

LEGAL NOTICE NO.....

THE CAPITAL MARKETS ACT
(*Cap. 485A*)

IN EXERCISE of the powers conferred by section 12 (1) of the Capital Markets Act, the Cabinet Secretary for the National Treasury and Economic Planning makes the following Regulations—

THE CAPITAL MARKETS (MARGIN TRADING) REGULATIONS, 2024

PART 1 –PRELIMINARY

Citation

1. These Regulations may be cited as the Capital Markets (Margin Trading) Regulations, 2024.

Interpretation

2. In these Regulations, unless the context otherwise requires-

“Act” means the Capital Markets Act;

“Authority” means the Capital Markets Authority established under section 5 of the Act;

“bank” means a bank licensed under the Banking Act;

“central depository” means an entity licensed under the Central Depositories Act or recognized by the Authority as a central depository;

“debit balance” means the amount owed by the account holder to the trading participant. It changes with additional purchases or sales in the margin account;

“eligible securities” means the securities published by an exchange as provided in regulation 9;

“equity” means the long market value minus the Debit Balance;

“exchange” means a securities exchange as defined in the Act;

“exposure” means the outstanding margin trading amount in the books of the trading participant for all its clients;

“investor” in relation to:

- (a) an individual, means a natural person;
- (b) a corporate, means a body corporate licensed by the Authority such as trading participants, banks, investment banks, or other corporate investors

“long market value” means the current market value of all securities in the margin account, calculated on a daily basis;

“margin” means the amount of cash and or approved securities deposited as collateral by a client as a percentage of the current market value of the securities held in a margin account;

“margin account” means an account maintained with the trading participant, which records transactions of margin trading;

“margin agreement” means the agreement provided in Regulation 6;

“margin call” means a notice issued in writing including by electronic mail by a trading participant to its client requiring the client to provide additional deposit in order to maintain the margin;

“margin financing” means the lending of money to a client by a trading participant or such person authorized by the Authority at an interest rate for purposes of purchasing securities;

“margin list” means the list of securities published in accordance with regulation 9;

“maintenance margin” means the minimum amount of equity that must be maintained by the client in a margin account;

“margin trading” means the buying and selling of securities by the trading participant for clients through margin finance;

“net assets” means shareholder funds computed by deducting total liabilities from total assets;

“single client” in the context of a corporate body means the borrowing company, its parent and subsidiary company and in the context of a natural person means the borrower, his or her spouse, parents, dependent children and companies over which the individual exercises control;

“trading participant” has the meaning assigned to it under the Act.

PART II-MARGIN FINANCING AND MARGIN TRADING

Division 1- Margin financing

Lenders

3. (1) A person shall not undertake margin financing unless such person is a trading participant approved by the Authority to offer margin trading.

(2) The Authority shall, in granting approval in paragraph (1) consider -

- (a) the technical and administrative capabilities necessary to undertake margin trading and manage margin trading accounts;
- (b) compliance with the capital adequacy requirements for margin trading; and
- (c) the trading participant’s compliance with the capital markets laws and that the trading participant has not substantially violated capital markets laws in the preceding three years.

(3) The Authority may impose such conditions as it may deem necessary in granting approval to a trading participant to undertake margin financing.

(4) A trading participant undertaking margin financing shall comply with-

- (a) these regulations;
- (b) the minimum capital adequacy requirements for purposes of margin trading prescribed in the Guidelines on Financial Resource Requirements; and
- (c) any additional requirements that may be imposed by the Authority.

Source of funds

4. (1) A trading participant carrying out margin financing may use—

- (a) its own funds;
- (b) borrow funds from a commercial bank; or
- (c) any other source as may be approved by the Authority.

(2) Where the source of funding is as provided in paragraph 1 (b) or 1(c) the trading participant shall make sufficient arrangements for the funding of its margin trading facility at all times.

Eligible investors

5. (1) A trading participant shall establish a criteria for assessing investors eligible for margin financing and trading facilities.

(2) The criteria established in paragraph (1) shall include-

- (a) the investor's identity;
- (b) assets and income status;
- (c) securities investment experience; and
- (d) risk tolerance profile

(2) A trading participant shall not provide margin financing facility to an investor who-

- (a) has not provided relevant specifications as provided under paragraph (1);
- (b) has engaged in securities trading for less than half a year;
- (c) lacks sufficient securities investment experience;
- (d) lacks financial capacity to shoulder risks;
- (e) has records of major breach of trust;
- (f) has been convicted of a financial crime; or
- (g) has filed for bankruptcy or insolvency.

(3) A person shall not open more than one margin trading account at more than one trading participant.

(4) Margin financing may be provided for secondary trading and subscription of new issuances.

Division 2- Margin Trading

Margin agreement

6. (1) A trading participant shall execute a margin agreement with a

client intending to undertake margin trading, which agreement shall be separate from the client account opening agreement prior to the client undertaking a margin transaction.

(2) The margin agreement shall at a minimum provide-

- (a) the initial margin;
- (b) the maintenance margin;
- (c) the description of securities that may be deposited in the margin account;
- (d) the interest rate and interest calculation methods of margin financing;
- (e) the ways of margin call and deadline for depositing additional margin;
- (f) trading participant's right to dispose of the collateral;
- (g) the expenses to be charged by the trading participant; and
- (h) rights and interests on disposition of securities bought on margin.

(3) The margin agreement shall authorize the trading participant to-

- (a) extend margin trading and margin financing facilities to its client up to the limit approved by the Authority;
- (b) choose securities only from the approved margin list;
- (c) mortgage, pledge or hypothecate the securities deposited for a sum not exceeding the outstanding balance in margin account;
- (d) state the approved period within which to make a margin call;
- (e) indicate period within which client should respond to a margin call;
- (f) use its discretion to sell or dispose of any or all the collateral in order to meet maintenance margin requirements;
- (g) send clients a statement of the amount of interest that will be charged on a margin account and shall contain-

- (i) method by which interest will be computed;
- (ii) the conditions under which interest charges will be imposed;
- (iii) the method of determining the debit balances on which interest will be charged.

(h) ensure all parties to the agreement discharge their duties and obligations as stated in the agreement.

Margin disclosure statement

7. A trading participant shall provide a client with a written disclosure statement, describing the nature and risks of undertaking margin trading and the client shall provide a written acknowledgement on their understanding and acceptance of the risks involved.

Client Margin account

8. (1) After execution of the margin agreement, the trading participant shall open a separate account for the margin amount of the client titled "Client Margin Account".

(2) The trading participant shall open a separate central depository account where securities deposited as margin shall be kept by the trading participant only for the purpose of margin trading.

(3) A client shall pay into the margin account an initial margin of fifty percent of the transaction value.

(4) A maintenance margin of forty percent of the market value of securities calculated with respect to the last trading day's closing price shall be maintained by the client with the trading participant.

(5) A trading participant may require a client to deposit additional margin based on-

- (a) risk assessment of client;
- (b) market volatility of securities; or
- (c) other factors as may be determined by the trading participant.

Eligible securities

9. (1) The Authority, in consultation with the exchange, shall determine securities eligible for margin trading on the basis of-

- (a) liquidity of the security;
- (b) market capitalization; and

(c) other factors as may be considered relevant by the Authority.

(2) A list of the eligible securities shall be published by the exchange on a monthly basis or from time to time and in a manner as may be determined by the Authority.

(3) Securities excluded from the list of eligible securities include-

- (a) securities of unlisted companies;
- (b) securities of companies listed on the exchange for less than twelve months;
- (c) securities offered through a private placement by a listed company;
- (d) securities that have not traded actively in the last three months;

Leverage and
exposure limits

10. (1) The maximum allowable exposure of the trading participant towards the margin trading facility should at no time exceed the borrowed funds or fifty per cent of a trading participants "Net Assets", provided that the trading participant shall at all times maintain the required minimum capital adequacy requirements.

(2) Exposure to any single client shall not exceed ten per cent of the trading participants total funds in the margin trading facility.

(3) The Authority may specify the range within which separate limits may be fixed for individual and corporate clients.

Collateral

11. (1) The collateral required in a margin trading transaction may include-

- (a) cash;
- (b) fixed income securities;
- (c) equity shares approved by the Authority; or
- (d) any other type of security that may be specified by the Authority.

(2) Clients shall pledge securities to the trading participant subject to haircuts prescribed below

a) Fixed Income 10% b) Equity Shares 20%

Valuation of collateral

12. (1) Collateral deposited in a margin account shall be marked to market on a daily basis.

(2) Excess funds shall be deposited into or credited to the client margin account and shall be recorded separately and shall include-

- (a) dividend on stock owned in the account;
- (b) interest on bonds owned in the account;
- (c) voluntary cash deposits made by the client; and
- (d) proceeds from the sale of securities in the account.

(3) A trading participant shall apply the funds to offset margin calls first before resorting to disposing securities.

margin maintenance

13. (1) A trading participant shall ensure that equity in the margin account shall be maintained at all times at the rate set out regulation 8.

(2) A trading participant shall request for additional margin and impose haircuts on any collateral carried in a margin account on the occurrence of-

- (a) changes in the value of the securities;
- (b) non-existence of an active market for the securities;
- (c) suspension of securities from trading on a market; or
- (d) no possibility of immediate liquidation for the securities.

Risk management

14. (1) A trading participant will collect mark to market margins from clients as soon as margin calls are made.

(2) A trading participant shall give the client a margin call to be responded within a period specified by the trading participant, when the maintenance margin falls below the prescribed level in regulation 8.

(3) A client shall on demand from the trading participant deposit cash or securities to meet the maintenance margin requirement.

(4) Failure to comply with sub-regulation 3 shall constitute an event of default.

Disposing securities	of	15. A trading participant shall with due notice to the client, in the event of default, liquidate securities when the client fails to meet margin call and shall notify the client at the end of the market day when the sale has been concluded.
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Margin Statement	Account	16. A trading participant shall send daily margin statements to the client which shall include-
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- (a) the total amount of margin facility granted;
- (b) collateral deposited;
- (c) the securities purchased;
- (d) the accrued interest;
- (e) the long market value (as at the date of the statement);
- (f) the debit balance (as at the date of the statement);
- (g) the equity (as at the date of the statement);
- (h) excess or shortfall of equity;
- (i) additional margin required or margin calls received within the period;
- (j) margin status (available balance/ due from client) which consists of total free balance for taking new trades.

Reporting	17. (1) A trading participant will be required to report and disclose the particulars of margin transactions to the securities exchange-
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- (a) on a daily basis-
 - (a) number of securities traded daily on margin;
 - (b) traded value;
 - (c) amount of margin financing provided to clients;
 - (d) value of collateral against margin financing provided to clients;

(e) source of funds, if borrowed name of lender and amount borrowed.

(b) on a monthly basis-

(a) the number of margin accounts opened, and the associated value of securities traded each month;

(b) the balance of margin financing of all clients and the top ten clients;

(c) the type and value of collateral by investors;

(d) the number of clients and the turnover in relation to forced liquidation;

(e) the risk control indicators;

(f) the profit and losses made in providing margin financing.

(3) A trading participant shall submit to the Authority and the exchange to which the trading participant is a member, a half-yearly certificate from an auditor confirming its shareholder funds.

Maintenance
records of

18. (1) A trading participant shall maintain all records relating to all margin trading transactions undertaken separate from the ordinary client account transactions.

(2) A trading participant shall maintain a separate record of details of the funds used and sources of funds for the purpose of margin trading.

PART III- OFENCES AND SANCTIONS

Suspension
revocation and

20. A trading participant who fails to comply with any provision of this Regulation is liable to sanctions as provided under section 25A of the Act.

Offences

21. A person who contravenes any provisions of these regulations shall be liable upon conviction to the penalty specified under section 34A of the Act.

Made on....., 2024.

NJUGUNA NDUNG’U,
*Cabinet Secretary for the
National Treasury and Economic Planning.*