- CDSC officers, CMA officers and all authorised persons should wear identification badges
- NSE trading floor personnel should wear green jackets
- stockbroker ATS operators should wear red jackets
- dealer ATS operators should wear light-blue jackets.

2.3.2 Trading Sessions

Trading of listed equity securities is conducted in sessions commencing at 9.00am and closing at 3.00pm each day.

Trading Hours	
The daily trading sessions are divided as follows:	
Pre-Open	9.00am to 9.30am
Opening Auction	9.30am
Continuous Trading	9.30am to 3.00pm
Close	3.00pm

The equity market and the fixed income market are divided into segments for the purpose of trading.

The equity market is divided into three segments – the Main Investment Market Segment; the Alternative Investments Market Segment; and the Growth Enterprise Market Segment. Trading in each segment is then divided between the 'normal board' and the 'odd lots board'.

In the fixed-income market, there are two segments – the 'Unrestricted Board' and the 'Restricted Board'. Trading on the latter is restricted to sophisticated investors. The minimum board lot is prescribed by the issuer but in any case is not less than one unit of the security.

2.3.3 Order Input

As mentioned earlier, only designated ATS operators may enter orders and execute transactions. The details inputted will depend on whether the trade is for an equity or fixed income security.

Order Input Details	
Equities	The order entry instructions for equity securities include: • security code • CDS account • whether it is a buy or sell order • quantity • price • limit or market order • order attributes.

Order Input Details	
Fixed Income	The order entry instructions for fixed income securities include: • security code • CDS account • whether it is a buy or sell order • quantity/volume • yield or price (either clean price or dirty price) • duration of validity of instructions • names of two authorised signatories of the CDS account.

Orders may be entered as either market orders or as limit orders that have qualifiers or conditions attached on price and time.

- Market orders will automatically execute against the best price available in the trading system.
- Limit orders will execute provided that the conditions attached to the order are met.
- Limit orders are entered with a price at which the order will execute if the price condition is met.
- A limit order that is marked as 'immediate or cancel' will execute immediately if there is a matching order in the system. If there is no matching order, it is cancelled and if it is only partly executed, the balance is cancelled.
- A limit order may also have a time qualifier attached. A 'good till cancelled' order will remain on the order book but will automatically expire 30 days from the date it was inputted. A 'good till day' order may remain on the order book for a maximum period of five days after which it will be automatically deleted. A 'day order' is automatically cancelled at the end of the trading session if not executed.

The volume of an order must also meet the rules on board lots. The minimum board lot on the Normal Board is 100 shares and the maximum board lot on the Odd Lots Board is 99 shares. Odd lots may only be entered as limit orders.

When trades are inputted, they are then processed by the ATS for validation, acceptance and execution. Following the entry of an order, the ATS validates the order by confirming that the seller's CDS account holds the required number of securities and that the same are available for trading. Once the order is accepted by the ATS it is automatically time-stamped and allocated an order ID and is then displayed anonymously in the order book.

An ATS operator may cancel or amend orders at any time prior to execution. An order may only be amended in respect of its price and volume attributes and once amended, is treated as a new order with a new time stamp.

2.3.4 Order Matching

The NSE is an order-driven market and uses an electronic order book. In an order-driven market, an investor places an order with their broker whose role is to find another trading participant with which they can undertake the trade. They do this by using the exchange's electronic order-driven system which looks to automatically match buyer and seller. On the NSE this is known as the automated trading system or ATS.

The orders to buy and sell shares are entered into the ATS and are displayed in the order book.

Order Book

Below is a simplified version of the content of an order book. The system displays the number of buying and selling orders that make up the order book.

ABC Ord Shares			
Buy		**Sell**	
Volume	**Price**	**Price**	**Volume**
1,000	25	26	2,000
2,000	24.75	26.25	3,000
3,000	24.50	26.50	4,000
4,000	24.25	26.75	5,000

- The buy column shows the limit orders that have been inputted by firms on behalf of clients who want to buy shares.
  - Under the buy column are details of the orders that are awaiting execution and the prices at which they are prepared to buy.
  - In this example, there are orders to buy 1,000 shares at a price of no more than Kshs 25 and further orders at lower prices.
- The sell column shows the limit orders that have been inputted for clients who wish to sell.
  - Under the sell column are details of those orders to sell that are also awaiting execution and the prices at which they are prepared to sell.
  - As can be seen, there are 2,000 shares available to sell at a price of no more Kshs 26 and further orders to sell at higher prices.
- No names are quoted as the system matches buyer and seller anonymously based on price and time.

All orders in the ATS order book are ranked by reference to first price and then time:

- Priority is given to the highest priced buy orders and the lowest priced sell orders.
- When buy or sell orders are entered at the same buy or sell price, priority is given to the earliest buy or sell order on a first-in-first-out basis.
- Market orders for equity securities have priority over limit orders. Where a market order is partially executed, the unexecuted balance is stored in the system for 15 minutes and then cancelled if unexecuted.
- Where no order qualifiers are specified for equity securities, orders are executed at the specified or better price.
- Where a partial execution of an order occurs, the remaining volume remains in the order book, preserving its original time-stamp.
- Orders for fixed-income securities execute when the yield or clean price matches.

2.3.5 Price Movements and Trading Halts

In order to ensure that trading takes place in an orderly fashion, the exchange has rules on permitted price movements and on halting trading.

The maximum daily price movement for any equity security in a single trading session is not more than 10% of the equity reference price. The equity reference price is calculated at the end of the day's trading session and is the volume weighted average price (VWAP) of transactions executed during the entire trading session for a specific equity security. The VWAP is calculated as the total value divided by the total volume traded in the period and excludes odd lot transactions.

Trading halts may be imposed by the exchange for the market as a whole or for individual securities.

Trading Halts	
Market Halts	A market halt can occur during a trading session in the following circumstances: • due to a technical failure of the ATS • when the 20 share Index decreases by more than 5% at the opening session compared to its closing value or during the continuous session compared to its opening value when the halt will not be for more than 15 minutes • where the exchange believes circumstances exist or are about to occur that could result in other than the transparent, fair and orderly trading of the listed securities.
Security Halts	The Exchange may temporarily halt trading in one or more securities in the following circumstances: • when there are unusual market movements in price/volume of a security • to obtain clarification from the company on a report brought to the attention of the exchange • on the request of the CMA • where the exchange believes circumstances exist or are about to occur that could result in other than the transparent, fair and orderly trading of the specific securities.

Trading participants are prohibited from executing transactions in the security for which a halt of trading has been announced. Where the exchange has reasonable grounds to suspect collusion or market manipulation, it may delete the orders in the order book at the time of halt. Where the orders are not deleted by the exchange, firms may withdraw their own orders but no other changes to the order book will be permitted during the halt. Trading in the security will resume as soon as the clarification from the exchange or the issuer is disseminated to the market.

2.4 Enforcement Rules

The Exchange has the power to enter the premises of a market participant during normal business hours and inspect its books, records and accounts and request an explanation for various issues that have come to light during the inspection. Additionally, the exchange may commence an investigation on a firm to look into a violation or potential violation of its own rules and those of the CMA.

Situations that may call for Disciplinary Action
• A breach of the conditions of its licence, the rules, or a failure to comply with an order of the board or the disciplinary committee. • Conduct that may call for disciplinary action including concealing any material fact, revealing confidential information, failing to maintain appropriate records and failing to make reports. • Conviction for fraud or a financial offence. • Selling a client's securities without the client's authority. • Failing to pay money due to clients, other market participants or the exchange. • Inducing another to buy and sell securities. • Disseminating false, misleading or inaccurate reports that affect the price of any security. • Publishing false and/or deceptive statements. • Suspicion of market malpractice or market abuse. • Failure to adequately supervise employees and agents or prevent a breach of securities laws. • Where after becoming aware of any financial inability it fails to notify the exchange or does not cease dealing. • Where winding up proceedings are commenced or it is declared insolvent and unable to pay its debts by a court of law.

The Disciplinary Committee has the power to enforce the rules of the exchange. It may impose sanctions on a participant that it deems appropriate to the gravity of the offence and the participant's past conduct and it will inform the CMA of any sanctions levied.

Sanctions Available to the Disciplinary Committee
• A private or public censure. • Require the participant to take action against its employee or agent for a breach of rules. • Restrict an ATS operator from continuing to act as an ATS operator for a defined period or indefinitely. • Restrict a participant's trading limits. • Restrict a participant's trading access for a duration not exceeding ten working days. • Order an audit of a participant and requiring the cost to be paid before commencement of the audit. • Suspend a participant subject to the approval of the board and the CMA. • Impose a financial penalty of up to Kshs 300,000 or refer the matter to the board for imposition of a fine up to a maximum of Kshs 5 million.

The decisions of the Disciplinary Committee are binding on participants although they have the right to be heard before a decision is made or sanction levied and may appeal decisions to the CMA.

3. Central Depositories Rules

Learning Objective

5.3.1 Know the duties of a central securities depository

5.3.2 Know the requirements for central depository agents

5.3.3 Know the rules surrounding the types and operation of securities accounts

5.3.4 Know how trades are settled at the CDSC

The creation of a central securities depository for the Kenyan market was authorised by the Central Depositories Act 2000.

3.1 Duties of a Central Securities Depository

The Act imposed duties on a central securities depository and required it to act in the interest of investors and the public.

Duties of a Central Securities Depository

• Establish and operate facilities for the handling of securities centrally.
• Provide fair, transparent and efficient depository, clearing and settlement arrangements for securities deposited and any transactions cleared or settled through its facilities.
• Ensure adequate measures are in place to prevent and mitigate fraud or any other system manipulation mechanisms:
  ◦ ensure safe custody of certificates and other documents deposited
  ◦ guard against falsification of the records or accounts
  ◦ ensure a proper and efficient system for tracing, verification, inspection, identification and recording of all transactions with the central depository.
• Seek approval for its proposed fees.
• Ensure that the risks associated with its business and operations are managed prudently.

The Act required a central depository to do all such things as are necessary to ensure orderly dealings in immobilised or dematerialised securities. In exercise of this duty, a central securities depository may therefore issue instructions to central depository agents (CDAs) or issuers to take certain action or refrain from certain actions. Failure to comply with the instructions is an offence and an issuer or central depository agent may be liable on conviction to a fine not exceeding Kshs 5 million, or to imprisonment for a term not exceeding five years, or to both.

The Act empowers the CMA to grant a licence subject to such conditions and restrictions as it considers proper and it subsequently approved the Central Depository and Settlement Corporation Ltd (CDSC). In exercise of powers in the Act, the CDSC has made rules that are approved by the CMA on its operations and membership.

3.2 Central Depository Agents (CDAs)

A central depository may appoint any of the following as its agent:

- any trading participant of a securities exchange for which it acts as a central depository
- a non-bank subsidiary of any bank or financial institution licensed under the Banking Act
- any institutional investor
- a corporate body of a type prescribed by the CMA.

The central depository will undertake checks to ensure that the applicant is a fit and proper firm to act as its agent. This will include a letter of no objection from the CMA and from the securities exchange where appropriate. Each applicant is also required to appoint a settlement bank to settle its transactions.

The appointment as CDA of a non-member of a securities exchange will exclude the power to operate the accounts for trading activities and shall be limited to non-trading activities including custody and mortgaging.

As a condition of its licence, a central depository is required to establish a guarantee fund to guarantee the settlement of all securities transactions through its system. The guarantee fund is financed by variable risk-based contributions from agents, any penalties and fines imposed and from other sources as agreed with the CMA

If appointed, the agent must meet the central depository's ongoing obligations and is then authorised to perform any or all of the following functions.

Authorised Functions
• Opening, maintenance and closing of securities accounts. • Collection and submission to the central depository of certificates for immobilisation. • Allocation of trades to securities accounts. • Submission of requests for withdrawal of certificates in respect of immobilised securities. • Collection of fees and charges imposed by the central depository.

An agent may be suspended or prohibited from maintaining or performing approved functions in any of the following circumstances:

- violation, whether directly or indirectly, of any provisions of the Act, the CMA rules or the central depository rules
- failure to pay any money due and owing to the central depository or the securities exchange on any account
- failure to make good any indemnity given to the central depository as a condition of its appointment
- becoming insolvent
- acting in a manner prejudicial to the interests of the depositors, the central depository or the capital markets generally.

The exercise of its power of suspension must be taken in consultation with the CMA and the exchange. Where a CDA is suspended or prohibited the central depository may appoint a manager to clear, settle or complete all outstanding or impending contracts, transactions, and transfers.

3.3 Central Depository Accounts

Eligible securities may be deposited into securities accounts at the central depository by the CDA.

Deposit Process
• Upon receipt of the deposit form and the securities certificates, the CDA is to forward the certificate to the issuer for verification and confirmation within one market day of the date of lodgement. • The issuer is to confirm the authenticity of the certificates and verify the depositor's signature within two market days of receipt in accordance with the operational procedures. • Following successful verification the issuer forwards all relevant documents to the central depository which then credits the account of the depositor with the securities.

Every central depository agent may open securities accounts for itself and for its clients.

- Accounts may be used to record securities that are available and unencumbered or may be held as collateral accounts or pledge accounts.
- Securities deposited into the central depository are held by the central depository in trust for the beneficial holders.
- When opening a client securities account a CDA must ensure that it has full particulars of the depositor's identity.
- A CDA must segregate its client accounts from the accounts in which it holds beneficial ownership of securities.

The securities account will record details of the CDA, the client and separate out securities that are held between those that are readily available and ones that are frozen due to trades, mortgages and court orders.

An investor may have more than one account, by registering a CDS account with more than one central depository agent. The investor can transfer securities among these accounts by making the request through the relevant CDA.

No entries relating to private transactions will be entered in the securities account without the prior approval of the CMA. This means that transfers of securities between custodians and their clients require prior approval for the following transactions – where there is no change in beneficial ownership, donations, hereditary transfers, sales on attachment, foreclosures on execution, pledges, free deliveries, loans and other dispositions of eligible securities.

3.4 Settlement of Trades

The central depository system is linked to the ATS at the Nairobi Securities Exchange. Once a trade is entered in the ATS, trade details are automatically fed into the CDS system and the relevant securities accounts are updated on a real-time basis (pending buy, pending sale). Transaction reports and settlement obligations are generated by CDSC and made available to central depository agents on trade date (T+0).

The CDSC employs a delivery versus payment (DvP) settlement system. This involves the simultaneous and irrevocable exchange of securities and cash in order to settle a trade. It means moving securities from seller to buyer in the central depository system and moving cash from the buyer to the seller in the banking system.

Global best practice dictates that settlement processes should as much as possible mitigate against credit and liquidity risk and where practical, settlement of the cash side of a trade should take place in central bank money. The cash side of the settlement process for transactions concluded on the Nairobi Securities Exchange is now carried out through the central bank's Real Time Gross Settlement System (RTGS). Through their design, RTGS eliminate counterparty risk. They provide the ultimate risk free means of discharging payment obligations between parties due to the finality and irrevocability of debits and credits to participants' accounts.

All settlement participants are required to open a settlement account with a settlement bank. On settlement date, funds transfer among participants takes place on a net basis at the settlement bank. Simultaneously the seller's securities account is debited and the buyer's securities account is credited in the CDS. This ensures strict delivery versus payment. This simultaneous exchange of cash and securities, guarantees irrevocability of settlement and offers a high level of customer protection.

The settlement cycle is T+3 which means that trades are settled three business days after the trade date.

End of Chapter Questions

1. Whose role is it to prepare the information memorandum needed for a listing?
Answer reference: Section 1.1.1

2. What is the minimum percentage of shares that must be publicly held for a listing on the MIMS?
Answer reference: Section 1.1.3

3. The role of chairman and chief executive in a company is undertaken by the same person. What action should the company take?
Answer reference: Section 1.2

4. In what circumstances is a takeover bid required?
Answer reference: Section 1.3

5. To become a trading participant, a firm requires authorisation from which three bodies?
Answer reference: Section 2.1

6. What is the objective of the business conduct principles?
Answer reference: Section 2.2.1

7. Where a conflict of interest is likely to affect the independence and objectivity of a firm, what action should it take?
Answer reference: Section 2.2.2

8. Who may access the NSE trading floor?
Answer reference: Section 2.3.1

9. How is priority allocated in the NSE trading system?
Answer reference: Section 2.3.4

10. Who imposes sanctions on trading participants for breaches of rules?
Answer reference: Section 2.4

11. What disciplinary actions can be imposed for breaches of rules?
Answer reference: Section 2.4

12. Failure to comply with a valid instruction from the CDSC would leave a firm liable to what potential penalty?
Answer reference: Section 3.1

13. Who may be appointed as a central depository agent and what functions can they undertake?
Answer reference: Section 3.2

14. Within what timescale from receipt must a central depository agent forward a securities certificate and deposit form to the issuer?
Answer reference: Section 3.3

15. If a trade is executed on Monday, when should you normally expect it to settle?
Answer reference: Section 3.4

Chapter Six

Investment Funds

This syllabus area will provide approximately 5 of the 50 examination questions

1. Collective Investment Schemes (CISs)

Learning Objective

6.1.1 Know the difference between the types of CIS that can be established in Kenya

6.1.2 Know the requirements for authorisation of a fund and the restrictions on advertising content

6.1.3 Know the purpose and main contents of the information memorandum

6.1.4 Know the role of the main participants in a collective investment scheme

6.1.5 Know the rules surrounding the valuation and pricing of a fund and investor dealing

6.1.6 Know the required content of half-yearly and annual reports

There is a range of investment funds available that pool the resources of a large number of investors to provide access to a range of investments. These pooled funds are known as collective investment schemes (CISs), investment funds or collective investment vehicles.

Collective Investment Schemes
The term 'collective investment scheme' is an internationally recognised one, but investment funds are also very well known by other names, such as mutual funds, unit trusts or investment companies with variable capital.

The EAC Council Directive on Collective Investment Schemes aims to harmonise the laws on collective investment schemes across partner states within East Africa. The directive defines a collective investment scheme as follows:

- an investment company
- a unit trust
- any other arrangement that enables investors to pool their resources for investment
- any other scheme designated as such by the regulatory authorities.

The rules surrounding the establishment and operation of a CIS in Kenya are contained in the Capital Markets Act and the collective investment scheme regulations.

1.1 Types of Collective Investment Scheme

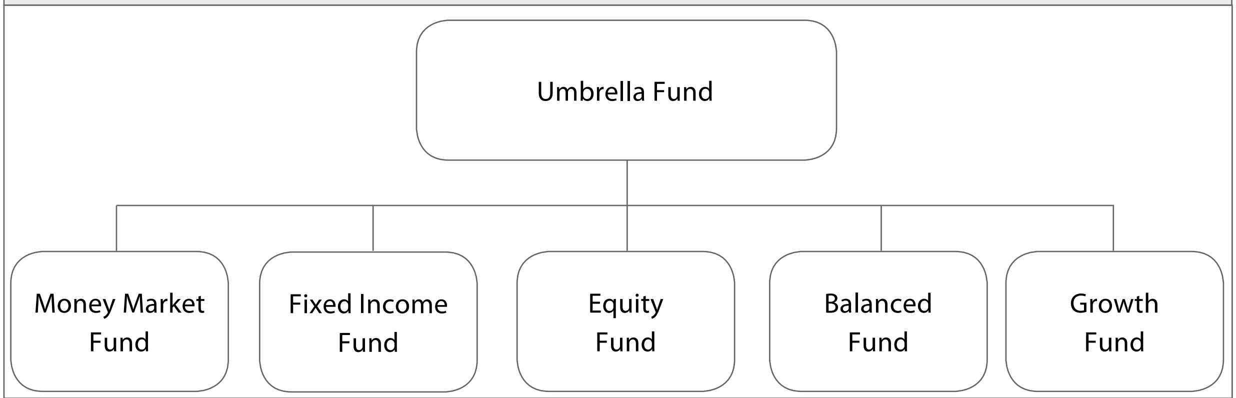
The Capital Markets Act permits the establishment of a collective investment scheme as either a unit trust or a mutual fund.

The main type of fund encountered in Kenya is a unit trust which is an investment scheme that pools money together from many investors who share the same financial objective to be managed by a group of professional managers who invest the pooled money in a portfolio of securities such as shares, bonds and money market instruments or other authorised securities to achieve the objectives of the fund. In exchange for the money received from the investors, the fund issues units to investors who are known as unit holders.

A mutual fund is very similar to a unit trust but is structured as a company rather than a trust; it therefore issues shares to investors rather than units. Where a fund group decides to launch a mutual fund, it must list on an approved securities exchange and raise a minimum of Kshs 25 million and in the event it fails to raise that amount, it must return the monies to the subscribers.

Collective investment schemes can be established as an umbrella fund which is where one CIS is established that has a number of separate sub-funds that will typically have separate investment objectives.

Umbrella Fund Structure Example



1.2 Launch and Approval of a CIS

The registration of a CIS is a two stage process. The CMA first considers and grants consent for the registration of the scheme and then it considers an application for registration of the CIS. The application for registration should be made within a period of three months from the date of issue of the consent to register the CIS.

When applying for consent, the CMA will wish to review the proposed documentation of the fund and assure itself as to the suitability of the key staff of the promoter:

- The promoter will need to submit among other things the draft information memorandum, trust deed and scheme rules.
- So that the CMA can satisfy itself as to whether the applicant is fit and proper, details of the promoter, references and comprehensive CVs of the directors and key personnel of the promoter must be provided.

Once the CMA has satisfied itself on the proposals, an application for registration is made by the promoter of the fund and the CMA will advise within 30 days whether registration has been granted.

A fund may only be advertised to the public if the fund is authorised. Any advertisement or invitation to the public must submitted to the CMA 48 hours in advance of publication and may be used until a significant or material change arises in the information contained in the advertisement, after which a new submission for approval must be made to the CMA.

Rules on General Contents of Advertisements
Warning statements must be written in such a manner as to be capable of being read with reasonable ease by anyone reading the advertisement. • Advertisements must specifically include warnings that: ◦ the price of shares, and the income may go down as well as up, and ◦ reminds investors that in certain specified circumstances their right to redeem their shares may be suspended. • Any advertisement which includes information on the trustee, shall be accompanied by the trustee's written consent. • Advertisements should make clear that any CMA approval for the fund does not imply that the authority takes any responsibility for the financial soundness of the scheme or for the correctness of any statements made or opinions expressed.

1.3 Fund Documentation and Investment and Borrowing Rules

The main documents for a fund are the trust deed and the information memorandum. The trust deed will contain details of the appointment of the trustee and the custodian and set out the scheme rules.

A key investor information document is the information memorandum or prospectus. It should contain sufficient information to enable an investor to make an informed decision about whether to invest in a fund and provide details of its main participants and how dealing will take place.

The main content of the information memorandum is summarised below.

Information Memorandum	
Scheme Details	• The name of the scheme and details of its registration. • Whether it is structured as a unit trust or mutual fund. • Whether it is structured as an umbrella fund and the its base currency.
Investment Objectives	• The fund's investment objectives and the investment policy that will be implemented to achieve those objectives. • The fund's investment and borrowing powers. • The general nature of the investment portfolio and any intended instrument, sector or geographic specialisation.

Information Memorandum	
Scheme Participants	• Details of the fund manager, of any other funds managed by them and any material provisions of their contract which may be relevant to the holders including provisions relating to terminations, compensation on termination and indemnity. • Details of the directors of the fund and their remuneration. • The name and address of the trustee, custodian and auditor of the fund.
Share Classes	• Where the register of the holders is kept and can be inspected. • Whether there is more than one class of shares in issue and the rights attached to each class. • How holders can exercise voting rights. • Method of conversion between shares of different classes. • In what circumstances a mandatory redemption, cancellation or conversion of shares from one class to another may be required.
Charges	• Details of the fund manager's remuneration and whether any is charged to capital. • The current amount or rate of any initial charge and whether any redemption charge will be applied. • The types of other charges and expenses that may be taken out of the scheme portfolio.
Valuation and Pricing	• How frequently and at what time of the day the portfolio will be valued for the purpose of determining the price at which shares may be purchased from or redeemed by the fund manager. • The basis on which the portfolio will be valued. • How the price of the shares of each class will be determined. • The policy on imposing a dilution levy.
Dealing	• The procedures for the sale and redemption of shares and the settlement of transactions and the circumstances in which the redemption of shares may be suspended. • The dealing days and times on which the fund manager will be available to receive requests for the issue and redemption of shares. • Whether certificates will be issued in respect of registered shares.
Distributions	• Details of scheme's accounting periods. • Policy in relation to interim distributions. • The annual date at which income will be paid or accumulated. • Whether income equalisation will be paid.
Reporting	• When annual and half-yearly reports will be published.

It must also contain a prominent statement on the period for which the prospectus is valid and a statement that permission has been granted by the Capital Markets Authority to offer the fund to the public.

While the information memorandum will set out the fund's investment and borrowing powers, it must operate within the restrictions set out in the regulations.

Investment and Borrowing Rules
• Any investment held must be consistent with the investment objectives of the scheme, be transferable, have a ready price or value, and have adequate proof of title or ownership to allow proper custodial arrangements to be made. • The book value of the investments of a collective investment scheme portfolio should not exceed the following limits: ◦ securities listed on a securities exchange in Kenya – 80% ◦ securities issued by the Government of Kenya – 80% ◦ immovable property – 25% ◦ other collective investment schemes including umbrella schemes – 25% ◦ any other security not listed on a securities exchange in Kenya – 25% ◦ off-shore investments – 10%. • In addition, the book value of any single investment or any holding of securities relating to any single issuer should not exceed 25% of the scheme's net asset value. • Securities lending is not permitted.

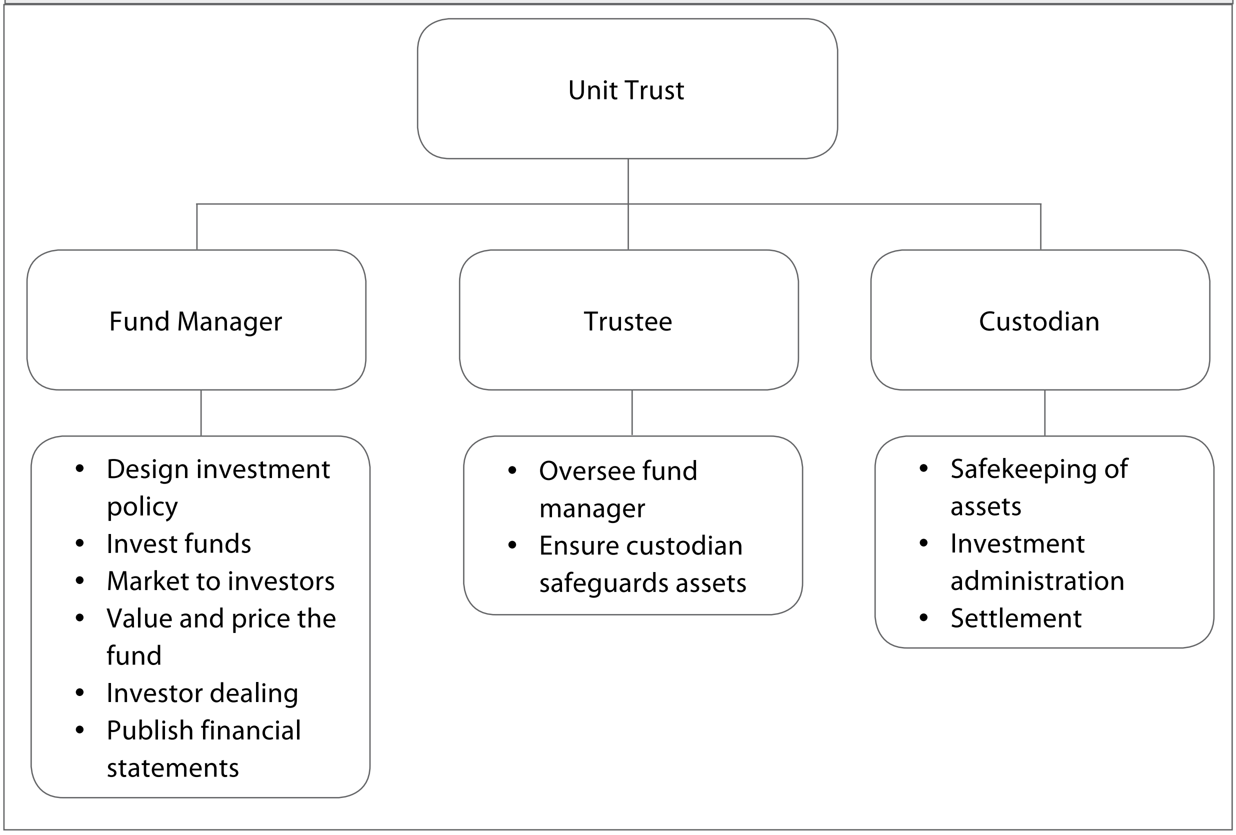
1.4 Role of Participants

The main participants in a unit trust are the fund manager, the trustee and a custodian. In addition, there is a requirement to appoint an auditor.

Each of the parties must be licensed by the CMA and once appointed may subsequently resign or be removed from their position.

- A participant may resign by giving three months' notice to the trustees or board of directors and must hand over detailed records to the incoming replacement.
- They may be removed where they go into liquidation or where the trustees or board consider that a change of fund manager is in the interests of the holders.
- They may be removed after three months notice, where an extraordinary resolution is passed by holders or where holders of three quarters of the shares request the trustee to do so.

Participants in a Unit Trust



1.4.1 Fund Manager

Every CIS must appoint in writing a fund manager approved by the CMA to manage the day to day operations of the collective investment scheme.

The role of the fund manager is to manage the fund's investment portfolio and administer the fund in accordance with the provisions of the incorporation documents, the information memorandum, as well as the collective investment scheme regulations.

Duties of Fund Manager
The principal duties of a fund manager are: • the formulation of a prudent investment policy and investment of the fund's assets • the valuation of the fund and the setting the dealing prices in accordance with the information memorandum • publication of dealing prices daily. Where the fund does not deal on a daily basis, prices should be published at least monthly and at least three days before the dealing day • dealing with investors when they wish to invest in the fund or redeem their existing holdings and issuing confirmation of the details of the transactions. The fund manager should pay any monies received to the trustees within 30 days of receipt • issuing certificates of entitlement to holders every 30 days that are prima facie evidence of the title of the holder to the units or shares • preparing and issuing dividend distributions and financial statements to investors.

In undertaking these duties, the fund manager must act in the interests of the fund and its investors and avoid conflicts of interest. They should keep detailed records of their activities and make these available to the trustee and others so that appropriate supervision of their activities can be undertaken. The rules protect them from liability for any loss in the value of the fund providing that they have acted in good faith and there is an absence of fraud or negligence.

1.4.2 Trustee

Every CIS must appoint a trustee that is a bank or financial institution approved by the CMA and it must disclose the fees payable to the trustee in the fund's annual report.

A key role of the trustee is to ensure that the fund is managed in accordance with the CMA rules, the incorporation documents, the information memorandum and the rules of the collective investment scheme.

The trustee must therefore supervise the activities of the fund manager and ensure that the custodian safeguards the assets of the fund. In particular, it must ensure that the fund manager adheres to the rules surrounding the valuation and pricing of the fund and that the fund manager does not exceed the fund's investment and borrowing powers. The trustee is required to report annually to holders in the annual report on whether the fund manager has managed the scheme in accordance with the rules and if not what steps have been taken.

1.4.3 Custodian

Every CIS must appoint a custodian that is a bank or financial institution approved by the CMA and it must disclose the fees payable to the custodian in the fund's annual report. A custodian cannot delegate its responsibilities to an agent except where assets are held overseas where it may appoint a sub-custodian.

The role of the custodian is to take the assets of the fund into safekeeping. It will then undertake the investment administration of the portfolio, settle trades, process corporate actions and provide details of company meetings to the trustee and fund manager so that the fund can vote at such meetings. It will provide regular reports to the fund manager and trustee on the portfolio and all transactions that have taken place.

The custodian is required to annually report to the CMA demonstrating how compliance with the regulations, the offering document, the incorporation documents, the information memorandum, the rules of the collective investment scheme and its service agreement has been achieved. The custodian must also report annually to holders.

1.4.4 Auditors

A fund manager is required to appoint an independent auditor who holds a valid practising certificate issued by the Institute of Certified Public Accountants of Kenya (ICPAK).

The auditor is responsible for auditing the fund's annual report and accounts. The responsibility of the auditor is to express an opinion on the financial statements based on their audit which should be conducted in accordance with International Standards on Auditing. These standards require that they obtain reasonable assurance that the financial statements are free from material misstatement so they will obtain audit evidence about the amounts and disclosures in the financial statements.

An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the trustee, as well as evaluating the overall presentation of the financial statements.

1.5 Fund Valuation, Dealing and Charges

It is the responsibility of the fund manager to undertake regular valuations of the investment fund and to calculate and publish the prices at which investors can buy or sell units.

The time at which the fund is valued is known as the valuation point and the frequency with which valuations are undertaken is set out in the information memorandum. There must be at least two valuation points in each calendar month and if there are only two valuation points in any calendar month they must be two weeks apart.

The portfolio of the fund is valued using the mid-price of the underlying securities to which is added any cash and undistributed income that is held. From this total amount, any expenses and accrued charges are deducted to arrive at the net asset value (NAV) of the fund. The value of each unit or share in the fund is the NAV divided by the total number of shares or units in issue.

The selling price and repurchase price quoted by the fund manager are based on the net asset value of the fund. When investors purchase units, they may also pay an initial charge and there may be charges when a sale is made. On redemption of the shares, the fund manager is to pay the proceeds to the investor no later than the sixth business day following the valuation point.

A dilution levy may become payable when the size of the purchase or redemption is large and using the mid-price would not be fair to the remaining holders.

1.6 Investor Reporting

A fund will issue both half-yearly and annual reports to its investors and to the CMA. Every CIS must have an annual accounting period ending the last day of December in each year. The annual report should be audited and issued not more than three months from the end of the accounting period; the half-yearly report should be issued within 30 days from the end of June.

The regulations require the trustee to prepare the financial statements for each financial year that giving a true and fair view of the state of affairs of the fund as at the end of the year and of the results of its operations:

- the annual financial statements should be prepared using appropriate accounting policies in conformity with International Financial Reporting Standards
- the trustee must ensure that the fund manager keeps proper accounting records that disclose, with reasonable accuracy, the financial position of the fund and enable preparation of financial statements that are free from material misstatements.

Investor reports should contain the following information:

- **Part 1** – a report of the trustee or fund manager
- **Part 2** – a comparative table
- **Part 3** – a report from the custodian
- **Part 4** – a report from the auditor.

The fund manager should provide an investment commentary on the fund that sets out the investment objectives of the fund and its investment performance during the accounting period. The report of the trustee should include certain declarations and confirm whether anything has come to the attention of the trustee to indicate that the fund will not remain a going concern for at least 12 months from the date of the statement.

The comparative table should provide details of the fund's performance, highest and lowest prices and distributions over the last five calendar years (or shorter if it has not been in existence for that long). In addition, it should show the value of the fund's portfolio and the price for each class of shares at the end of each of the last three annual accounting periods.

The custodian must also report annually to holders. The fund's annual accounts should contain a report from the custodian on the creation and redemption process and whether the fund's investment and borrowing powers have been exceeded.

Report of the Custodian
The report should confirm that it has discharged its duties as custodian as required by the regulations and state whether: • the issue, sale, redemption and cancellation, and calculation of the price of the collective fund's shares and the application of income have been carried out in accordance with the regulations, and • whether the investment and borrowing powers and restrictions prescribed in the regulations and the documents of incorporation have been exceeded.

The auditor is responsible for auditing the fund's annual report and accounts which should contain a formal report of the auditor as to whether the accounts give a fair and clear view of the fund's accounts.

Report of the Auditors
The report of the auditor to the shareholders in respect of the accounts of the collective investment scheme is to state whether in the auditor's opinion: • the accounts have been properly prepared in accordance with the regulations • the accounts give a true and fair view of the net income and the net gains or losses of the fund for the annual accounting period and the financial position of the fund or the sub-fund as at the end of that period • proper accounting records have been kept and the accounts are in agreement with those records • they have been given all the information and explanations which, to the best of their knowledge and belief, are necessary for the purpose of their audit • the information given in the report of the directors is consistent with the accounts.

2. Exchange-Traded Funds (ETFs)

Learning Objective

6.2.1 Know the main characteristics of exchange-traded funds

6.2.2 Know how ETFs are listed, traded and settled

The CMA has issued a policy guidance note on the operational environment for exchange-traded funds (ETFs) to enable the introduction of ETFs into the Kenyan capital markets.

2.1 Characteristics of ETFs

An ETF, is a collective investment scheme that is quoted and traded intra-day on a stock exchange. Its purpose is to pool the savings of investors into one investment vehicle and provide access to an underlying investment portfolio that tracks an index. The index may be composed of shares, bonds, commodities, futures or a combination of assets.

Its major differentiating feature is that it is listed and traded on a stock exchange and is cleared and settled as with any other equity trade. Market makers quote two way prices on the ETF giving investors the ability to trade the stock at any time that the market is open, rather than at a set daily price.

Characteristics of ETFs
Some of their distinguishing features include the following: • They track the performance of a wide variety of fixed-income and equity indices as well as a range of sector and theme-specific indices and industry baskets. Some also now track actively managed indices. • Some ETFs are more liquid, or more easily tradable, than others depending upon the index they are tracking. • The details of the funds' holdings are transparent so that their NAV can be readily calculated. • They have continuous real-time pricing so that investors can trade at any time. They will generally have low bid-offer spreads depending upon the market, index or sector being tracked. • They have low expense ratios and no initial or exit charges are applied. Instead, the investor pays normal dealing commissions to their stockbroker.

ETFs use passive investment management which is a method of managing an investment portfolio that seeks to match the performance of a broad based market index. Its investment style is described as passive because portfolio managers don't make decisions about which securities to buy and sell. Instead, they invest in exactly the same securities, in the same proportions, as make up an index. The approach is based on the belief that it is impossible to beat the market average on a risk-adjusted basis consistently. It therefore seeks to hold a portfolio that mirrors the index it is tracking and undertakes trading only to ensure that the portfolio's performance is in line with the index.

2.2 Listing ETFs

ETFs require authorisation from the CMA and approval for listing from the stock exchange. Some of the main requirements for authorisation are as follows:

- Where they are created domestically they must be open ended and structured as a unit trust.
- The minimum participants involved are the fund manager, market maker, trustee, custodian or administrator, index provider and external auditor.
- The fund must produce an information memorandum that sets out its purpose, how its net asset value will be calculated, its creation and cancellation process and how its portfolio will be periodically rebalanced in order to stay in line with the index.
- How the fund will manage the risks associated with early-stage ETF markets in line with established international standards.

Where an offshore ETF seeks a secondary listing on the stock exchange it requires approval from both the CMA and its home regulator.

2.3 Trading and Settlement

While ETFs are structured in the same way as other pooled funds, their main differences typically come about in the creation and redemption process and the way they are traded.

As with other securities, investors buy and sell their ETFs through a securities exchange and clear or settle trades through existing clearing and settlement infrastructure. ETFs are traded in their own market sub-segment created by the listing exchange. Each ETF must also have one or more market makers whose role is to create liquidity in the shares and to quote firm two-way prices.

The way in which the creation and redemption process typically operates is for market makers and other financial institutions to deal directly with the ETF to create new ETF shares. They can do this in one of two ways:

1. They go into the markets and buy a basket of shares that corresponds exactly with the construction of the underlying index and then deposit this with the ETF and receive in exchange an institutional block of shares known as creation units.
2. Deliver cash to the ETF provider in exchange for a creation unit.

When they wish to redeem units, the firm delivers the creation unit back to the ETF provider and receives either the underlying shares or cash.

These institutions will also be market makers on the stock exchange and will then make a two way market in the underlying ETF shares during market hours. For the investor, dealing in ETFs is then identical to any other stock market trade. They simply place an order with their broker who will then execute the order with whichever market maker is offering the best price at that moment in time.

In order to keep the market price of the ETF as close as possible to the fund's net asset value, the ETF publishes the net asset value at the start of each day and during the trading day, the stock exchange publishes information on the indicative NAV enabling investors to compare this with the bid/offer in the market. This allows an arbitrage band to be created around each ETF's net asset value by arbitrageurs and other traders who can profit from any discrepancy between the two prices. This ensures that the ETF's price never varies significantly from its NAV.

To enable this trading and settlement process to operate efficiently and fairly, the CMA rules require among other things:

- The calculation of the NAV should be undertaken by a competent institution that is either an approved exchange or an outsourced organisation that also provides tracking error services.
- Market makers should be appointed who undertake to quote buying and selling prices in respect of units in the ETF on a daily basis. The market maker is to submit to the CMA and the listing exchange a copy of the market making agreement concluded with the issuer prior to the commencement of market making.
- The NAV of the ETF should be disseminated to participants based on the last traded price on a daily basis before the commencement of trading.

- There should be clear procedures for market data disclosure and circulation including the dissemination by the exchange of intra-day NAV.
- Units in an ETF should be listed and traded in Kenyan shillings and the maximum fees that can be charged should be the same as equities.
- Domestic ETFs should be subject to intra-day price fluctuation limits on trading like shares. Offshore ETFs should be subject to the limits that have been imposed in their home jurisdiction.
- An Index Review Committee of the exchange should undertake an objective assessment of the historical reliability of the ETF's valuation process.
- As with equities, the exchange provides first line supervision and surveillance and must have a linkage with CMA's surveillance infrastructure.

3. Real Estate Investment Trusts (REITs)

Learning Objective

6.3.1 Know the main characteristics and requirements for REITs

A real estate investment trust (REIT) is a collective investment scheme that specialises in investing in real estate. REITs are usually structured as a trust where an investor owns interest in real estate assets and earns returns from income and capital gains. The property is held by a trustee and is professionally managed.

Types of REITs	
I-REIT	An income real estate investment trust (I-REIT) is a real estate trust that primarily derives its revenues from property rentals.
D-REIT	A development real estate investment trust (D-REIT) is a real estate trust that is principally involved in development and construction for sale and/or rental.

REITs have the following characteristics:

- If the REIT is unrestricted, it must be listed on an approved exchange such as the NSE.
- A restricted I-REIT is an offer that is made to specific groups meeting certain thresholds such as being a professional investor. The intent of the restrictions is to protect the public by ensuring that only investors that meet certain criteria participate.
- D-REITs should only be offered to professional investors and do not need to be listed on a securities exchange.
- Restricted I-REITs and D-REITs may only be listed on an approved market segment of an exchange which limits trades to professional investors.
- A D-REIT may convert to an I-REIT after the property has been developed.

There is no regulatory minimum amount of investment for investors investing in unrestricted I-REITs. However, a minimum investment of Kshs 5 million is required for an investor to qualify to be categorised as a professional investor for the purposes of investment in a D-REIT or restricted I-REIT.

Some of the other regulatory requirements concerning both types of REIT are noted below.

Regulatory Requirements for REITs	
Structure	• Property must be held in trust and professionally managed by a REIT manager. • The trustee must be independent of the promoter. • For D-REITs, a promoter must maintain an investment of at least 10% of the value of the fund for two years from the date of issue. • For I-REITs, a promoter must maintain an investment of at least 20% of the net asset value for the first year and 10% for the second. • There must be a minimum of seven investors in both D-REIT and I-REIT.
Assets	• The minimum size of initial assets for I-REITs is Kshs 300 million. • The minimum size of initial assets for D-REITs is Kshs 100 million.
Borrowing Powers	• I-REITs may borrow up to 35% of the total asset value. This can be increased to 40% with approval of unitholders by way of an ordinary resolution for a temporary period of up to six months. • D-REITs may borrow up to 60% of the total asset value. This can be increased to 75% with approval of unitholders by way of an ordinary resolution for a temporary period of up to six months.

4. Venture Capital Companies

Learning Objective

6.4.1 Know the main characteristics and requirements for venture capital companies

A venture capital company is a company incorporated for the purposes of providing risk capital to small- and medium-sized businesses in Kenya with high growth potential.

A venture capital company can apply to the CMA for authorisation provided it meets certain eligibility requirements. Its application for authorisation must also detail its investment objectives and in particular:

- its investment rules, investment process and exposure limits to individual eligible venture capital enterprises and the risk factors that apply to its intended investments
- the minimum and maximum investment that will be made in any single enterprise
- disclose a clear strategy for the diversification of investments in eligible venture capital enterprises

- how it will realise its investment and its preferred mode of divestiture from eligible venture capital enterprises.

Eligibility Requirements for a Registered Venture Capital Company
• Incorporated under the Companies Act as a company limited by shares that has as its principal object the provision of risk capital to small- and medium-size businesses in Kenya. • A minimum paid up share capital of Kshs 100 million. • A minimum fund of Kshs 100 million. • Audited financial statements for the three years immediately preceding the date of application • Have a demonstrable track record as a venture capital company of at least three years. • Has engaged a fund manager duly licensed by the CMA. • A board of directors of which at least one third are independent directors. • Has appointed an auditor who is a member of the Institute of Certified Public Accountants of Kenya. • Has appointed a secretary who is a member of the Institute of Certified Public Secretaries of Kenya.

Once authorised, the registered venture capital company must not change its shareholders, directors or fund manager unless it has received a written confirmation stating that the CMA has no objection to the proposed change.

A fund may not invest in enterprises whose primary business activity includes trading in real property, banking and financial services, or retail and wholesale trading services. It is also prohibited from raising funds from the general public and instead must raise funds via a private placement.

5. Employee Share Ownership Plans (ESOPs)

Learning Objective

6.5.1 Know the requirements for establishing an ESOP and the main scheme rules

An employee share ownership plan (ESOP) is a scheme used by companies as part of their remuneration benefits that they pay to employees. An ESOP enables a company to offer shares to its employees as part of a strategy to motivate and further increase employee engagement by making them shareholders.

5.1 Creation of an ESOP

In Kenya, the term 'ESOP' refers to a plan in which a trust is established for the exclusive benefit of employee participants and the employees beneficially own the stock held in trust for them.

Use of an ESOP
So far, 11 companies have set up and had an ESOP authorised by the regulator. Equity Bank has the largest ESOP of a publicly listed company followed by Safaricom, Kenya's largest telecoms provider. These organisations use employee compensation schemes to motivate and retain key employees.

A listed company may set up an employee share ownership plan. It is up to the board of directors to determine whether one should be established and if so, the board must seek shareholder approval at a general meeting of the company.

The ESOP must be authorised by the CMA. The scheme must be structured as a trust and have at least three trustees unless a trust corporation is appointed as sole trustee. Its trust deed must meet certain CMA requirements and set out how the unit trust will operate and eligibility for membership.

Once authorised, the scheme must then meet ongoing requirements.

- Every listed company is to disclose any options granted to employees under the ESOP and disclose the total value of the ESOP (including the number of shares purchased from the exchange and the number of units created and issued under the ESOP) in its annual report.
- The ESOP should be audited once every year and the auditors should submit a copy of the auditor's report to the unitholders and the CMA within 60 days of the completion of the audit.
- An ESOP may be varied or wound up in accordance with its rules but three months' notice is to be given to the unitholders and the CMA.

5.2 Scheme Requirements

The scheme must be structured as a unit trust which will acquire or purchase shares only in the listed company for which it is established and have scheme rules which include the following:

- eligibility for membership
- procedure for saving and/or acquisition and repurchase of units
- maximum individual holding
- employee rights in respect of units
- pricing and valuation of units
- in the case of an options scheme there shall be a procedure for granting options, maximum limit, executive rights in respect of units and entitlement in the event of reconstruction or winding up.

The scheme rules should prescribe the price at which an ESOP unit trust will allot the units to the employee, the price at which the trustees shall repurchase units and the liability for incidental expenses. The price used for re-purchase must reflect the latest traded price of the company's shares at the securities exchange.

The certificates representing the shares of the listed company will be held in the trustees' names and the trustees create corresponding units in the same denominations as the listed company's shares and issue these to the employees entitled under the ESOP. The trustees issue certificates of entitlement to the employees and maintain a register of all unitholders. The certificates are not transferable, cannot be traded at any securities exchange but the units may be pledged.

When the employee exercises their entitlement, they have a choice of having shares in the listed company transferred into their name or requesting the trustees to repurchase the surrendered units. On termination of employment, however, the employee has to surrender all certificates representing the units to the trustees at such time as prescribed by the ESOP rules.

6. Special Interest Schemes

Learning Objective

6.6.1 Know the characteristics and requirements for special interest schemes

A special interest collective investment scheme means a collective investment scheme established by a promoter for the purposes of facilitating investment by a special group of individuals with a common interest in a listed company and may include farmers, distributors, suppliers and others.

All special interest schemes must be registered with the CMA, be structured as a unit trust and have at least three trustees. Its trust deed must meet certain CMA requirements and set out how the unit trust will operate and eligibility for membership. It must also be audited annually and the audit report sent to the CMA.

Once authorised, the promoter must notify the company of the scheme. The company must then disclose details in its annual report of any special interest collective investment scheme which has acquired or is to acquire shares, the number of shares purchased from the exchange and the aggregate holding of the scheme in the listed company.

The trustees will hold the certificates representing the shares in the listed company and issue corresponding units in the unit trust to the investors. The investor can request the trustee repurchases the units and the price of the units must reflect the latest or previous day's traded price of the company's shares at the securities exchange. Alternatively, they may request that the underlying shares represented by the units are transferred to them in a private transaction.

End of Chapter Questions

1. What are the two main legal structures that can be used for collective investment schemes?
Answer reference: Section 1.1

2. What is an umbrella fund?
Answer reference: Section 1.1

3. What factors will the CMA take into account when considering the authorisation of a collective investment scheme?
Answer reference: Section 1.2

4. An advertisement for a unit trust should contain what specific warnings?
Answer reference: Section 1.2

5. If an adviser wants to know when a unit trust will undertake dealing and distribute they income, it should refer to which document?
Answer reference: Section 1.3

6. What are the maximum investment limits that a collective investment scheme must adhere to?
Answer reference: Section 1.3

7. Who are the main participants in a collective investment scheme and how do their roles differ?
Answer reference: Section 1.4

8. What does the NAV of a fund represent?
Answer reference: Section 1.5

9. When might a dilution levy be imposed?
Answer reference: Section 1.5

10. What is the purpose of the comparative table in a fund's annual report?
Answer reference: Section 1.6

11. What type of investment management technique does an ETF utilise?
Answer reference: Section 2.1

12. A retail investor would approach which organisation to buy shares in an ETF?
Answer reference: Section 2.3

13. What are the two main types of REIT found in Kenya?
Answer reference: Section 3

14. How do the borrowing powers of an I-REIT differ from those of a D-REIT?
Answer reference: Section 3

15. What type of REIT can only be offered to professional investors?
Answer reference: Section 3

16. What role do venture capital companies perform?
Answer reference: Section 4

17. Is a venture capital company established as an open-ended or closed-ended company?
Answer reference: Section 4

18. Why would a company establish an ESOP?
Answer reference: Section 5

19. To set up an ESOP requires what approvals?
Answer reference: Section 5.1

20. How does an ESOP differ from a special interest scheme?
Answer reference: Sections 5 and 6

Glossary and Abbreviations

Agent

An agent is normally a representative of a stockbroker and undertakes the business of buying and selling securities for a return commission through the principal, the stockbroker.

Articles of Association

A document describing the purpose, place of business and details of a company.

Authorised Securities Dealer

A firm that acts as a market maker and dealer in the fixed income securities market.

Automated Trading System (ATS)

A computerised system of trading where trades are executed online.

Beneficial Owner

The true owner of a security, which may, for convenience, be recorded under the name of a nominee.

Bonus Issue

These are additional shares given to existing shareholders at a specified ratio and paid for from the company's normal revenue reserves. Bonus shares are mostly issued in lieu of paying cash dividends although a company can issue both.

Central Depository Agent

A person appointed by a central depository to be an agent of the central depository.

Closed-Ended Fund

A collective investment scheme where the investor typically can sell their holding only in a secondary market and is not entitled to require the fund to redeem the shares.

Collective Investment Scheme (CIS)

Includes an investment company, unit trust, mutual fund or other scheme whether or established or organised in Kenya or not which pools funds from the public for the purpose of investment.

Corporate Governance

Mechanism used by firms to govern and control an organisation in accordance with regulatory guidelines and industry best practice.

Custodian

A company approved by the CMA to hold in custody funds, securities, financial instruments or documents of title to assets of a collective investment scheme.

Dealer

A person who carries on the business of buying, selling, dealing, trading, underwriting or retailing of securities except exchange-traded derivative contracts.

Dilution

The reduction in the value of a collective investment scheme portfolio as a result of costs incurred in dealing in its underlying investments and of any spread between the buying and the selling prices of such investments.

D-REIT

A development real estate investment trust scheme.

Ex-All

This terms means 'without dividend', 'without bonus' or 'without rights'. The buyer of a security, which has been declared as 'ex-all', will not be entitled to dividends or the issue.

Executive Director

A director of a company that is a member of the board who performs day-to-day functions within the company such as the chief executive.

Fidelity Insurance

Fidelity implies the faithful or loyal performance of a duty and a fidelity guarantee policy is an insurance against the results of dishonesty or disloyalty.

Fit and Proper

A term used to indicate whether an organisation or firm meets appropriate standards to operate in the capital markets.

Fund Manager

A manager of a collective investment scheme, or a registered venture capital company or an investment adviser who manages a portfolio of securities in excess of a prescribed amount.

Futures Broker

A corporate body that is a member of a derivatives exchange and duly licensed by the CMA to engage in the business of trading in exchange-traded derivative contracts as an agent for investors.

General Meeting

A meeting of the shareholders of a company – also referred to as annual general meetings or extraordinary general meetings.

International Financial Reporting Standards (IFRS)

The International Financial Reporting Standards issued from time to time by the International Accounting Standards Board as adopted in Kenya.

Immobilisation

Process whereby physical share certificates are deposited with the central depository with a view to having them eventually having them entered into electronic form ready for trading.

Immobilised Securities

Securities where the underlying physical certificates have been deposited with and are held by a central depository.

Inducement

A payment or some other form of benefit paid directly or indirectly in order to provide some favour or benefit.

Information Memorandum

A prospectus or similar document containing information on the issue of securities or a collective investment scheme calculated to invite offers from the public.

Initial Charge

The portion of the selling price of a unit trust which represents the fund manager's charges in respect of the creation and issue of such shares.

Initial Public Offering (IPO)

An IPO is an offer made to the public to subscribe for securities by an issuer for the first time. An IPO is also termed as 'going public'.

Insider

Any person who is or was connected with a company and who is reasonably expected to have access, by virtue of such connection to unpublished information which if made generally available would be likely to materially affect the price or value of the securities of the company, or who has received or has had access to such unpublished information.

Insider Dealing

A criminal offence committed by an insider in possession of unpublished price-sensitive information if they attempt to deal in affected securities, encourage others to deal, or pass the information on.

Investment Adviser

Any person who carries on the business of advising others on securities, undertakes the management of a portfolio, issues company analysis or advises on long term equity and debt financing.

Investment Company

A collective investment scheme organised as a limited liability company under the Companies Act in which the rights of participants are represented by shares of that company.

Investor Compensation Fund (ICF)

A fund to compensate investors who suffer loss resulting from the failure of a licensed broker or dealer to meet its contractual obligations.

I-REIT

An income real estate investment trust.

Issued Share Capital

The amount of capital, which has been subscribed to and fully paid out of the authorised share capital of a company.

Issuer

A company, corporation, government or body corporate offering (or having already offered) securities for sale to investors or to the public.

Jointly and Severally

A legal phrase that means two or more persons are fully responsible equally for the liability.

Key Personnel

Individuals who manage or control the activities of a licensed or a regulated person.

Last Day to Register or Books Closed Date

The day by which securities must be lodged with the company's office to qualify for dividends, rights or bonus shares.

Limit Order

An order placed by a customer with a broker stipulating a limit as to the price at which shares are to be bought or sold.

Margin

A deposit or payment to create, vary or maintain a position in a futures contract.

Market intermediaries

Firms that are licensed to operate in the capital markets as stockbrokers, dealers, authorised securities dealers or futures brokers.

Market Price

The market price refers to the ruling price of shares on the trading floor of the exchange at any given time. The market price of a share is normally a indicator of the level of demand of that security.

Material Information

This means any information that may affect the price of an issuer's securities or influence investment decisions and includes a merger, acquisition or joint venture; a block split or stock dividend, earnings and dividend of an unusual nature or a significant law suit against the issuer.

Maturity Date

The date specified in a commercial paper, note, bond or other evidence of debt on which the debt is due and payable. Maturity depends on the terms of the debt.

Merger

The combining of two or more firms into one firm where the shareholders of the combining firms retain their powers, rights and benefits in the new firm. It is also called uniting of interests. There is potentially neither acquirer nor acquiree and the combining entities may be of similar size.

Money Market

This is market for short-term debt securities with maturity of one year or less. These securities include treasury bills, certificates of deposits, commercial paper, and repurchase agreements (REPOs).

Money Market Fund

Generally, a mutual fund/unit trust which typically invests in short-term debt securities such as government securities, commercial paper and certificates of deposits of banks.

Mutual Fund

A collective investment scheme established as a corporate body which is authorised to redeem or repurchase its shares.

Mutual Fund

A pool of stocks, bonds or other securities purchased by a group of investors and managed by a professional/registered investment company. The investment company itself is also commonly referred to as a mutual fund.

Net Asset Value (NAV)

Net asset value means the value of all assets of the fund less the value of all liabilities of the trust, including trustee and management fees, as at the day the calculation is made.

Net Asset Value

In the context of a mutual fund or unit trust, it is the value of one share of a unit trust/mutual fund at a given point in time, which is calculated by adding up the value of all the unit trust/mutual fund portfolio and dividing by the number of outstanding shares.

Netting

Determining the net payment or delivery obligations by setting off buying and selling trades or contracts.

Nominal or Face Value

The amount of money that the issuer of a bond promises to repay to the bondholder on or before the maturity date.

Non-Executive Director

A director of a company who is a member of the board and who does not perform any day-to-day functions.

Novation

The legal process by which the futures exchange and its clearinghouse become the legal counterparty to both parties of every trade.

Odd Lots

This is a lot which is less than the stipulated board lot. For example, a board lot at the Nairobi Securities Exchange comprises a trade of more than 100 shares and anything less than this is an odd lot.

Offer

This is the opposite of a bid and is the price paid when buying securities. Sometimes referred to as the 'Ask'.

Offer for Sale

This refers to the process whereby a company announces its intention to issue new shares at a certain price and therefore invites the public to apply for them through a prospectus.

Offer Period

This refers to the period during which an offer for subscription or sale of securities to the public remains.

Open-Ended Fund

A collective investment scheme where the number of shares or units in issue changes over time in response to investors buying and selling units in the fund.

Option

This is a contract between a dealer and a buyer, which gives the latter the right to buy (a call option) or sell (a put option) a given number of shares at a fixed price within a given period.

Options Contract

A contract that gives its holder the right and not the obligation to buy or sell a fixed number of securities or any other instrument at a fixed price on or before a given date.

Ordinary Shares

Shares that give the shareholder part ownership of the company in proportion to the number of shares held and which entitle the shareholder to dividends. It is the risk capital that is entitled to claim residual assets in the event of liquidation.

Over-The–Counter (OTC) Market

This is a market for buying and selling stocks through a network of telephone and telecommunications systems rather than going through the stock exchange. It is sometimes referred as 'off-board' trading.

Paid Up Capital

Paid-up capital refers to the amount of money paid by shareholders of the company and is a total of all shares issued multiplied by the par value for each share.

Par Value

The face value or principal or maturity value of a security appearing on the face of the security instrument.

Preference Shares

Shares bearing a fixed annual rate of dividend with a prior right over all ordinary shares in the distribution of dividends from annual profits and having prior claim to repayment of capital on the winding-up of the company.

Primary Market

This refers to the initial offering of a security as well as the activities of investors subscribing to securities being offered by the issuer. In the primary market, the investors buy the securities directly from the issuer as opposed to the secondary market.

Private Placement

The sale of securities directly to institutional investors, such as banks, mutual funds, insurance companies, pension funds and foundations. Does not require CMA registration, providing the securities are bought for investment purposes rather than resale, as specified in the investment letter.

Privatisation

This is the act of transferring government owned assets (ie, state-owned enterprises) into private hands or to the general public, either through public offering, tender or private contract. The act is also referred to as divestiture since it entails divestment by the government.

Prospectus

A document, notice, circular, advertisement or any other invitation offering to the public for subscription (or purchase) any shares or securities of a company or a mutual fund. It must explain the offer, including the terms, issuer, objectives (if mutual fund) or planned use of the money (if securities), historical financial statements, and other information that could help an individual decide whether the investment is appropriate for them. It is also called offering circular or circular.

Proxy

An authorisation by a shareholder of a company transferring their right to vote to another person through written instructions.

Public Offer

A public offer is an offer made by a company to the public to subscribe to new or existing shares being offered for sale.

Registered Office

Each company is required to have a formal address where contact can be made and to which notices may be sent.

Registration

Registration refers to the act of entering into a company's register the names and addresses of all shareholders. Thereafter, a shareholder receives a share certificate made out in their name and receives reports, circulars and dividends issued by the company.

REIT

A specialised type of collective investment scheme that pools funds from investors for investment in either development or income-producing real estate

Rights Issue

This is an offer to the existing shareholders to subscribe for a new issue, usually at a preferential price, in proportion to their existing shareholdings. When doing a secondary market offering of shares to raise money, a company can opt to do a rights issue to raise equity. With the issued rights, existing shareholders have the right to buy a specified number of new shares from the firm at a specified attractive price within a specified time.

Scrip

The term scrip refers to share certificates.

Scrip or Stock Dividend

This refers to a share that is issued to existing shareholders in lieu of dividend.

Secondary Market

The market in which securities are traded after their primary offering. An organised stock exchange and an over-the-counter market are examples of secondary markets.

Securities

Financial instruments or legal documents signifying either an ownership position in a company (ie, shares) or a creditor relationship with a company or government (ie, stocks and bonds).

Self-Regulatory Organisation

An organisation whose object is to regulate the operations of its members or of the users of its services.

Settlement Guarantee Fund

A fund established and maintained by a futures exchange to strengthen the financial integrity of settlement by the futures exchange and used in the event of default of a member.

Settlement Period

The time prescribed with reference to the date of trade (T) within which brokers are required to deliver the security and pay for the trade through the Nairobi Securities Exchange.

Shares

A share is a unit of ownership. It is also referred to as equity. When one purchases a share in a company they become a part-owner in that company. They will be entitled to certain rights, eg, dividends, voting etc.

Special Interest Collective Investment Scheme

A collective investment scheme established by a promoter for the purposes of facilitating investment by a special group of individuals with a common interest in a listed company and which may include farmers, distributors and suppliers, among others.

Spread

This means the difference between the bid and the offer prices of a security.

Start-Up Financing

Financing provided by a registered venture capital company for the purpose of commencing operations, production or implementation of a concept or prototype where a venture capital enterprise has completed the seed stage of development.

Stockbroker

A person who carries on the business of buying or selling securities as an agent for investors in return for a commission.

Stockbroker

A market professional who buys and sells securities on behalf of clients at a stock exchange in return for a brokerage commission.

Subsidiary Financing

Financing provided for the purchase by one registered venture capital of the equity interests of another registered venture capital company in an eligible venture capital enterprise to allow for total or partial exit by the latter.

Treasury Bill

A non-interest bearing obligation with a maturity of one year or less, fully guaranteed by the Kenyan government, payable to the bearer. Treasury bills offer the government short-term financing and are sold on a discount basis so that the yield is the difference between the purchase price and the face value thereof.

Treasury Bond

This is a fixed-interest security issued by government as source of long-term funds and is issued with a maturity of more than one year.

Trust

A legal arrangement in which an individual gives fiduciary control of property to a person or institution (the trustee) for the benefit of beneficiaries.

Trustee

Individuals or a trust corporation appointed to act as trustee of a collective investment scheme.

Trustee

An individual or organisation, which holds or manages and invests assets for the benefit of another. The trustee is legally obliged to make all trust-related decisions with the beneficiaries' interests in mind, and may be liable for damages in the event of not doing so. Trustees may be entitled to a payment for their services, if specified in the trust deed. In the specific case of the bond market, a trustee administers a bond issue for a borrower, and ensures that the issuer meets all the terms and conditions associated with the borrowing. In relation to a unit trust, a trustee has legal ownership of the money, investments or other CIS portfolio that are subjected to trusts governing the unit trust.

Umbrella Fund

A single authorised CIS with any number of constituent parts where each part may have an entirely separate portfolio.

Unit

A unit means an undivided share in the collective investment scheme portfolio of a unit trust scheme.

Venture Capital Company

A company incorporated for purposes of providing risk capital to small- and medium-sized businesses in Kenya with high growth potential

Venture Capital Enterprise

A small- or medium-sized company which is in need of venture capital investment for the purposes of financing a new product or for the expansion of the business.

Venture Capital Fund

A company incorporated for the purposes of providing risk capital to small- and medium-sized business which are new and have a high growth potential but without ready access to markets.

Warrant

A corporation instrument which offers the holder the right, not an obligation, to subscribe for new ordinary shares at a predetermined exercise price within a stipulated exercise period. Warrants become worthless after the expiry of the exercise period.

AIMS

Alternative Investment Market Segment

AML

Anti-Money Laundering

ATS

Automated Trading System

BCBS

Basel Committee on Banking Supervision

CDA

Central Depository Agent

CDD

Customer Due Diligence

CDS

Central Depository System

CDSC

Central Depository & Settlement Corporation

CFT

Combating the Financing of Terrorism

CIS

Collective Investment Scheme

CMA

Capital Markets Authority

D-REIT

Development Real Estate Investment Trust

DvP

Delivery versus Payment

EAC

East African Community

EASEA

African Securities Exchange Association

EASRA
East African Securities Regulatory Association

EDD
Enhanced Due Diligence

ETD
Exchange-Traded Derivative

ETF
Exchange-Traded Fund

ESOP
Employee Share Ownership Plan

FISMS
Fixed Income Securities Market Segment

FRC
Financial Reporting Centre

GEMS
Growth Enterprise Market Segment

I-REIT
Income Real Estate Investment Trust

ICF
Investor Compensation Fund

ICPAK
Institute of Certified Public Accountants of Kenya

IFRS
International Financial Reporting Standards

IPO
Initial Public Offering

MIMS
Main Investment Market Segment

MLRO
Money Laundering Reporting Officer

NAV
Net Asset Value

NSE
Nairobi Securities Exchange

OTC
Over-The-Counter

plc
Public Limited Company

REIT
Real Estate Investment Trust

RTGS
Real Time Gross Settlement System

SRO
Self-Regulatory Organisation

UNSC
United Nations Security Council

VaR
Value-at-Risk

VWAP
Volume Weighted Average Price

Multiple Choice Questions

The following additional questions have been compiled to reflect as closely as possible the examination standard that you will experience in your examination. Please note, however, they are not the CISI examination questions themselves.

1. Which of the following is a principle that a market intermediary is required to apply when conducting business with the public?

   A. Act with due skill and diligence
   B. Advise clients they may not be independent and objective in their activities
   C. Observe standards of integrity and fair dealing only when necessary
   D. Operate below basic standards of market conduct

2. An issuer from another country is seeking a listing on the Nairobi Securities Exchange but without raising any new capital. What type of offer is this?

   A. Introduction
   B. Offer for sale
   C. Offer for subscription
   D. Placing

3. Prior approval from the CMA is required for which type of transaction?

   A. Sale of shares
   B. Purchase of shares
   C. Heredity transfers
   D. Trade in fixed income securities

4. Distinguishing between fact and opinion in the presentation of investment analysis and recommendations is a requirement of which conducting business with clients rules?

   A. Client rights
   B. Cold calling
   C. Conflicts of interest
   D. Fair and clear communications

5. A mutual fund has what type of legal structure?

   A. A contract structure
   B. A corporate structure
   C. A limited partnership structure
   D. A trust structure

6. Which of the following activities would require an application for approval rather than an application for a licence?

   A. Authorised depository
   B. Dealer
   C. Stockbroker
   D. Derivatives exchange

7. Which of the following is an example of an internal corporate governance control?

   A. Corporate governance regulations
   B. Independent audit
   C. Specialist committees
   D. SRO rules

8. A fiduciary duty is one that requires a market intermediary to:

   A. act solely in another party's interests
   B. address the risk of money laundering
   C. comply with the rules of the regulatory system
   D. execute trades in an orderly fashion

9. What is the main reason for segregation of client money?

   A. Enable operation of discretionary accounts
   B. Ensure proper registration of shares
   C. Prevent a liquidator from claiming the monies
   D. So a firm can access funds to settle trades

10. A market intermediary has nine directors on its board of directors. How many of these should be independent non-executive directors?

   A. One
   B. Three
   C. Five
   D. Nine

11. Which of the following is a fiduciary duty placed on a financial adviser when acting for clients?

   A. Act in the client's best interest
   B. Detect money laundering activity
   C. Maintain prudential levels of capital
   D. Make disclosures to the regulator

12. Ensuring the proper conduct of all licensed persons and market institutions is undertaken by the CMA to fulfil which of its objectives?

    A. Capital market development
    B. Orderly, fair and efficient markets
    C. Use of electronic commerce
    D. Wider participation in the securities and derivatives market

13. With regard to suitability of advice, when assessing a client's knowledge and experience a firm would typically gather information on which of the following?

    A. Age
    B. Financial position
    C. Profession
    D. Tax status

14. In determining whether a person is fit and proper to hold any particular position, the CMA will take a number of factors into account, one of which is assessing their competence to undertake the role. Which of the following factors would be taken into account?

    A. Any past convictions or offences
    B. Suitability of any employees or agents who will be conducting regulated activities
    C. Their probity, competence and soundness of judgment
    D. Whether they have taken part in any fraudulent, prejudicial or otherwise improper business practice

15. A nominated adviser is required for a listing on which market segment of the Nairobi Securities Exchange?

    A. Main Investment Market Segment
    B. Alternative Investment Market Segment
    C. Growth Enterprise Market Segment
    D. Fixed Income Securities Market Segment

16. Which participant in a unit trust scheme is responsible for overseeing that the fund is managed in accordance with CMA rules?

    A. Custodian
    B. Depositary
    C. Fund manager
    D. Trustee

17. When determining a client's attitude to risk, which of the following is considered to be a subjective factor?

   A. Family commitments
   B. Level of financial knowledge
   C. Stage of life
   D. Timescale over which they are able to invest

18. Who should be responsible for submitting a corporate governance report to the board of a market intermediary?

   A. Compliance officer
   B. Internal audit
   C. Risk management
   D. Senior non-executive director

19. Following a listing, a company listed on the Main Investment Market should have at least what percentage of its shares held by the public and with what minimum number of shareholders excluding employees?

   A. 20% held by the public and 1,000 shareholders
   B. 20% held by the public and 100 shareholders
   C. 25% held by the public and 1,000 shareholders
   D. 25% held by the public and 100 shareholders

20. An adviser is conducting a fact-finding meeting with a client. While it is important that a complete picture is formed, the MOST important outcome of the fact-finding process is a clear understanding of the investor's:

   A. assets and liabilities
   B. attitude to risk
   C. income and expenditure
   D. needs and objectives

21. A stockbroker must have professional indemnity cover of at least what amount?

   A. Annual turnover
   B. Monthly average turnover
   C. Quarterly average turnover
   D. Five times their daily average turnover

22. Depositing criminally obtained cash directly into a bank account is an example of which stage of the money laundering process?

    A. Integration
    B. Investment
    C. Layering
    D. Placement

23. Specifying trading and position limits in relation to proprietary trading is an example of an internal control standard addressing which area?

    A. Credit risk
    B. Liquidity risk
    C. Market risk
    D. Operational risk

24. If a member of staff has suspicions about the source of funds used to open an account, to whom should they report their suspicions?

    A. Regulator
    B. Police
    C. MLRO
    D. The customer

25. A customer complaint is still outstanding after three months. What action should the firm take under the conduct of business rules?

    A. Advise the customer of their right to appeal to the chief executive
    B. Close the complaint as it is unlikely to be resolved
    C. Immediately notify the CMA
    D. Refer the complaint to the Capital Markets Tribunal

26. Which principle for business of the Nairobi Securities Exchange requires market participants to avoid situations that might put the interests of the firm, or adviser, before those of the client?

    A. Principle 1 – Act with integrity
    B. Principle 2 – Exercise diligence
    C. Principle 3 – Disclose conflicts
    D. Principle 4 – Act in the client’s best interest

27. What is the MAXIMUM compensation payable from the Investor Compensation Fund?
    A. Kshs 5,000
    B. Kshs 10,000
    C. Kshs 50,000
    D. Kshs 100,000

28. Which of the following is permissible under the AML/CFT regulations?
    A. Breaking client confidentiality by reporting your suspicions of a possible money laundering transaction
    B. Failing to report a suspicion that a customer is investing the proceeds of illegal drug trafficking
    C. Helping someone to invest funds that are known to be the proceeds of terrorism
    D. Tipping off someone that they are to be interviewed for money laundering activities

29. What is the MINIMUM board lot on the Normal Board?
    A. 99 shares
    B. 100 shares
    C. 999 shares
    D. 1,000 shares

30. Best execution, as a concept, means that a firm must take:
    A. reasonable steps to execute client orders in due turn
    B. all possible steps to prevent the risk of money laundering
    C. all reasonable steps to obtain the best possible result for its client
    D. steps to aggregate all client orders

31. What is the MAXIMUM financial penalty that the Disciplinary Committee of the Nairobi Securities Exchange can impose?
    A. Kshs 300,000
    B. Kshs 5 million
    C. Kshs 10 million
    D. Kshs 30 million

32. Firms are required to have, and apply, procedures and arrangements that provide for the prompt, fair and expeditious handling of client orders. In particular, comparable client orders should be executed in:

    A. the order in which they are received
    B. whatever order the firm thinks best
    C. order of transaction size
    D. the order in which they are captured to the firm's systems

33. What is the MAXIMUM value of all client portfolios that can be managed under the investment adviser's licence?

    A. Kshs 1 million
    B. Kshs 2.5 million
    C. Kshs 10 million
    D. Kshs 50 million

34. Segregation of duties is an example of control standards required to address:

    A. corporate culture
    B. corporate governance
    C. management of market risk
    D. proper conduct of a licensed business

35. Which of the following best describes inside information?

    A. General information that a company is doing well
    B. Information which, if made public, could significantly affect the share price
    C. Public information announced by a shareholder
    D. Specific information on a takeover which has been printed in a newspaper

36. Within what timescale from receipt must a central depository agent forward a securities certificate and deposit form to the issuer?

    A. One day
    B. Two days
    C. Three days
    D. Five days

37. Which of the following is primary legislation for the capital markets?

A. The Capital Markets (Foreign Investors) Regulations 2002

B. The Capital Markets (Takeovers and Mergers) Regulations 2002

C. The Capital Markets Tribunal Rules 2002

D. The Central Depositories Act 2000

38. A fund manager has decided to sell a holding for all of his discretionary clients in one single trade and the firm's own trade is included in the order. If the trade is only partially executed, what should the fund manager do?

A. Allocate the firm's trade in full and cancel the balance of the trade

B. Allocate the firm's trade in full and pro rata the remainder among the clients

C. Allocate the trade to the longest-standing discretionary clients first

D. Allocate the trades in accordance with an allocation policy that is fair and equitable

39. What is the MAXIMUM percentage of a collective investment scheme's portfolio that can be held in immovable property?

A. 10%

B. 25%

C. 80%

D. 100%

40. An investor sold their holding of shares on Wednesday. When could they normally expect to receive the proceeds of sale?

A. Wednesday

B. Thursday

C. Friday

D. Monday

41. An investor has appointed a discretionary fund manager who uses a custodian for safekeeping of assets through a nominee company. Whose name would appear on the register of shareholders?

A. Custodian

B. Fund manager

C. Investor

D. Nominee company

42. Specifying trading and position limits for each client is an example of an internal control standard addressing which area?

    A. Credit risk
    B. Liquidity risk
    C. Market risk
    D. Operational risk

43. What is the purpose of the Internal Control Standards developed by the CMA?

    A. To define the role and responsibilities of internal audit
    B. To ensure the proper conduct of a licensed or approved business
    C. To ensure the proper management of risks to which the firm and its clients are exposed
    D. To set standards for the operation of the board of directors of a market

44. Which of the following is required to act as a self-regulatory organisation?

    A. Collective investment scheme
    B. Credit rating agency
    C. Securities exchange
    D. Venture capital company

45. Which of the following would require notification to the CMA within 24 hours?

    A. A substantial acquisition
    B. Appointment of a new auditor
    C. Change of chief executive
    D. Material breach

46. Which area of a market intermediary should be responsible for providing confirmation of the effective operation of the firm's internal control system?

    A. Compliance
    B. Internal audit
    C. Operational control
    D. Risk management

47. Which type of collective investment scheme would you most expect to use passive investment management techniques?

    A. Exchange-traded fund
    B. Real estate investment trust
    C. Unit trust
    D. Venture capital company

48. The CMA periodically undertakes an assessment of the way in which licensed and approved businesses operate. One area it will consider is how employees are supervised. This will be considered as part of how management approaches which area?

A. Corporate culture

B. Supervisory approach

C. Compliance approach

D. Risk management

49. What is the MAXIMUM fine that the CMA has the power to impose on an employee of a licensed participant without the need for court action?

A. Kshs 50,000

B. Kshs 5,000,000

C. Kshs 10,000,000

D. Kshs 30,000,000

50. An investor is concerned about the level of leverage that an I-REIT can employ. What is normally the MAXIMUM percentage?

A. 25%

B. 35%

C. 60%

D. 75%

Answers to Multiple Choice Questions

1. A Chapter 4, Section 1

A market intermediary is required to apply the following principles when conducting business with the public: observe a high standard of integrity and fair dealing; maintain independence and objectivity in their activities; act with due skill, prudence, loyalty, care and diligence; and observe high standards of market conduct.

2. A Chapter 5, Section 1.1.1

An 'introduction' is where an issuer from another country seeks a listing without raising any new capital.

3. A Chapter 5, Section 3.3

No entries relating to private transactions will be entered in the securities account without the prior approval of the CMA. This includes where there is no change in beneficial ownership, donations, hereditary transfers, sales on attachment, foreclosures on execution, pledges, free deliveries, loans and other dispositions of eligible securities.

4. D Chapter 4, Section 2.1

When communicating with clients, a market intermediary is required to ensure that any form of written communication given or sent to its clients is presented fairly and clearly.

5. B Chapter 6, Section 1.1

A mutual fund is very similar to a unit trust but is structured as a company rather than a trust; it therefore issues shares to investors rather than units.

6. D Chapter 2, Section 1.1

Applications received by the CMA are broadly classified into two categories for the purposes of review, namely applications for licence and applications for approval. Any organisation intending to carry on the business of a securities exchange, registered venture capital company, collective investment scheme, central depository or credit rating agency has to have the approval of the CMA.

7. C Chapter 3, Section 1

The internal controls that can be established include an independent board of directors, the separation of the roles of chairman and chief executive, independent non-executive directors, and specialist committees.

8. A Chapter 4, Section 2.5

A fiduciary duty is a legal duty to act solely in another party's interests and is the strictest duty of care recognised by the legal system.

CISI
CHARTERED INSTITUTE FOR SECURITIES & INVESTMENT

9. C Chapter 4, Section 6.1.2

Records of the trust status must be both complete and comprehensive and be retained; otherwise, on insolvency a liquidator may challenge the validity of the arrangements and delay the return of money to clients.

10. B Chapter 3, Section 2.1

At least one third of the board of a market intermediary must be composed of independent non–executive directors.

11. A Chapter 4, Section 3.1

A fiduciary relationship is one in which one person places special trust, confidence and reliance in, and is influenced by, another who has a fiduciary duty to act for the benefit of that person. The fiduciary responsibilities that a financial adviser must follow therefore include: a duty to act in the client's best interest; a duty to disclose material information; and a duty to avoid potential conflicts of interest.

12. B Chapter 1, Section 2.1

The CMA supervises market participants as part of its objective to ensure markets operate in an orderly, fair, and efficient manner.

13. C Chapter 4, Section 3.3

In assessing the client's knowledge and experience, the firm should gather information on: the types of services and transactions with which the client is familiar; the nature, volume, frequency and time that the client has been involved in such services and transactions; and the client's level of education, profession or relevant former profession.

14 . C Chapter 2, Section 1.2

In assessing competence to undertake a role, the CMA will take into account their probity, competence and soundness of judgment in fulfilling the responsibilities of that position and the diligence with which they are likely to satisfy those responsibilities.

15. C Chapter 5, Section 1.1.2

Where a company is seeking a listing on the Growth Enterprise Market Segment, they are required to appoint a nominated adviser.

16. D Chapter 6, Section 1.4

A key role of the trustee is to ensure that the fund is managed in accordance with the CMA rules, the incorporation documents, the information memorandum and the rules of the collective investment scheme. The trustee must therefore supervise the activities of the fund manager and ensure that the custodian safeguards the assets of the fund.

17. B Chapter 4, Section 3.2.4

When determining a client's attitude to risk there are a number of objective factors that can be established such as stage of life, family commitments and timescale. However, subjective factors, which cover a client's attitudes and experiences, such as their level of financial knowledge, also need to be considered.

18. A Chapter 3, Section 3

The compliance officer should submit an annual corporate governance report to the board.

19. C Chapter 5, Section 1.1.3

Following the listing, a company listed on the Main Investment Market should have at least 25% of its shares held by the public with a minimum of 1,000 shareholders excluding employees.

20. D Chapter 4, Section 3.2

The most important outcome of the fact-finding process is the discovery of the client's needs and objectives. The remaining factors will help determine the strategy needed to meet those needs.

21. D Chapter 2, Section 1.4

Stockbrokers and investment banks must have professional indemnity insurance with cover equal to an amount not less than five times their daily average turnover for the previous year or an amount set by the CMA.

22. D Chapter 4, Section 4.1

Placement is the introduction of the money into the financial system. Typically, this involves placing the criminally derived cash into a bank account, a bureau de change or any other type of enterprise which can accept cash, such as a casino.

23. C Chapter 3, Section 5.2.2

Market risk is the risk of loss arising from changes in the value of financial instruments. Relevant control techniques should include reviewing and enforcing compliance with trading and position limits in relation to proprietary trading and open positions with respect to each authorised product the firm trades or invests in.

24. C Chapter 4, Section 4.6

A Money Laundering Reporting Officer must be appointed to act as a central point for reporting of suspicious transaction reports to the Financial Reporting Centre. Staff within the business must report such matters, in confidence, to the MLRO.

25. C Chapter 4, Section 7.1

The time frame for resolving the complaint should not be more than three months and in the event that a complaint is still unresolved three months after it was received, a market intermediary should immediately inform the CMA within 24 hours.

26. C Chapter 5, Section 2.2.1

Principle 1 requires that market participants should act at all times with integrity and in a professional manner towards clients, the Exchange, the CMA and the general public.

27. C Chapter 1, Section 3.2

Where an investor has suffered pecuniary loss, they can claim compensation for a remaining net loss from the compensation fund for compensation up to a maximum of Kshs 50,000.

28. A Chapter 4, Sections 4.4 and 4.6

Failure to report a suspicion to the MLRO (or failure on the part of the MLRO to report to the Financial Reporting Centre where appropriate) is a criminal offence, as is releasing information that might 'tip off' the person to whom the report relates that a disclosure has been made or an investigation may be underway.

29. B Chapter 5, Section 2.3.2

The minimum board lot on the Normal Board is 100 shares and the maximum board lot on the Odd Lots Board is 99 shares.

30. C Chapter 4, Section 5.1.3

The best execution rule requires that firms, when executing orders, take all reasonable steps to obtain the best possible result for their clients.

31. A Chapter 5, Section 2.4

The Disciplinary Committee has the power to enforce the rules of the Exchange. One of the sanctions available is to impose a financial penalty of up to Kshs 300,000, or to refer the matter to the board for imposition of a fine up to a maximum of Kshs 5 million.

32. A Chapter 4, Section 5.1.4

A market intermediary should execute client orders in the chronological sequence in which the orders were received and give priority to outstanding orders.

33. C Chapter 2, Section 3.2

The maximum value of all client portfolios that can be managed under the investment adviser's licence is Kshs 10 million and if it is in excess of this, a fund manager's licence is needed.

34. D Chapter 3, Section 4.2.2

Key duties and functions must be appropriately segregated and are a requirement of the Internal Control Standards to ensure the proper conduct of a licensed or approved business.

35. B Chapter 4, Section 5.2

Inside information is specific or precise information that has not been made public, and if it were made public, would be likely to have a significant effect on the price of the securities.

36. A Chapter 5, Section 3.3

Upon receipt of the deposit form and the securities certificates, the CDA is to forward the certificate to the issuer for verification and confirmation within one market day of the date of lodgement.

37. D Chapter 1, Section 1.1

Acts of Parliament are primary legislation and the others are regulations which specify substantive and procedural provisions for implementing them.

38. D Chapter 4, Section 5.1.4

Where an order may not be fully executed, a firm must have an allocation policy that drives how it will allocate the executed part of the order among the participating clients in such a way that it represents a fair and equitable treatment for each client.

39. B Chapter 6, Section 1.3

The book value of the investments of a collective investment scheme portfolio should not exceed 25% for immovable property, other collective investment schemes or securities not listed on a securities exchange in Kenya.

40. D Chapter 5, Section 3.4

Trades settle at T+3, ie, three business days after the trade date.

41. D Chapter 4, Section 6.2.2

Assets held on behalf of clients by a nominee company will be registered in the name of the nominee and so its name will appear in the records held by the Central Depository and Settlement Corporation and on the company's share register.

42. A Chapter 3, Section 5.2.1

Credit risk is the potential loss of earnings or capital due to a client's or a counterparty's failure to meet its obligations. Among the controls that should be implemented is specifying trading and position limits for each client based on their respective credit rating and trading needs.

43. B Chapter 3, Section 4.1

The CMA has developed the Internal Control Standards to ensure the proper conduct of a licensed or approved business.

44. C Chapter 2, Section 2.1

An exchange or central securities depository is required to operate as a self-regulatory organisation.

45. D Chapter 4, Section 7.3

A market intermediary is required to notify the CMA of certain occurrences within specified timescales. A material breach is an example of where notification is required within 24 hours. The others require notification in not less than 28 calendar days.

46. B Chapter 3, Section 6

The internal audit charter should require internal audit, among other things, to provide confirmation of the effective operation of the firm's internal control system.

47. A Chapter 6, Section 2.1

ETFs use passive investment management, which is a method of managing an investment portfolio that seeks to match the performance of a broad-based market index.

48. A Chapter 3, Section 7

As part of the review of a firm's supervisory structure, it will review how employee supervision is undertaken.

49. B Chapter 1, Section 4.2

The CMA has the power to impose financial penalties on its own initiative without the need for court action. For employees of licensed or approved persons it can impose a maximum fine of Kshs 5 million.

50. B Chapter 6, Section 3

I-REITs may borrow up to 35% of the total asset value.

Syllabus Learning Map

Syllabus Unit/ Element		Chapter/ Section

Element 1	Legal and Regulatory Framework	Chapter 1
1.1	**Regulatory Framework** On completion the candidate should:	
1.1.1	know the key elements of the regulatory framework in Kenya	1
1.1.2	know how the regulatory framework links to East African Community (EAC) Directives	1.2
1.1.3	know the objectives and functions of the Capital Markets Authority (CMA)	2
1.1.4	know the approach to the licensing and supervision of the capital markets	3
1.1.5	know how the investor compensation scheme is funded and the cover provided	3.2
1.1.6	know the enforcement powers of the CMA	4
1.1.7	know the role and powers of the Capital Markets Tribunal	4.3

Element 2	Licensing of Capital Market Intermediaries	Chapter 2
2.1	**General Licensing Requirements** On completion the candidate should:	
2.1.1	know which capital market activities require approval and licensing	1
2.1.2	understand the criteria used to assess the suitability of applicants and the factors taken into account as part of the fit and proper test	1
2.1.3	know the general licensing requirements that apply to capital market intermediaries • Requirement to register details of key personnel with the CMA • Ongoing obligations that licensed intermediaries must meet • Requirement for approval of auditors by the CMA and their reporting obligations	1
2.2	**Exchanges and Central Securities Depositories** On completion the candidate should:	
2.2.1	know the general requirements for an exchange or central securities depository to be approved: • Role as a self regulatory organisation and rule making powers • CMA powers of direction and intervention	2
2.2.2	know the requirements for securities and derivatives exchanges to be approved	2
2.2.3	know the requirements for a central securities depository to be approved	2

Syllabus Unit/ Element		Chapter/ Section
2.3	**Capital Market Intermediaries** On completion the candidate should:	
2.3.1	know the requirement for capital market intermediaries to be licensed: • Role and authorised functions of different types of intermediary • Criteria for authorisation • Financial requirements and investment limits	3
2.3.2	understand the following obligations of licensed intermediaries • Conduct obligations • Client accounts • Record keeping and reporting obligations	3
2.3.3	know the roles of an authorised depository and when the appointment of a custodian is required	3

Element 3	**Governance and Controls of Market Intermediaries**	**Chapter 3**
3.1	**Objective of the Governance Rules** On completion, the candidate should:	
3.1.1	know the purpose of corporate governance rules and the types of mechanisms available	1
3.2	**Board of Directors and Governance** On completion, the candidate should:	
3.2.1	know the rules on the composition of the board of directors of a market intermediary	2
3.2.2	know the main responsibilities of the board and the requirement for a board charter	2
3.2.3	understand the main provisions of the prescribed code of conduct	2
3.3	**Management and Employees** On completion, the candidate should:	
3.3.1	know the requirements to implement a recruitment policy and the specific requirements concerning compliance, risk management and internal audit	3
3.3.2	know the sanctions for non-compliance with the corporate governance rules	3
3.4	**Internal Controls** On completion, the candidate should:	
3.4.1	know the purpose of the Internal Control Standards issued by the CMA	4
3.4.2	know the main features of the Internal Control Standards • management and supervision • personnel and training • information management • compliance • audit	4
3.4.3	know the requirements for segregation of duties and functions	4

Syllabus Unit/ Element		Chapter/ Section
3.4.4	understand the key operational controls required by market intermediaries	4
3.5	**Risk Management** On completion, the candidate should:	
3.5.1	know the role of the various parties involved in risk management	5
3.5.2	know the CMA Internal Control Standards and guidelines for a firm's risk management approach	5
3.6	**Audit** On completion, the candidate should:	
3.6.1	know the role of the audit committee and internal audit	6
3.7	**CMA Audits** On completion, the candidate should:	
3.7.1	know the objectives of CMA compliance reviews	7
3.7.2	know the factors that the CMA will consider when conducting compliance reviews	7

Element 4	Conduct of Business	Chapter 4
4.1	**Standards of Conduct** On completion, the candidate should:	
4.1.1	know the standards of conduct that market intermediaries must apply when conducting business with the public	1
4.2	**Conducting Business with Clients** On completion, the candidate should:	
4.2.1	know the purpose of the fair and clear communications rule	2
4.2.2	know the rules surrounding cold calling	2
4.2.3	know the rules surrounding the disclosure of charges	2
4.2.4	know the required content of a client agreement	2
4.2.5	understand the requirement not to exclude any rights owed to a client and the concept of fiduciary duty	2
4.2.6	understand when conflicts of interest may arise and the steps that should be taken to manage them	2
4.2.7	understand the rules around client confidentiality and access to client information	2
4.3	**Suitability of Advice** On completion, the candidate should:	
4.3.1	know the definition of 'client's best interest', the rules on independence and the implications of this rule for a market intermediary	3
4.3.2	understand the 'know your customer' rules and their impact on investment advice and management	3
4.3.3	understand the key stages in investment advice and determining investment objectives and strategy	3

Syllabus Unit/ Element		Chapter/ Section
4.3.4	understand how to assess a client's risk tolerance, capacity for loss, investment experience and the impact of these factors on the selection of suitable investments	3
4.3.5	understand the suitability of advice rules	3
4.3.6	understand the rules surrounding presentation of investment recommendations and the standards that must be met	3
4.4	**Anti-Money Laundering Requirements** On completion, the candidate should:	
4.4.1	know the stages of money laundering and when capital market firms are most at risk	4
4.4.2	know the obligations placed on senior management to develop Anti-Money Laundering (AML)/Combating the Financing of Terrorism (CFT) processes and procedures	4
4.4.3	understand what factors might indicate whether a client poses a higher or lower AML risk	4
4.4.4	understand what is involved in customer due diligence and when enhanced due diligence is required	4
4.4.5	understand what constitutes acceptable customer identification and when additional verification measures should be undertaken	4
4.4.6	know the requirements for capital markets staff to make suspicious transaction reports	4
4.4.7	know the other obligations associated with AML/CFT • exchange surveillance • staff training • record keeping	4
4.5	**Dealing** On completion, the candidate should:	
4.5.1	understand the rules surrounding execution of trades • necessary funds and securities • money laundering checks • timely and best execution • timely and fair allocation • contract notes • private transactions	5
4.5.2	understand what constitutes unacceptable trading practices • front running • churning • insider dealing	5
4.6	**Client Assets** On completion, the candidate should:	
4.6.1	know the purpose of the client asset rules	**6**

Syllabus Unit/ Element		Chapter/ Section
4.6.2	know why client bank accounts are used, the importance of trust status and the need for reconciliation	6
4.6.3	know how title to client assets may be held and the difference between omnibus and designated accounts	6
4.7	**Other Conduct of Business Rules** On completion, the candidate should:	
4.7.1	know the complaint handling rules	7
4.7.2	know the standard expected of accounting records and the checks required on an external audit	7
4.7.3	know what matters must be reported to the CMA and within what timescales	7

Element 5	Markets and Trading Rules	Chapter 5
5.1	**Stock Market Listings** On completion, the candidate should:	
5.1.1	know the main stages of the listing process and the role of the advisers in a listing	1
5.1.2	know the main eligibility requirements for a listing and the continuing obligations that a listed company must follow	1
5.1.3	know the purpose of the corporate governance guidelines	1
5.1.4	know the general provisions applying to takeovers and mergers	1
5.1.5	know the impact of the foreign investor rules	1
5.2	**Nairobi Securities Exchange** On completion, the candidate should:	
5.2.1	know the requirements for authorisation as a participant at the Nairobi Securities Exchange (NSE)	2
5.2.2	understand the NSE business conduct principles	2
5.2.3	understand the standards of conduct expected from the NSE business conduct rules	2
5.2.4	know the rules of the NSE surrounding trading access and trading sessions	2
5.2.5	know the trading rules of the NSE	2
5.2.6	know the enforcement powers of the exchange and the sanctions available	
5.3	**Central Depositories Rules** On completion, the candidate should:	
5.3.1	know the duties of a central securities depository	3
5.3.2	know the requirements for central depository agents	3
5.3.3	know the rules surrounding the types and operation of securities accounts	3

Syllabus Unit/ Element		Chapter/ Section
5.3.4	know how trades are settled at the Central Depository and Settlement Corporation (CDSC)	3

Element 6	Investment Funds	Chapter 6
6.1	**Collective Investment Schemes** On completion, the candidate should:	
1.1.1	know the difference between the types of collective investment scheme that can be established in Kenya	1
1.1.2	know the requirements for authorisation of a fund and the restrictions on advertising content	1
1.1.3	know the purpose and main contents of the information memorandum	1
1.1.4	know the role of the main participants in a collective investment scheme	1
1.1.5	know the rules surrounding the valuation and pricing of a fund and investor dealing	1
1.1.6	know the required content of half yearly and annual reports	1
6.2	**Exchange-Traded Funds** On completion, the candidate should:	
6.2.1	know the main characteristics of exchange traded funds	2
6.2.2	know how exchange traded funds are listed, traded and settled	2
6.3	**Real Estate Investment Trusts** On completion, the candidate should:	
6.3.1	know the main characteristics and requirements for real estate investment trusts	3
6.4	**Venture Capital Companies** On completion, the candidate should:	
6.4.1	know the main characteristics and requirements for venture capital companies	4
6.5	**Employee Share Ownership Plans** On completion, the candidate should:	
6.5.1	know the requirements for establishing an employee share ownership plan and the main scheme rules	5

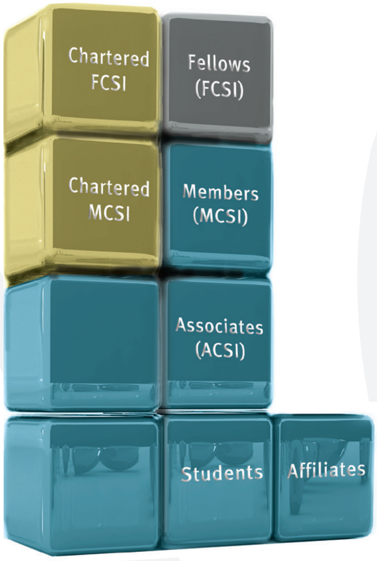
Examination Specification

Each examination paper is constructed from a specification that determines the weightings that will be given to each element. The specification is given below.

It is important to note that the numbers quoted may vary slightly from examination to examination as there is some flexibility to ensure that each examination has a consistent level of difficulty. However, the number of questions tested in each element should not change by more than plus or minus 2.

Element Number	Element	Questions
1	Legal and Regulatory Framework	4
2	Licensing of Capital Market Intermediaries	5
3	Governance and Controls of Market Intermediaries	9
4	Conduct of Business	18
5	Markets and Trading Rules	9
6	Investment Funds	5
Total		**50**

CISI Associate (ACSI) Membership can work for you...



Studying for a CISI qualification is hard work and we're sure you're putting in plenty of hours, but don't lose sight of your goal!

This is just the first step in your career; there is much more to achieve!

The securities and investments industry attracts ambitious and driven individuals. You're probably one yourself and that's great, but on the other hand you're almost certainly surrounded by lots of other people with similar ambitions.

So how can you stay one step ahead during these uncertain times?

Entry Criteria:
Pass in either:

- Investment Operations Certificate (IOC), IFQ, ICWIM, Capital Markets in, eg, Securities, Derivatives, Advanced Certificates; or
- one CISI Diploma/Masters in Wealth Management paper

Joining Fee: £25 or free if applying via prefilled application form **Annual Subscription (pro rata):** £125

Using your new CISI qualification* to become an Associate (ACSI) member of the Chartered Institute for Securities & Investment could well be the next important career move you make this year, and help you maintain your competence.

Join our global network of over 40,000 financial services professionals and start enjoying both the professional and personal benefits that CISI membership offers. Once you become a member you can use the prestigious ACSI designation after your name and even work towards becoming personally chartered.

* ie, Investment Operations Certificate (IOC), IFQ, ICWIM, Capital Markets

Benefits in Summary...

- Use of the CISI CPD Scheme
- Unlimited free CPD seminars, webcasts, podcasts and online training tools
- Highly recognised designatory letters
- Unlimited free attendance at CISI Professional Forums
- CISI publications including *S&I Review* and *Change – The Regulatory Update*
- 20% discount on all CISI conferences and training courses
- Invitation to CISI Annual Lecture
- Select Benefits – our exclusive personal benefits portfolio

The ACSI designation will provide you with access to a range of member benefits, including Professional Refresher where there are currently over 60 modules available on subjects including Behavioural Finance, Cybercrime and Conduct Risk. CISI TV is also available to members, allowing you to catch up on the latest CISI events, whilst earning valuable CPD hours.

Plus many other networking opportunities which could be invaluable for your career.

Revision Express Interactive

You've bought the workbook… now test your knowledge before your exam.

Revision Express Interactive is an engaging online study tool to be used in conjunction with CISI workbooks. It contains exercises and revision questions.

Key Features of Revision Express Interactive:

- Examination-focused – the content of Revision Express Interactive covers the key points of the syllabus
- Questions throughout to reaffirm understanding of the subject
- Special end-of-module practice exam to reflect as closely as possible the standard you will experience in your exam (please note, however, they are not the CISI exam questions themselves)
- Interactive exercises throughout
- Extensive glossary of terms
- Useful associated website links
- Allows you to study whenever you like

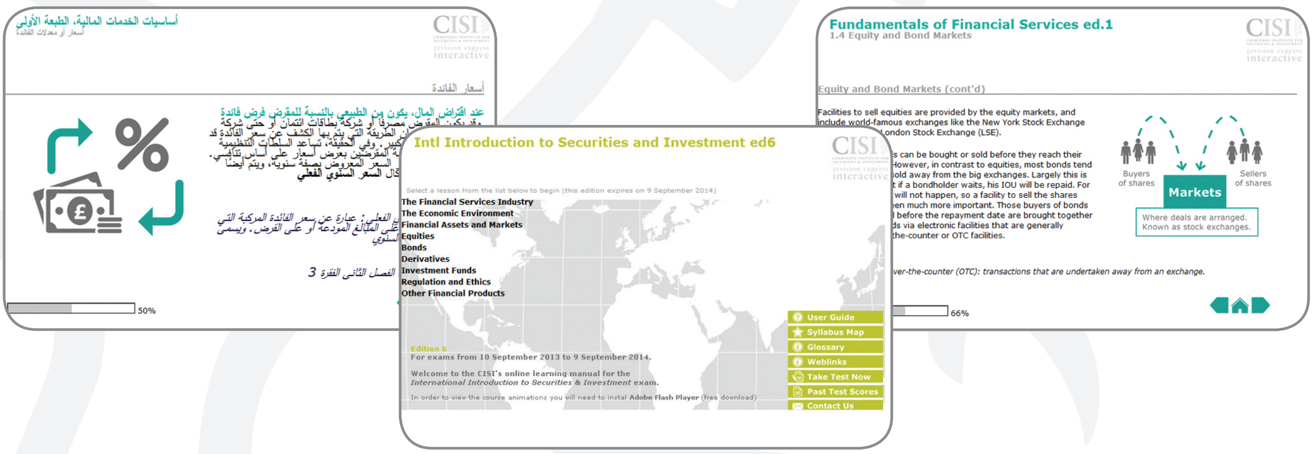
IMPORTANT: The questions contained in Revision Express Interactive elearning products are designed as aids to revision, and should not be seen in any way as mock exams.

Price per elearning module: £35
Price when purchased with the CISI workbook: £100 (normal price: £110)

To purchase Revision Express Interactive:

call our Customer Support Centre on:
+44 20 7645 0777

or visit CISI Online Bookshop at:
cisi.org/bookshop



For more information on our elearning products, contact our Customer Support Centre on +44 20 7645 0777, or visit our website at cisi.org/study

Professional Refresher

Self-testing elearning modules to refresh your knowledge, meet regulatory and firm requirements, and earn CPD hours.

Professional Refresher is a training solution to help you remain up-to-date with industry developments, maintain regulatory compliance and demonstrate continuing learning.

This popular online learning tool allows self-administered refresher testing on a variety of topics, including the latest regulatory changes.

There are currently over 70 modules available which address UK and international issues. Modules are reviewed by practitioners frequently and new topics are added to the suite on a regular basis.

Benefits to firms:

- Learning and tests can form part of business T&C programme
- Learning and tests kept up-to-date and accurate by the CISI
- Relevant and useful – devised by industry practitioners
- Access to individual results available as part of management overview facility, 'Super User'
- Records of staff training can be produced for internal use and external audits
- Cost-effective – no additional charge for CISI members
- Available to non-members

Benefits to individuals:

- Comprehensive selection of topics across industry sectors
- Modules are frequently reviewed and updated by industry experts
- New topics introduced regularly
- Free for members
- Successfully passed modules are recorded in your CPD log as Active Learning
- Counts as structured learning for RDR purposes
- On completion of a module, a certificate can be printed out for your own records

The full suite of Professional Refresher modules is free to CISI members or £250 for non-members. Modules are also available individually. To view a full list of Professional Refresher modules visit:

cisi.org/refresher

If you or your firm would like to find out more contact our Client Relationship Management team:

+ 44 20 7645 0670
crm@cisi.org

For more information on our elearning products, contact our Customer Support Centre on +44 20 7645 0777, or visit our website at cisi.org/study

Feedback to the CISI

Have you found this workbook to be a valuable aid to your studies? We would like your views, so please email us at learningresources@cisi.org with any thoughts, ideas or comments.

Accredited Training Partners

Support for examination students studying for the Chartered Institute for Securities & Investment (CISI) Qualifications is provided by several Accredited Training Partners (ATPs), including Fitch Learning and BPP. The CISI's ATPs offer a range of face-to-face training courses, distance learning programmes, their own learning resources and study packs which have been accredited by the CISI. The CISI works in close collaboration with its ATPs to ensure they are kept informed of changes to CISI examinations so they can build them into their own courses and study packs.

CISI Workbook Specialists Wanted

Workbook Authors

Experienced freelance authors with finance experience, and who have published work in their area of specialism, are sought. Responsibilities include:

- Updating workbooks in line with new syllabuses and any industry developments
- Ensuring that the syllabus is fully covered

Workbook Reviewers

Individuals with a high-level knowledge of the subject area are sought. Responsibilities include:

- Highlighting any inconsistencies against the syllabus
- Assessing the author's interpretation of the workbook

Workbook Technical Reviewers

Technical reviewers provide a detailed review of the workbook and bring the review comments to the panel. Responsibilities include:

- Cross-checking the workbook against the syllabus
- Ensuring sufficient coverage of each learning objective

Workbook Proofreaders

Proofreaders are needed to proof workbooks both grammatically and also in terms of the format and layout. Responsibilities include:

- Checking for spelling and grammar mistakes
- Checking for formatting inconsistencies

If you are interested in becoming a CISI external specialist call:

+44 20 7645 0609

or email:

externalspecialists@cisi.org

For bookings, orders, membership and general enquiries please contact our Customer Support Centre on +44 20 7645 0777, or visit our website at cisi.org