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**The way to a safer financial services sector: A comparison between South  
Africa and Kenya**

by

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## Contents

CHAPTER ONE: INTRODUCTION AND BACKGROUND TO THE STUDY.....	4
1. BACKGROUND.....	4
1.1 THE GLOBAL CRISIS IN BRIEF.....	5
1.2 CONSEQUENCES OF THE 2008 GFC.....	6
1.3 LESSONS FROM THE 2008 GFC.....	7
2. NATURE AND SCOPE OF DISSERTATION .....	9
CHAPTER TWO: THE WAY TO A SAFER FINANCIAL SERVICES SECTOR: A SOUTH AFRICAN CONTEXT ..	11
2.1 INTRODUCTION.....	11
2.2 FINANCIAL REGULATORY MODELS .....	13
a) The Institutional approach.....	13
b) Functional approach .....	13
c) Single-regulator/integrated approach .....	14
d) Twin Peaks approach .....	14
2.3 SOUTH AFRICAN CONTEXT.....	15
2.3.1 TWIN PEAKS .....	16
2.3.2 FINANCIAL STABILITY .....	17
2.3.3 CO-ORDINATION AND INDEPENDENCE BETWEEN MARKET CONDUCT AUTHORITY AND PRUDENTIAL AUTHORITY.....	19
2.4 CONCLUSION.....	19
CHAPTER THREE: FINANCIAL REGULATION IN KENYA .....	21
3.1. INTRODUCTION.....	21
3.2. THE FRAMEWORK OF KENYA’S FINANCIAL SECTOR .....	22
3.3. FINANCIAL SECTOR REFORMS.....	24
3.4. M-PESA.....	26
3.5. KENYA’S FINANCIAL REFORMS AFTER THE 2008 GFC.....	28
3.5.1. KENYA’S MONETARY POLICIES AND OTHER INTERVENTIONS .....	30
a) Expansionary monetary policy.....	30
b) Financial sector policy measures .....	31
3.6 CONCLUSION.....	32
CHAPTER FOUR: THE COLLAPSE OF AFRICAN BANK .....	33
4.1. INTRODUCTION.....	33
4.2. SOUTH AFRICA’S FINANCIAL REFORMS AFTER THE 2008 GFC.....	34
4.3. African Bank Limited synopsis .....	35

4.3.1. Brief history.....	35
4.3.2. Reasons for failure .....	36
4.3.3. Curatorship .....	36
4.4. ROLE OF THE SOUTH AFRICAN RESERVE BANK.....	38
4.4.1. ROLE OF SARB IN AFRICAN BANK'S RESCUE .....	39
CHAPTER FIVE: CONCLUSION.....	41
6. BIBLIOGRAPHY .....	43

## CHAPTER ONE: INTRODUCTION AND BACKGROUND TO THE STUDY

### 1. BACKGROUND

In the wake of the 2008 global financial crisis (GFC), countries had to adapt to and create new measures in order to cope with the likelihood of future financial crisis or at least to reduce the collateral damage of a future financial crisis. Whilst the 2008 GFC highlighted the immense cost of a poorly regulated financial services sector, South Africa withstood the crisis and was not affected as much due to, amongst others, its robust financial regulatory system, conservative risk management practices in banks, limited exposure to foreign assets as well as subsidiary structure and listing requirements.<sup>1</sup> South Africa was spared the direct effects of the GFC but the resulting depression brought with it substantial job losses.<sup>2</sup>

Globally there has been a shift from a traditional sector-by-sector approach to supervision toward a greater cross-sector integration of financial supervision.<sup>3</sup> This to a large extent can be seen as the response to the growing integration of the banking, securities and insurance markets which has had crucial impact on the practice of supervision and regulation around the globe.<sup>4</sup>

In South Africa, the Financial Sector Regulation Bill is spearheading financial policy reforms. The Bill follows two policy papers, *A safer Financial Sector to Serve South Africa better* and a *Roadmap for implementing Twin Peaks Reforms*.<sup>5</sup> The Twin Peaks model of financial regulation aims at making the financial sector safer by *inter alia* introducing measures aimed at enhancing financial stability and providing for

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<sup>1</sup> National Treasury (2011) *A Safer Financial Sector to serve South Africa Better*, National Treasury policy document 23 February 2011 available at <http://www.treasury.gov.za/documents/national%20budget/2011/A%20safer%20financial%20sector%20to%20serve%20South%20Africa%20better.pdf> accessed 19 November 2014.

<sup>2</sup> National Treasury (2011) *A Safer Financial Sector to serve South Africa Better*, National Treasury policy document 23 February 2011 4. Job losses close to a million jobs was recorded.

<sup>3</sup> Cihak M and Podpiera, R "Integrated financial supervision: which model?" *North American Journal of Economics and Finance* 19 (2008) 135.

<sup>4</sup> *Ibid.*

<sup>5</sup> *A Safer Financial Sector to serve South Africa Better*, released with the 2011 budget whilst a *Roadmap for Implementing Twin Peaks Reforms* released on 1 February 2013 available at <http://www.treasury.gov.za/twinpeaks/20131211%20-%20Item%203%20Roadmap.pdf> accessed 19 November 2014.

enhanced market conduct oversight, as well as providing a comprehensive framework for regulating the financial sector.<sup>6</sup>

The financial sector is a sector touches the life of each and every South African. It enables economic growth, job creation, the building of vital infrastructure and sustainable development for South Africa and her people. Financial services also allow people to make daily economic transactions, save and preserve wealth to meet future aspirations and retirement needs. It is therefore imperative that measures are put in place to ensure the stability of the financial sector for the benefit of all its participants.

## 1.1 THE GLOBAL CRISIS IN BRIEF

The most recent Global Financial Crisis (GFC) occurred in 2008 and its effects are still being felt. The global economy is emerging from the most adverse financial crisis since the great depression of the 1930s.<sup>7</sup> The 2008 GFC was primarily brought about by imbalances in saving and consumption between different parts of the world which were characterised by large savings in emerging economies such as China flowing into industrialised economies such as the UK, US and Eurozone.<sup>8</sup>

“Light-touch” regulation of the financial sector supported the explosion in allowed household debt to rise to unsound levels.<sup>9</sup> The US is such an example. In the US, abundant credit regulation led to the proliferation of products such as subprime mortgages.<sup>10</sup> The financial crisis peaked with the collapse of the Lehman Brothers in September 2008.<sup>11</sup> This triggered panic and uncertainty to the extent that financial

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<sup>6</sup> National Treasury (2013) *Implementing the twin peaks model of financial regulation* media statement, available at <http://www.treasury.gov.za/twinpeaks/20131211%20-%20TwinPeaks.pdf> accessed 19 November 2014.

<sup>7</sup> National Treasury (2011) *A Safer Financial Sector to serve South Africa Better*, National Treasury policy document 23 February 2011 9.

<sup>8</sup> *Ibid.*

<sup>9</sup> National Treasury (2011) *A Safer Financial Sector to serve South Africa Better*, National Treasury policy document 23 February 2011 10.

<sup>10</sup> A subprime mortgage is a type of loan that was granted to a person with a poor credit history who did not qualify for a conventional mortgage loan product. The loan was offered at a very low initial interest rate, which reset later to a higher rate. This low interest rates explain the US housing boom and eventually the US housing bubble in the years leading to the 2008 GFC.

<sup>11</sup> *Ibid.*

institutions became unwilling to lend to each other resulting to the drying up in liquidity in the interbank market.<sup>12</sup>

## 1.2 CONSEQUENCES OF THE 2008 GFC

The effects of the 2008 GFC were experienced globally. Governments were forced to provide extraordinary support to financial institutions by buying debt worth hundreds of billions of dollars and/or bailing out distressed companies for example AIG received a \$85 Billion bailout by the US government.<sup>13</sup> Distressed companies such as General Motors and Chryslers' loans were rescued by the financial institution, Citi Group.<sup>14</sup> Other adverse effects included the collapse of stock markets around the world, household wealth being wiped out and lending to corporations coming to a grinding halt.<sup>15</sup>

In the Eurozone, the high-debt and high-deficit PIIGS (Portugal, Ireland, Italy, Greece and Spain) were adversely affected.<sup>16</sup> More advanced economies such as the UK faced slow growth, high unemployment and mounting public debt.<sup>17</sup>

In Africa, there was significant drop in stock market indices among the major economies. The examples of such declines in stock market indices were as follows: Egypt (64.45%), Nigeria (62.11%), Mauritius (50.53%), Zambia (43.7%), Kenya (42.28%), Morocco (27.58%), South Africa (27.49%), Botswana (18.32%) and Uganda (17.09%).<sup>18</sup>

Other consequences as a result of the 2008 GFC included:<sup>19</sup>

- Rapid increase in debt to about 140%.

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<sup>12</sup> *Ibid.*

<sup>13</sup> See [http://reference.sabinet.co.za/webx/access/electronic\\_journals/afgrow/afgrow\\_apr\\_2009\\_a3.pdf](http://reference.sabinet.co.za/webx/access/electronic_journals/afgrow/afgrow_apr_2009_a3.pdf) accessed 24 September 2015.

<sup>14</sup> *Ibid.*

<sup>15</sup> *Ibid.*

<sup>16</sup> *Ibid.*

<sup>17</sup> University of Pretoria. 2014 'Banking, banking law and banking regulation and supervision' lecture presented by Mr Blackbeard of the South African Reserve Bank. Department of Mercantile Law University of Pretoria 3 November 2014

<sup>18</sup> See [http://reference.sabinet.co.za/webx/access/electronic\\_journals/afgrow/afgrow\\_apr\\_2009\\_a3.pdf](http://reference.sabinet.co.za/webx/access/electronic_journals/afgrow/afgrow_apr_2009_a3.pdf) accessed 20 November 2014

<sup>19</sup> University of Pretoria. 2014 'Banking, banking law and banking regulation and supervision' lecture presented by Mr Blackbeard of the South African Reserve Bank. Department of Mercantile Law University of Pretoria 3 November 2014.

- Developed economies such as UK, US and Asia entered a recession. It is projected that the global GDP shrank by 2%.
- World exports plummeted by 35%.
- Unemployment rate worldwide increased from 5.8% to 9%.

### 1.3 LESSONS FROM THE 2008 GFC

It is an old adage that when the United States' sneezes the rest of the world catches a cold, the contagion and spill-over effects of the credit crisis induced by the US and subsequent 2008 GFC reveals the truth in this idiom.<sup>20</sup> Over the past three decades financial markets around the world have become increasingly interconnected and in as much as emerging economies have benefitted from the global financial integration, they have also succumbed to increased financial turbulence.<sup>21</sup>

There is also clear evidence of financial contagion.<sup>22</sup> This can be evidenced in the manner in which a significant number of major African stock markets fell as dramatically as the US stock market.<sup>23</sup> Falling commodity prices, which portend lower export revenues, are of equal concern, especially as many African countries are still struggling to cope with the lingering effects of recent historically high food and oil prices.<sup>24</sup> These developments put at risk the enormous efforts Africa has made and is making to meet the UN Millennium Development Goals.<sup>25</sup>

Several lessons were learnt from the 2008 GFC. The main lessons are indicated by the South African National Treasury as the following:<sup>26</sup>

- **Need for a holistic view of financial sector regulation.**

The GFC highlighted the need for macro prudential regulation which entails the analysis of macroeconomic trends and how they interact with the prudential

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<sup>20</sup> See [http://reference.sabinet.co.za/webx/access/electronic\\_journals/jb\\_prej/jb\\_prej\\_v9\\_n6\\_a39.pdf](http://reference.sabinet.co.za/webx/access/electronic_journals/jb_prej/jb_prej_v9_n6_a39.pdf)

<sup>21</sup> *Ibid.*

<sup>22</sup> See [http://reference.sabinet.co.za/webx/access/electronic\\_journals/afgrow/afgrow\\_apr\\_2009\\_a3.pdf](http://reference.sabinet.co.za/webx/access/electronic_journals/afgrow/afgrow_apr_2009_a3.pdf) accessed 20 November 2014.

<sup>23</sup> *Ibid.*

<sup>24</sup> *Ibid.*

<sup>25</sup> *Ibid.*

<sup>26</sup> National Treasury (2011) *A Safer Financial Sector to serve South Africa Better*, National Treasury policy document 23 February 2011

soundness and stability of financial firms and the financial system.<sup>27</sup> Micro prudential regulation on the other hand is mostly concerned with the prudential soundness of individual financial institutions or groups.<sup>28</sup> The macro prudential approach also attempts to identify and control risks arising from linkages between financial institutions. If one financial institution has large exposures to another, then the health of one will necessary affect the health of the other. Also, actions to boost the health of one entity might have unanticipated and adverse effects on the other.

- **The importance of regulatory market conduct to support prudential regulation.**

Using the US as an example, inappropriate lending practices such as banks lending to consumers who cannot afford to repay their loans as well as the resultant fall-out of the subprime mortgages highlighted that regulation of market conduct must eliminate lending malpractices in order to reduce systemic risk as well as protect consumers.<sup>29</sup>

- **Global cooperation in preventing macroeconomic imbalances.**

The macroeconomic imbalances in savings and consumption that laid the ground for the crisis have shown no signs of disappearing. The global community must act together to find a sustainable solution to this problem.<sup>30</sup>

- **Failure of “light-touch” regulation of the financial sector in a global arena.**

Light-touch regulation of the financial sector, as was evident, resulted in most financial sectors being unable to withstand the aftermath in the wake of the 2008 GFC. This shows that regulators must proactively monitor changes in systemic risks.<sup>31</sup>

- **The importance of swift regulatory action to prevent contagion.**

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<sup>27</sup> National Treasury (2011) *A Safer Financial Sector to serve South Africa Better*, National Treasury policy document 23 February 2011 12.

<sup>28</sup> *Ibid.*

<sup>29</sup> National Treasury (2011) *A Safer Financial Sector to serve South Africa Better*, National Treasury policy document 23 February 2011 13.

<sup>30</sup> *Ibid.*

<sup>31</sup> *Ibid.*

“Contagion” can be described as the main mechanism through which financial instability becomes so widespread that a crisis reaches systemic dimensions.<sup>32</sup> Contagion effects can be deemed as the probability that the instability of a given institution will spread to other parts of the financial system with negative effects, leading to a system-wide crisis.<sup>33</sup> Contagion was evident during the 2008 GFC as the financial crisis spread from a prudential crisis of a few institutions to a liquidity crisis across global markets in 2008 and 2009. As of 2010, the crisis had turned into a sovereign crisis in fiscally weak European economies, especially the PIIGS, which then spilled into political crisis in countries which have suffered from extended unemployment.<sup>34</sup> This shows that regulatory action must be swiftly taken to prevent the spread of contagion.<sup>35</sup>

## 2. NATURE AND SCOPE OF DISSERTATION

This dissertation aims to evaluate the means by which South Africa has implemented or plans to implement the Twin Peaks model of Financial Regulation in order to make its financial system more rigorous and viable. It will evaluate these systems or plans in comparison to other countries that have adopted the same approach or measures. A comparison will be made to determine and evaluate the measures Kenya have put into place to alienate the adverse impact of a potential global crisis.

The dissertation will investigate the measures undertaken in South Africa to provide for a safer financial sector and will consider generally the Financial Sector Regulation Bill and specifically the Twin Peaks model of financial regulation. Twin Peaks will be dealt with in detail, its merits and demerits analysed and other jurisdictions that have implemented the Twin Peaks model will also be considered and the justifications of it being a worthy solution to ensure a safer financial South African sector shall be considered.

The Kenyan financial regulatory framework will be investigated and its model of financial regulation will also be analysed with the aim of establishing whether there

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<sup>32</sup> University of Pretoria. 2015 *The failure of African bank and the consequences thereof* LBF 420 Assignment . Unpublished

<sup>33</sup> *Ibid.*

<sup>34</sup> National Treasury (2011) *A Safer Financial Sector to serve South Africa Better*, 23 February 2011 13

<sup>35</sup> *Ibid.*

are lessons Kenya can learn from South Africa in regard to its move to a Twin Peaks model of financial regulation. Chapter Two of this dissertation will address the South African context whilst Chapter Three will look at the Kenyan context. Chapter Four will consist of conclusions and recommendations for reform.

## CHAPTER TWO: THE WAY TO A SAFER FINANCIAL SERVICES SECTOR: A SOUTH AFRICAN CONTEXT

### 2.1 INTRODUCTION

The 2008 GFC has demonstrated the weakness of a light-touch financial regulatory system. Even though South Africa's financial system weathered the storm, South Africa still lost nearly a million jobs as a result of the global contamination that originated from the crisis in the banking and financial systems of the developed world. Had South Africa experienced a full-blown financial crisis, many more jobs would have been lost.<sup>36</sup>

After the 2008 global financial crisis there was a global movement to make the financial sector safe and as a result South Africa opted to introduce a Financial Sector Regulation (FSR) Bill with the aim of making the financial sector safer and to serve South Africa better.<sup>37</sup> This was in line with international measures proposed after the crisis where G20 members agreed to a framework to assess their domestic financial systems.<sup>38</sup> The framework includes International Monetary Fund Financial Sector Assessment Programs (FSAP) every 5 years and G20 Financial Stability Board Peer Review (FSB) in between FSAPs.

The FSR Bill has four policy objectives/areas which are seen as priority areas for a safer financial sector:<sup>39</sup>

- **The need to improve market conduct.**

This is to be done by treating customers fairly, ensuring fit and proper requirements, putting in place ombudsman schemes as well as promoting financial literacy.

- **The need to combat crime**

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<sup>36</sup> National Treasury (2013) *Implementing Twin Peaks model of financial regulation in South Africa* (published for public comment by the financial regulatory reform steering committee), 2013 2

<sup>37</sup> Financial Sector Regulation Bill (B 34-2015).

<sup>38</sup> National Treasury (2015) *Financial Sector Regulation Bill implementing Twin Peaks* 11 August 2015 available at <http://www.treasury.gov.za> accessed 2 September 2015.

<sup>39</sup> Financial Sector Regulation Bill, 2013.

This is to be done through enforcement agencies who are to investigate and prosecute abuses. In addition work with international partners is to continue.

- **The need to strengthen financial stability**

Given the enormous costs trickled down to the taxpayer after or during a financial crisis, it is vital to ensure financial stability in order to avoid such losses.

- **The need to widen access to financial services**

The National Treasury is to spear-head with widening access to financial services through co-operative and dedicated banks as well as the Postbank.<sup>40</sup> A micro-insurance framework is to be introduced whilst ensuring international co-operation.<sup>41</sup>

The aim of the FSR Bill is evident from its very comprehensive preamble which reads as follows:

“To establish a system of financial regulation by establishing the Prudential Authority and the Financial Sector Conduct Authority, and conferring powers on these entities; to preserve and enhance financial stability in the Republic by conferring powers on the Reserve Bank; to establish the Financial Stability Oversight Committee; to regulate and supervise financial product providers and financial services providers; to improve market conduct in order to protect financial customers; to provide for co-ordination, co-operation, collaboration and consultation among the Reserve Bank, the Prudential Authority, the Financial Sector Conduct Authority, the National Credit Regulator and other organs of state in relation to financial stability and the functions of these entities; to establish the Financial System Council of Regulators and the Financial Sector Inter-Ministerial Council; to provide for making regulatory instruments, including prudential standards, conduct standards and joint standards; to make provision for the licensing of financial institutions; to make comprehensive provision for powers to gather information and to conduct supervisory on-site inspections and investigations; to make provision in relation to significant owners of financial institutions and the supervision of financial conglomerates in relation to eligible financial institutions that are part of financial conglomerates; to provide for powers to enforce financial sector laws, including by the imposition of administrative penalties; to establish the Ombud Regulatory Council and confer powers on it in relation to ombud schemes; to require financial product and financial service providers to be members of, or be covered

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<sup>40</sup> According to the South African Post Bank Act No.9 of 2010, Postbank is defined as a savings financial institution which operates as a division of the South African Post Office and whose aim is to improve access to affordable As a separate legal entity, the Postbank’s principal aim will be to expand the existing range of banking services in order, amongst other things, improve access to affordable services, including loans, especially in rural and lower-income communities and to promote a culture of savings.

<sup>41</sup>National Treasury (2015) *Financial Sector Regulation Bill implementing Twin Peaks* 11 August 2015 available at <http://www.treasury.gov.za> accessed 2 September 2015

by, appropriate ombud schemes; to establish the Financial Services Tribunal as an independent tribunal and to confer on it powers to review decisions by financial sector regulators, the Ombud Regulatory Council and certain market infrastructures; to establish the Financial Sector Information register and make provision for its operation; to provide for information sharing arrangements; to create offences; to provide for regulation making powers of the Minister; to amend and repeal certain financial sector laws; to make transitional and savings provisions; and to provide for matters connected therewith".<sup>42</sup>

From the preamble it can be seen that in making the South African financial sector safer and in so doing to serve South Africa better, the focus areas are establishing two regulatory authorities responsible for prudential regulation and market conduct regulation respectively of financial institutions, providing co-operation between these two authorities, promoting financial stability and establishing a tribunal to hear appeals.

## 2.2 FINANCIAL REGULATORY MODELS

Before embarking on a discussion of the proposed Twin Peaks Model of Financial Regulation to be implemented in South Africa, it is apposite to remark on the nature of financial regulatory models. Regulatory models/structures differ substantially across the world but can be reduced to four types:

### a) The Institutional approach

This approach is adopted by countries such as China and Mexico. Under this approach, a firm's legal status i.e. a bank or insurance company determines which regulator is tasked with overseeing its activities from a safety and soundness perspective and a business perspective as well as the scope of the entity's permissible business activities.<sup>43</sup>

### b) Functional approach

This approach is adopted in countries such as France, Italy and Spain. Under this approach, supervisory oversight is determined by the type of business that is being transacted by the entity without regard to its legal status. This means that each type

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<sup>42</sup> Preamble, Financial Sector Regulation Bill, 2013 .

<sup>43</sup> National Treasury (2011) *A safer financial sector to serve South Africa better* 2011 29.

of business may have its own regulator.<sup>44</sup> The functional approach ensures consistency with regards to applying rules to the same activity however it may be difficult in practice to distinguish which type of activity occurs within the jurisdiction of a particular regulator.<sup>45</sup>

### **c) Single-regulator/integrated approach**

This approach is adopted by countries such as Germany and the UK. Under this approach a single regulator is tasked with conducting both prudential oversight and business conduct regulation for all financial services.<sup>46</sup> The advantage of this approach unlike the functional and institutional approach is that there is a streamlined focus on regulation without conflict over jurisdictional lines.<sup>47</sup> Also the regulator has a holistic view of the entity's business activities hence can assess the risks associated with changing market conditions and regulatory arbitrage. However there is a likelihood of conflict(s) between prudential regulation and market conduct regulation since market conduction regulation requires 'thinking like a customer' whilst prudential regulation requires 'thinking like a banker'.<sup>48</sup>

### **d) Twin Peaks approach**

This approach is adopted by countries such as Australia, Belgium, Canada and Netherlands.<sup>49</sup> The Twin Peaks model separates regulatory functions between two regulators; prudential authority and market conduct regulation. It is designed to garner the benefits of the integrated approach (regulatory consistency and jurisdictional clarity) as well as addressing the inherent conflicts between prudential regulation and consumer protection.<sup>50</sup>

The Twin Peaks Model is regarded as the optimal means of ensuring that transparency, market integrity and consumer protection receive sufficient priority

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<sup>44</sup> National Treasury (2011) *A safer financial sector to serve South Africa better* 2011 29.

<sup>45</sup> *Ibid.*

<sup>46</sup> National Treasury (2011) *A safer financial sector to serve South Africa better* 2011 29.

<sup>47</sup> *Ibid.*

<sup>48</sup> National Treasury (2011) *A safer financial sector to serve South Africa better* 2011 29.

<sup>49</sup> National Treasury (2011) *A safer financial sector to serve South Africa better* 2011 29.

<sup>50</sup> *Ibid.*

## 2.3 SOUTH AFRICAN CONTEXT

South Africa's system of financial regulation was a single-regulatory model as it was broadly modelled around countries it is historically linked to, particularly the UK and other former British colonies such as Australia and Canada. Australia and Canada opted for the Twin Peaks model of financial regulation a few decades back whilst the UK opted for the single regulator model.<sup>51</sup> For example in Australia, the Australian Prudential Regulation Authority (APRA) supervises banks and insurers whilst the Australian Securities and Investments Commission (ASIC) is responsible for enforcing financial services and corporation laws. In contrast to the UK, the Financial Services Authority was responsible for regulating all financial services before the crisis.<sup>52</sup> After the 2008 GFC, the UK opted for the Twin Peaks model of financial regulation and now its Prudential Regulatory Authority operates as a subsidiary of the Bank of England and is responsible only for the prudential regulation of systemic institutions like banks, insurers and some asset managers, whilst the Financial Conduct Authority is responsible for market conduct supervision.<sup>53</sup>

Since the 2008 financial crisis there has been a global shift from the single-regulator model to the Twin Peaks Model and many countries adopted the Twin Peaks approach to integrated regulation.<sup>54</sup> In line with the International standards, South Africa has also opted for the Twin Peaks Model. In South Africa the Financial Sector Regulation Bill gives effect to the government decision in 2011 via a government policy paper published in February 2011, entitled "A safer financial sector to serve South Africa better" to shift to a Twin Peaks model of financial sector regulation.<sup>55</sup> As remarked by the National Treasury, Twin Peaks is a comprehensive and complete system for regulating the financial sector.<sup>56</sup> It represents a decisive shift away from a fragmented regulatory approach to reduce the possibility of regulatory

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<sup>51</sup> National Treasury (2011) *A safer financial sector to serve South Africa better* 2011 28.

<sup>52</sup> *Ibid.*

<sup>53</sup> National Treasury (2014) *Twin Peaks in South Africa: response and explanatory document* available at <http://www.treasury.gov.za/public%20comments/FSR2014/2014%2012%2012%20Response%20document.pdf> accessed on 24 February 2015 8

<sup>54</sup> National Treasury (2011) *A safer financial sector to serve South Africa better* 2011 28.

<sup>55</sup> *Ibid.*

<sup>56</sup> National Treasury (2014) *Twin Peaks: Second draft of Financial Sector Regulation Bill and draft Market Conduct Policy Framework discussion document published for comment* available at [http://www.treasury.gov.za/comm\\_media/press/2014/2014121201%20-%20Media%20release%20FSR%20Bill%20and%20MCP.pdf](http://www.treasury.gov.za/comm_media/press/2014/2014121201%20-%20Media%20release%20FSR%20Bill%20and%20MCP.pdf) accessed on 24 February 2015 1

arbitrage or forum shopping and close gaps in the regulatory system.<sup>57</sup> Characteristic of this model of regulation is that it aims to achieve separation of prudential authority and market conduct authority.

### 2.3.1 TWIN PEAKS

The regulatory framework that will be phased out by the implementation of the Twin Peaks Model of Financial Regulation is the outdated model in terms whereof the Reserve Bank is responsible for supervision of banks and the Financial Services Board (FSB) is responsible for both prudential and market conduct supervision of all non-banking institutions such as insurance companies and pension funds whilst the National Credit Regulator (NCR) is responsible for supervising all retail credit providers and ideally focuses on promoting access to credit and the market conduct regulation of retail credit providers in South Africa.<sup>58</sup> This fragmented nature of the regulatory framework has resulted in gaps in regulatory applications hence the call for a more streamlined and cohesive regulatory framework i.e. the Twin Peaks Model.<sup>59</sup>

The implementation in South Africa of the Twin Peaks Model of which the third draft was recently tabled in Parliament on 27 October is envisaged to entail a two-phase process and the Financial Sector Regulation Bill covers the first phase.<sup>60</sup> According to the South African National Treasury a phased approach is vital as it not only reduces the risks of failure but also simplifies the implementation.<sup>61</sup> The first phase, whose implementation began towards end of 2013, entails establishing two regulatory authorities as per chapter 3 and chapter 4 of the FSR Bill:

- A new prudential authority (PA) within the Reserve Bank. This authority will be responsible for the oversight of the safety and soundness of banks,

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<sup>57</sup> National Treasury (2013) *implementing the Twin Peaks model of financial regulation* available at <http://www.treasury.gov.za/twinpeaks> accessed on 18 October 2014 1

<sup>58</sup> National Treasury (2013) *Implementing Twin Peaks model of financial regulation in South Africa*, published for public comment by the financial regulatory reform steering committee, 1 February 2013

<sup>59</sup> *Ibid.*

<sup>60</sup> *Ibid.*

<sup>61</sup> *Ibid.*

insurance companies and financial institutions.<sup>62</sup> The reserve bank will also be tasked with overseeing financial stability.<sup>63</sup>

- A new Financial Sector Conduct Authority (FCSA) that will assess how financial institutions conduct their business and whether they treat customers fairly.<sup>64</sup> The FCSA will be a stand-alone market conduct authority.<sup>65</sup>

The formation of a new Prudential Authority as well as the FCSA means that the FSB and bank supervision department will be done away with. Added advantage(s) in establishing the two authorities is that regulators will have a more harmonised system of clear internal policies and procedures for enforcement, enhanced transparency and accountability as well as strong appeal mechanisms and consumer advice and education.<sup>66</sup>

The first phase of the implementation of a Twin Peaks Model of Financial Regulation also entails integrating resources and staff who are currently responsible for prudential regulation from the FSB to the Reserve Bank.<sup>67</sup> Phase Two of the Twin Peaks implementation process will entail new law underpinning Twin Peaks, new consolidated market conduct law and extension of prudential law.<sup>68</sup> A discussion of this second phase is however beyond the scope of this dissertation.

### 2.3.2 FINANCIAL STABILITY

The GFC illustrated the importance of having mechanisms in place to deal with disruptions that threaten financial stability. The SARB has been identified as the resolution authority due to its financial stability mandate, its responsibility for both micro and macro prudential supervision and its role in managing money-market liquidity.<sup>69</sup> In the event that taxpayer's money is at risk, decisions regarding use of

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<sup>62</sup> Chapter 3 of the Financial Sector Regulation Bill 2015.

<sup>63</sup> Chapter 2 of the Financial Sector Regulation Bill 2015.

<sup>64</sup> Chapter 4 of the Financial Sector Regulation Bill 2015.

<sup>65</sup> *Ibid.*

<sup>66</sup> Chapter 3 of the Financial Sector Regulation Bill 2015.

<sup>67</sup> National Treasury (2013) *Implementing Twin Peaks model of financial regulation in South Africa*, published for public comment by the financial regulatory reform steering committee, 1 February 2013 75

<sup>68</sup> *Ibid.*

<sup>69</sup> National Treasury (2013) *Implementing Twin Peaks model of financial regulation in South Africa*, published for public comment by the financial regulatory reform steering committee, 1 February 2013 11.

fiscal resources will be taken by the Minister of Finance, who operates within the appropriate legislative framework.<sup>70</sup>

Chapter 2 of the FSR Bill imposes the responsibility of financial stability on the Reserve Bank in terms of Section 3 of the Reserve Bank Act.<sup>71</sup> Recent G20 reforms in dealing with systematically important financial institutions (SIFIs) and 'Too-Big-To-Fail' institutions form a critical part of this stability objective, which aims to reduce the likelihood of using tax-payer funds to bail out failing financial institutions.<sup>72</sup> This is evident from the recent financial collapse of the African Bank where the SARB had to rescue the bank by injecting about R10 billion capital into the financial institution.<sup>73</sup>

The FSR Bill also provides for the establishment of the Financial Stability Oversight Committee (FSOC).<sup>74</sup> The FSOC will assist the Reserve Bank to maintain, protect and enhance financial stability. It is also tasked with responding to financial crises while maintaining the operational independence of financial regulators.<sup>75</sup> The Governor of the Reserve Bank will be the chairperson of the FSOC which shall comprise of the Governor of the Reserve Bank, CEO and deputy governors of the Reserve Bank, Commissioner of the Market Conduct Authority and at least two deputy commissioners of the Market Conduct Authority as well as the Director-general of the National Treasury.<sup>76</sup> As part of its financial stability oversight responsibilities, the Bank will also be charged with overseeing systemic risks emanating from financial markets infrastructures such as the central securities depository, the trade repository, central clearing counterparty and the exchanges.<sup>77</sup>

The resolution framework which shall ensure financial stability rather than institutional soundness shall be based the International Financial Stability Board's "2 Key attributes for effective resolution regimes".<sup>78</sup> It shall not be limited to specific

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<sup>70</sup> *Ibid* .

<sup>71</sup> Chapter 2, Financial Sector Regulation Bill, 2015.

<sup>72</sup> National Treasury (2013) *Implementing Twin Peaks model of financial regulation in South Africa*, published for public comment by the financial regulatory reform steering committee, 1 February 2013 13.

<sup>73</sup> See chapter four for a detailed analysis of African Bank failure.

<sup>74</sup> S 5, Financial Sector Regulation Bill, 2013.

<sup>75</sup> *Ibid*.

<sup>76</sup> S 6, Financial Sector Regulation Bill, 2013.

<sup>77</sup> National Treasury (2013) *Annual Report of the South African Reserve Bank 2012/2013* available at <http://www.treasury.gov.za> accessed 19 November 2014 8.

<sup>78</sup> *Ibid*.

institutions but shall be applied to all elements of the financial system that are systematically significant elements include banks, non-bank financial institutions, major participants or exposures in financial markets-including market infrastructure organisations and market themselves.<sup>79</sup>

### **2.3.3 CO-ORDINATION AND INDEPENDENCE BETWEEN MARKET CONDUCT AUTHORITY AND PRUDENTIAL AUTHORITY**

The erstwhile SARB governor, Gill Marcus in the 2012/13 Annual Report of the SARB notes that co-ordination between the Prudential Authority regulator and the Market Conduct Authority regulator will be crucial as market conduct issues can result in prudential problems and/or financial instability and vice versa.<sup>80</sup> It is thus vital to ensure co-ordination and information sharing between regulators, particularly in the face of an event that threatens systemic stability”.<sup>81</sup> In order to give effect to increased co-operation between the Market Conduct Authority and Prudential Authority regulators, the FSR Bill provides that there should be:

- a) General co-operation between regulatory authorities
- b) Co-operating in rule making.
- c) Co-operation in relation to entitlements and applications in terms of regulatory laws.
- d) Co-operation between regulatory authorities and other financial regulators.

## **2.4 CONCLUSION**

The 2008 GFC demonstrated the weakness of a light-touch financial regulatory system and in so doing prompted the National Treasury to formulate the Financial Sector Regulation (FSR) Bill with the aim of making the financial sector safer and to serve South Africa better .The FSR Bill advocates for a Twin Peaks form of Financial Regulation. The FSR Bill not only highlights the competent bodies tasked with implementing this form of Financial Regulation but also emphasises on the principles

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<sup>79</sup> National Treasury (2013) *Annual Report of the South African Reserve Bank 2012/2013* 9.

<sup>80</sup> National Treasury (2013) *Annual Report of the South African Reserve Bank 2012/2013* 8.

<sup>81</sup> *Ibid.*

of co-operation, co-ordination as well as independence that should be adhered to. It is envisaged that this shall result in the successful implementation of the decisive shift to a Twin Peaks Model of Financial Regulation.

## CHAPTER THREE: FINANCIAL REGULATION IN KENYA

### 3.1. INTRODUCTION

The regulation of the financial sector of Kenya shall be considered in this chapter. Regard will be had to measures implemented by Kenya in the context of financial regulation in the wake of the 2008 GFC.

The primary purpose of the Kenyan financial sector is to facilitate productive economic activity whilst the aim of regulation is to maintain financial stability and promote economic growth.<sup>82</sup> In the wake of the GFC many countries are prioritizing stability by strengthening financial regulation. Mwega mentions that there are two ways that regulation could impact on growth and stability: The first is by influencing day to day behaviour of financial market actors so that financial regulator has direct effects i.e. on how a bank chooses to lend to small and medium enterprises (SMEs) and the second is by influencing how the financial system evolves structurally.<sup>83</sup> It is thus important that financial stability be key when it comes to formulating policies in regards to financial regulation.

Kenya, in terms of financial regulation, is defined as a ‘small, open economy which is highly vulnerable to domestic and external shocks, but with a lightly regulated financial system and a fairly open capital account’.<sup>84</sup> The Central Bank of Kenya (CBK), which is in charge of supervision and regulation of banks in Kenya, has adopted a “consolidated” supervision approach, which requires information sharing and co-ordination amongst the various regulators in the financial sector.<sup>85</sup> This is consistent with the approach advocated by Spratt namely, a unified and comprehensive approach, with the central bank playing a dominant role and

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<sup>82</sup> Mwega, F.M “Financial Regulation in Kenya: Balancing inclusive growth with financial stability”, ODI Working paper 407 2014 1.

<sup>83</sup> *Ibid.*

<sup>84</sup> *Ibid.*

<sup>85</sup> Mwega, F.M “The competitiveness and efficiency of the financial services sector in Africa: A case study of Kenya” *African Development Review* Vol 23 No 1, 2011 46

comprehensive approach that should utilize the already wider ‘toolkit’ available to the regulator.<sup>86</sup>

Mwega indicates that following the enactment of the National Payments Systems Act in 2011, the CBK now has the oversight mandate with all payment service providers including mobile phone service providers offering money transfer services falling under CBK’s regulatory framework.<sup>87</sup> The CBK continues to regulate banks based mainly on Basel 1 but is in the process of formulating a policy position on Basel II implementation.<sup>88</sup>

Overall Kenya has endeavoured to implement the Basel principles for ensuring financial stability of its financial sector. Also the Kenyan banking system has continued to record compliance with the minimum capital and liquidity prudential requirements.<sup>89</sup> The CBK has focussed more on micro prudential regulation which relates to factors that affect the stability of individual banks and less on macro prudential regulation which relates to factors which affect the stability of the financial system as a whole.<sup>90</sup> The regulatory toolkit in Kenya has also relied substantially on other variables such as the structure of banking assets and liabilities such as restrictions on banks’ large loan concentration and foreign exchange exposure limits.<sup>91</sup>

### **3.2. THE FRAMEWORK OF KENYA’S FINANCIAL SECTOR**

Kenya has a variety of financial and banking institutions, insurance companies, stock and bond markets that provide a wide range of financial products.<sup>92</sup> As mentioned earlier, the CBK is in charge and responsible for regulation and supervision of banks.

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<sup>86</sup> Spratt (2013) in Mwega, F.M “Financial Regulation in Kenya: Balancing inclusive growth with financial stability” ODI Working paper 407 2014 29.

<sup>87</sup> Mwega, F.M “Financial Regulation in Kenya: Balancing inclusive growth with financial stability” ODI Working paper 407 2014 17

<sup>88</sup> Mwega, F.M “Financial Regulation in Kenya: Balancing inclusive growth with financial stability” ODI Working paper 407 2014 27.

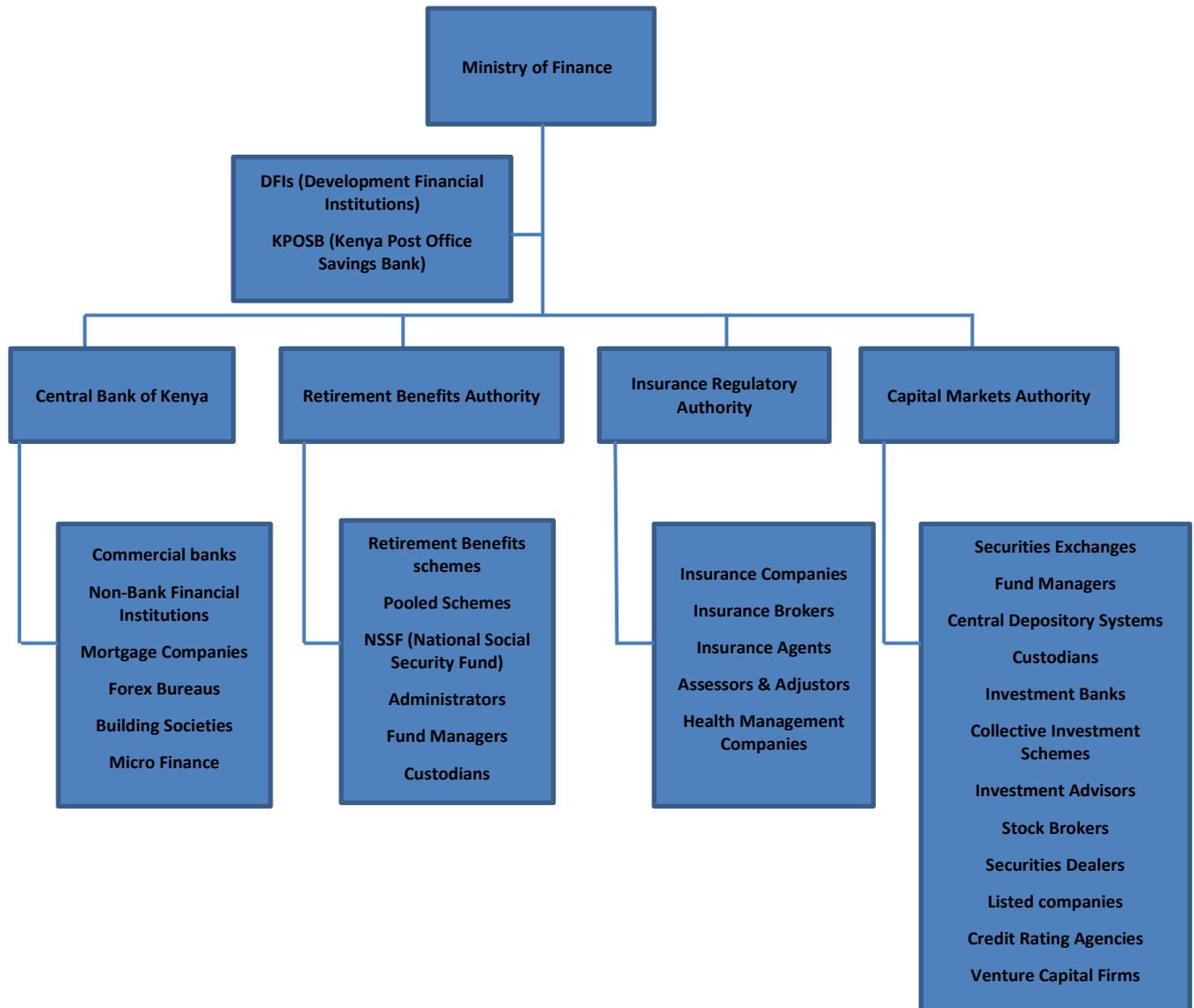
<sup>89</sup> *Ibid.*

<sup>90</sup> Mwega, F.M “Financial Regulation in Kenya: Balancing inclusive growth with financial stability” ODI Working paper 407 2014 28.

<sup>91</sup> Mwega, F.M “Financial Regulation in Kenya: Balancing inclusive growth with financial stability” ODI Working paper 407 2014 29.

<sup>92</sup> Mwega, F.M “Financial Regulation in Kenya: Balancing inclusive growth with financial stability” ODI Working paper 407 2014.

Section 32 of the Banking Act provides that the central bank is the coordinator of the consolidated supervision of banking groups.<sup>93</sup> Over the past decades, there have been numerous revisions of the Banking Act, Central Bank of Kenya Act and prudential guidelines.<sup>94</sup> Kenya has different regulatory authorities within the financial sector as pointed out by Mwege.<sup>95</sup> The existing framework for the financial sector in Kenya consists of a number of independent regulators each charged with the supervision of their particular sub-sectors as illustrated below.<sup>96</sup>



<sup>93</sup>Section 32(5) of the Banking Act 57 of 2012.

<sup>94</sup> Beck, T et al 'Banking sector stability, efficiency and outreach in Kenya' Policy Research Working Paper WPS 5442 2010 6.

<sup>95</sup>Mutuku, N *Case for consolidated financial sector regulation in Kenya*, 2008 1.

<sup>96</sup> Mutuku, N *Case for consolidated financial sector regulation in Kenya*, 2008 4.

As seen from the above diagram, each regulator is responsible for a specific sub-sector. This can be seen as a functional approach. A functional financial sector model means that supervisory oversights are determined by the type of business that is being transacted by the entity with no regard its legal status.<sup>97</sup> According to the functional approach, each type of business may have its own regulator and can be seen as a “silo” form of regulation. Whilst this approach ensures consistency with regards to applying rules to the same activity, it may be difficult in practice to distinguish which type of activity comes within the jurisdiction of a particular regulator.<sup>98</sup> This approach however has a limitation in that it results in overlap in regulation as some institutions are regulated by more than one regulator.

Mutuku indicates that the existing regulatory framework for the financial sector in Kenya consists of a number of independent regulators each charged with the supervision of their particular sub-sectors.<sup>99</sup> The recent creation of the Insurance Regulatory Authority has completed the shift from having departments under the Ministry of Finance to having independent regulators for each sub-sector.<sup>100</sup>

The current regulatory structure is characterized by regulatory gaps, regulatory overlaps, multiplicity of regulators, inconsistency of regulations and differences in operational standards.<sup>101</sup> For example, some of the regulators have at least partial exemption from the State Corporations Act while others do not, some have tax exemption, others do not. Some regulators have powers to issue regulations while in other cases the power is retained by the Minister for Finance.<sup>102</sup>

### 3.3. FINANCIAL SECTOR REFORMS

The Kenyan Banking Act has been reviewed over time to give more legal powers to the CBK and to broaden the responsibilities and coverage of institutions.<sup>103</sup> Financial/banking reforms have resulted in an increase of synergies between the

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<sup>97</sup> National Treasury (2011) *A Safer Financial Sector to serve South Africa Better*, National Treasury policy document 23 February 2011 28.

<sup>98</sup> *Ibid.*

<sup>99</sup> Mutuku, N *Case for consolidated financial sector regulation in Kenya*, 2008 4

<sup>100</sup> *Ibid.*

<sup>101</sup> Mutuku, N *Case for consolidated financial sector regulation in Kenya*, 2008 4

<sup>102</sup> *Ibid.*

<sup>103</sup> Beck, T et al 'Banking sector stability, efficiency and outreach in Kenya' *Policy Research Working Paper WPS 5442* 2010 6.

banking, insurance and securities sectors with removal of regulatory barriers between the different segments of the financial sector.<sup>104</sup> Also the convergence and consolidation of financial services has resulted in some players in the financial sector calling for the establishment of an overall services regulatory authority.<sup>105</sup> According to the CBK, the convergence of financial services is a global phenomenon with among its key drivers being the customer demands for a 'one-stop financial services supermarket' and competition. This poses regulatory challenges as different financial sector entities are subject to different regulatory regimes.<sup>106</sup> These challenges are best highlighted by Mwega who points out that Kenya now has banks that own insurance firms, while others own stock brokerage firms and that this poses regulatory challenges as different financial sector entities are subject to different regulatory regimes.<sup>107</sup> It is as a result of these regulatory challenges that the CBK has adopted a consolidated supervision approach which requires information sharing and coordination amongst the various regulations in the financial sector.

The Kenyan financial sector has fortified in the last decade or so in terms of product offerings and service quality, stability and profitability. Quite a number of financial vulnerability indicators show some improvement during this period including: capital adequacy ratio, rates of return on assets, extent of non-performing loans and the growth and composition of creditors as well as the assets held by the commercial banks.<sup>108</sup>

In 2007, the government of Kenya published “Kenya’s Vision 2030” as a long-term development plan for the country.<sup>109</sup> The Vision aims to create a vibrant and globally competitive financial sector that shall not only create jobs but also promote high levels of savings to finance Kenya’s overall investment needs.<sup>110</sup> It envisages a

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<sup>104</sup>Mwega, F. M. “ The Competitiveness of the Financial Services in Africa: A Case Study of Kenya” *African Development Review*. Vol 23, No. 1,2011 45.

<sup>105</sup> *Ibid.*

<sup>106</sup>Mwega, F. M. “ The Competitiveness of the Financial Services in Africa: A Case Study of Kenya” *African Development Review*. Vol 23, No. 1,2011 57.

<sup>107</sup>Mwega, F.M “Financial Regulation in Kenya: Balancing inclusive growth with financial stability” ODI Working paper 407 2014 29.

<sup>108</sup> Beck, T et al ‘Banking sector stability, efficiency and outreach in Kenya’ Policy Research Working Paper WPS 5442 2010 4.

<sup>109</sup> *Ibid.*

<sup>110</sup> Mwega, F.M “Financial Regulation in Kenya: Balancing inclusive growth with financial stability” ODI Working paper 407 2014 2.

dynamic financial sector comprised of banks, pensions, insurance, the capital market, development finance and financial co-operatives (SACCOs).<sup>111</sup> The 2030 Vision therefore aims to revamp Kenya's fairly diversified financial sector.<sup>112</sup>

The 2030 Vision put the financial services at the centre of the planned economic growth through 2030.<sup>113</sup> The main objectives that were envisaged in Vision 2030 of the financial sector were:<sup>114</sup>

- a) To improve financial stability.
- b) To enhance efficiency in the delivery of credit and other financial services.
- c) To improve access to financial services and products for a much larger number of Kenyan households.

### 3.4. M-PESA

A talk on the demographics of Kenya's financial sector would be incomplete without mentioning the mobile banking innovations such as those spear headed by Kenya's largest cellular phone provider. Many observers have identified the potential for systems such as M-PESA to expand the financial systems and to provide a platform to deliver financial services to the poor and excluded especially in many African countries with low levels of financial development.<sup>115</sup> Today millions of Kenyans use M-PESA to make payments, send remittances and store funds for short periods.<sup>116</sup> In March 2007, the leading cell phone company in Kenya, Safaricom, launched M-PESA, an SMS-based money transfer system that allows individuals to deposit, send and withdraw funds using their cell phone.<sup>117</sup>

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<sup>111</sup> *Ibid.*

<sup>112</sup> *Ibid.*

<sup>113</sup> Beck, T et al 'Banking sector stability, efficiency and outreach in Kenya' *Policy Research Working Paper WPS 5442* 2010 4.

<sup>114</sup> *Ibid.*

<sup>115</sup> Beck, T et al 'Banking sector stability, efficiency and outreach in Kenya' *Policy Research Working Paper WPS 5442* 2010

<sup>116</sup> Kimenyi, S.M and Ndung'u S.N 'Expanding the financial frontier: Lessons from mobile banking in Kenya' 2009 2.

<sup>117</sup> Jack, W. and Suri, T. 'The economics of M-PESA' 2010 available at <http://www.mit.edu/~tavneet/M-PESA.pdf> accessed on 12 October 2015 1

M-PESA allows users to exchange cash for 'e-float' in their phones, to send e-float to other cellular phone users and to exchange e-float back into cash.<sup>118</sup> Within eight months of its inception in March 2007, over 1.1 million Kenyans had registered to use M-PESA and over \$87 million had been transacted over the system.<sup>119</sup> Currently mobile money services have close to 20 million customers handling over \$54.4 million worth of transactions per day.<sup>120</sup>

The role of the CBK in the growth of M-PESA has not gone unnoticed. The CBK through prudent monitoring and review of the financial system, amended the CBK Act to the effect that section 4(A)(1)(d) mandates the bank to "formulate and implement policies as best to promote the establishment, regulation and supervision of efficient and effective payment, clearing and settlement system".<sup>121</sup> The CBK has undertaken various strategies to enhance the oversight capacity effectively keeping abreast of innovation and technologically driven financial services thereby not only increasing access to financial services but at the same time maintaining financial stability. The CBK has aided in the adoption of mobile banking innovations, this should be an example to other regulatory authorities that they too have the same adequate supervisory and oversight capacity to advance the adoption of mobile banking innovations.<sup>122</sup>

The significance of mobile banking to the Kenyan economy and financial sector is best comprehended by looking at the value of M-PESA transactions relative to commercial bank deposits as well as the country's GDP and financial access. The massive increase in access to financial services in the country since 2006 is mainly due to enhanced usage of mobile money services from virtually 0% in 2006 to 28.4% in 2009 and 61.6% in 2013, making Kenya a global leader in mobile phone platforms.<sup>123</sup> Currently the four mobile money services have close to 20 million users transacting about \$54.4 million per day however M-PESA remains dominant with

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<sup>118</sup>Weil, D.N and Mbiti I 'Mobile banking: The impact of M-pesa in Kenya' *working paper 17129* 2011 available at <http://www.nber.org/papers/w17129> accessed on 25 May 2015 3.

<sup>119</sup>*Ibid.*

<sup>120</sup>*Ibid.*

<sup>121</sup>Section 4(A)(1) Central Bank Amendment Bill 2014

<sup>122</sup>Mwega, F.M "Financial Regulation in Kenya: Balancing inclusive growth with financial stability" ODI Working paper 407 2014 17.

<sup>123</sup> Mwega, F.M "Financial Regulation in Kenya: Balancing inclusive growth with financial stability" ODI Working paper 407 2014 38.

a82% market share, Airtel money at 15%, Yucash at 2% and Orangemoney with 1%.<sup>124</sup>

The CBK called for introduction of prudential regulation and supervision consistent with their mandate as done in Nigeria and China amongst others.<sup>125</sup> By doing this, Kenya will customize the regulatory and supervisory framework for local circumstances.<sup>126</sup>

### 3.5. KENYA'S FINANCIAL REFORMS AFTER THE 2008 GFC

Over the last two decades, financial sector reforms, technological advancement and globalization have led to significant transformation of the banking industry in Kenya.<sup>127</sup> The banking industry has experienced unprecedented growth coupled with impressive performance over the same period.<sup>128</sup> The industry has remained largely profitable in spite of the economy performing poorly in some years and facing the adverse effects of the global financial crisis in 2008.<sup>129</sup> This is attributed to improved technology that has enabled banks to process data/information faster and efficiently. Technology has also resulted in a cashless society due to plastic and mobile money, other reasons being the widening of the scope and scale of banks' operations as well as increased and diversified consumer products.<sup>130</sup>

In addition to the 2008 GFC, Kenya was experiencing a domestic crisis. Kenya's domestic crisis was politically triggered by the post-election violence which began in December 2007 as a result of disputed presidential and general elections.<sup>131</sup> As a result of the post-election violence, the economy slipped into a recession as the key

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<sup>124</sup>Mwega, F.M "Financial Regulation in Kenya: Balancing inclusive growth with financial stability" ODI Working paper 407 2014

<sup>125</sup> Mwega, F.M "Financial Regulation in Kenya: Balancing inclusive growth with financial stability" ODI Working paper 407 2014 37

<sup>126</sup>*Ibid.*

<sup>127</sup> Kamau, A and Were, M. "What drives banking sector performance in Kenya?" *Global Business and Economics Research Journal*, 2 (4) 2014 46.

<sup>128</sup> *Ibid.*

<sup>129</sup> Kamau, A and Were, M. "What drives banking sector performance in Kenya?" *Global Business and Economics Research Journal*, 2 (4) 2014 46

<sup>130</sup> *Ibid.*

<sup>131</sup> Were, M & Tiriorgi, S. "Monetary responses to economic crises from African economy perspective: An examination of Kenya's experience" *International Journal of Economics* 2013 15.

sectors that form the backbone of the economy such as agriculture and tourism, were adversely affected.<sup>132</sup>

With respect to the financial sector, Kenya's banking sector is fairly insulated from foreign finance in the sense that banks hardly have derivatives or asset-backed securities on their portfolios as African banks largely retain loans that originate from their balance sheets and the market for securitised/derivative instruments is either small or non-existent.<sup>133</sup> Based on this, Kenya's banking sector remained resilient to the adverse developments in respect to the GFC. In as much as the adverse effects of the 2008 GFC were not felt, the government had to adopt monetary policies and interventions to make the financial sector safer/better.<sup>134</sup>

Most Sub-Saharan African (SSA) countries, including Kenya, adopted expansionary monetary and fiscal policies in response to the effects of the global crisis, in line with similar trends worldwide.<sup>135</sup> This can be largely attributed to the international increase in food and fuel prices which in turn added pressure to inflation in most SSA countries however as the prices shock reduced, there was a slowdown in inflation consequently creating room for loosening monetary policy.<sup>136</sup> In Kenya's case easing monetary policies was not much of a priority to pursue compared to the need to ascertain whether the extent of monetary expansion was appropriate and would have yielded the desired effects.<sup>137</sup> Following the derailment of the growth trajectory occasioned by both the domestic and global financial crises, there is no doubt there was need for counter cyclical monetary and fiscal policies to resuscitate the economy and restore growth.<sup>138</sup>

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<sup>132</sup> *Ibid.*

<sup>133</sup> Were, M & Tiriorgi, S. "Monetary responses to economic crises from African economy perspective: An examination of Kenya's experience" *International Journal of Economics* 2013 16.

<sup>134</sup> *Ibid.*

<sup>135</sup> Were, M & Tiriorgi, S. "Monetary responses to economic crises from African economy perspective: An examination of Kenya's experience" *International Journal of Economics* 2013 17.

<sup>136</sup> Were, M & Tiriorgi, S "Monetary responses to economic crises from African economy perspective: An examination of Kenya's experience" *International Journal of Economics* 2013 17.

<sup>137</sup> *Ibid.*

<sup>138</sup> Counter cyclical policies refer to those policies aimed at reducing the effects of economic cycles for example such policies encourage tightening credit during inflation.

### 3.5.1. KENYA'S MONETARY POLICIES AND OTHER INTERVENTIONS

After experiencing both the domestic crisis as well as the global financial crisis, the Central Bank of Kenya had to address the waning confidence towards the economy by amongst others loosening monetary policy complemented by other intervention measures.<sup>139</sup> It was envisaged that the expansionary monetary policy would facilitate the release of resources that would eventually be channelled to the real sector to finance economic recovery.<sup>140</sup> This however would not be effective by itself hence the government initiated an infrastructure bonds programme to finance public investments in targeted infrastructure project, to serve as a fiscal economic stimulus to stimulate demand.<sup>141</sup> Also, at the time, it was projected that lower interest rates would facilitate the government to spend more on infrastructure without crowding the private sector. The actual implementation of the aforesaid stimulus did however not go as smooth as expected as it was marred by implementation challenges relating to bureaucracy and delays due to government procurement procedures amongst others hindrances.<sup>142</sup>

In as much as the implementation of the fiscal economic stimulus lagged behind, the flexibility in employing monetary policy tools however established a quick response by the central bank in mitigation the effects of the crises.<sup>143</sup>

The monetary policy interventions and other interventions undertaken by the Kenyan government can be classified into two groups:

#### a) Expansionary monetary policy

The Central bank of Kenya follows a monetary targeting framework in that it uses the CBK rate which is set by the monetary policy committee (MPC) to signal the

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<sup>139</sup>Were, M & Tiriorgi, S "Monetary responses to economic crises from African economy perspective: An examination of Kenya's experience" *International Journal of Economics* 2013 17.

<sup>140</sup>Were, M & Tiriorgi, S "Monetary responses to economic crises from African economy perspective: An examination of Kenya's experience" *International Journal of Economics* 2013 17.

<sup>141</sup> Were, M & Tiriorgi, S "Monetary responses to economic crises from African economy perspective: An examination of Kenya's experience" *International Journal of Economics* 2013 17.

<sup>142</sup> *Ibid.*

<sup>143</sup> Were, M & Tiriorgi, S "Monetary responses to economic crises from African economy perspective: An examination of Kenya's experience" *International Journal of Economics* 2013 18.

monetary policy stance.<sup>144</sup> The CBK rate is raised or lowered depending on the prevailing circumstances. For example in 2008 following the GFC, the bank lowered its policy rate from 9% to 8.5% as a sign of lower interest rate. Lower interest rates at the time, were envisaged to enhance credit supply in the economy.<sup>145</sup> All through 2010 the CBK rate was further lowered to 6.75% and this resulted in enhancing the availability of liquidity which resulted in more liquidity being injected into the banking system as opposed to the withdrawals.<sup>146</sup> These injections signalled a historic policy shift from the tight monetary policy Kenya was associated with. Tight monetary policy stance was a dominant feature of Kenya's economy but the policy shift was a clear indication of counter cyclical policy. Over and above the injection of liquidity, there was a communication strategy in place so as to continuously keep the market informed of the 'new' monetary policy stance being adopted/orchestrated as well as other measures, with the aim of defusing market anxiety and unnecessary panic at the onset of both domestic and financial crises as well as fostering stability of the market.<sup>147</sup>

## **b) Financial sector policy measures**

Financial sector policy measures undertaken by the CBK were amongst others, creation of credit reference bureaus.<sup>148</sup> The purpose of these credit bureaus was to facilitate credit profiling.<sup>149</sup> Credit profiling was essential as it had emerged that challenges in the realization of collateral and the sufficiency of information for pricing risk were among the factors impeding the efficiency in the banking sector.<sup>150</sup> The first credit reference bureau obtained its license in 2010.<sup>151</sup>

The CBK also pursued a policy of broadening financial inclusion to the majority of Kenyans. This was done through, amongst others, introduction of agency banking i.e. use of third party agents to offer specific banking services with the aim of

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<sup>144</sup> *Ibid.*

<sup>145</sup> *Ibid.*

<sup>146</sup> *Ibid.*

<sup>147</sup> Were, M & Tiriorgi, S. "Monetary responses to economic crises from African economy perspective: An examination of Kenya's experience" *International Journal of Economics* 2013 19.

<sup>148</sup> *Ibid.*

<sup>149</sup> Credit bureaus were also envisaged to be effective in bringing down the cost of credit

<sup>150</sup> Were, M & Tiriorgi, S. "Monetary responses to economic crises from African economy perspective: An examination of Kenya's experience" *International Journal of Economics* 2013 19.

<sup>151</sup> *Ibid*

reaching the unbankable population especially in small towns and rural areas as well as promote the information communication technology (ICT) awareness.<sup>152</sup> ICT awareness was enhanced by the adoption or integration of mobile money transfer services with banking services.<sup>153</sup> In this light, mobile banking can be seen as an avenue to promote or increase financial inclusion. Mobile banking platforms such as M-PESA can be seen as third party agents who offer banking services to the unbankable population especially in the rural and under-developed areas.

Also the minimum investment in the Treasury Bill was lowered from about Kshs1,000,000 (USD\$10000) to Kshs100,000 (\$10000) with the aim of encouraging the participation of small investors in the risk-free government debt market and offer increased competition to large investors.<sup>154</sup> In addition to this, another measure adopted was to operationalize the Microfinance Act in 2008 by placing the deposit-taking microfinance institution under the regulatory purview of the CBK.<sup>155 156</sup>

### 3.6 CONCLUSION

From the aforementioned, it is clear that Kenya's financial sector can be seen as a fragmented financial sector. This is because the central bank is now focussing on micro prudential regulation and over and above that there are various regulatory bodies tasked with supervising the areas of pensions, insurance and market conduct. The need for a consolidated integrated Kenyan financial sector has however been identified by many authors such as Mutuku and Mweya. The fragmented nature of Kenya's financial sector has resulted in regulatory gaps, regulatory overlaps, multiplicity of regulators, inconsistency of regulations and differences in operational standards and as such highlighting the need of a consolidated financial sector.

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<sup>152</sup> Were, M & Tiriorgi, S. "Monetary responses to economic crises from African economy perspective: An examination of Kenya's experience" *International Journal of Economics* 2013 19

<sup>153</sup> *Ibid*

<sup>154</sup> Exchange rate at 1 USD=101.491 available at <http://themoneyconverter.com/USD/KES.aspx> accessed on 29 October 2015.

<sup>155</sup> *Ibid*.

<sup>156</sup> Microfinance Act No. 19 of 2006.

## CHAPTER FOUR: THE COLLAPSE OF AFRICAN BANK

### 4.1. INTRODUCTION

This research was modelled on measures to make the financial sector safer especially after the global financial crisis (GFC) in 2008. In this chapter, a comparison of approaches undertaken by both Kenya and South Africa shall be considered. The response to the GFC by both countries can be understood in light of the varying design of their operational frameworks for monetary policy and the different structures of the respective financial systems.

The role of a central bank during a crisis is to contain the damage and limit the impact of the crises on the real economy.<sup>157</sup> This can be achieved through enhancing confidence and calming the market, ensuring uninterrupted flow of credit, reducing uncertainty and ensuring that markets for short term credit function properly amongst others.<sup>158</sup> Central banks also have a role in reducing the probability of a crisis occurring by undertaking pre-emptive measures that reduce amongst others, systemic risks. Systemic risks arise from excessively risky activities of a single or group of traders, an aggressive type of organizational culture and a collective failure of management in the bank leads to inertia and the inability to respond to changed economic circumstances and high overexposure of banks to the same type of risk as a whole.<sup>159</sup> There are a number of tools that can be used to reduce systemic risks. These include a leverage ratio to cap credit growth at banks; loan-to-value or debt-to-income limits on certain types of lending; the adjustment of risk-weights on specific asset classes or types of loans to discourage asset bubbles in certain sectors; and the adjustment of collateral or margin requirements to reduce the growth of leverage in the sector.<sup>160</sup> This highlights the critical role that central banks play.

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<sup>157</sup> Were, M & Tiriorgi, S. "Monetary responses to economic crises from African economy perspective: An examination of Kenya's experience" *International Journal of Economics* 2013 14.

<sup>158</sup> *Ibid.*

<sup>159</sup> Smaga (2014) 5 *SRC Special Paper* 3.

<sup>160</sup> National Treasury (2011) *A Safer Financial Sector to serve South Africa Better*, National Treasury policy document 23 February 2011.

## 4.2. SOUTH AFRICA'S FINANCIAL REFORMS AFTER THE 2008 GFC

At national level, South Africa has undergone some significant financial reforms after the 2008 GFC and these policy measures that were subsequently adapted will be considered below.

In 2007, the Treasury launched a formal review of South Africa's financial regulatory system, kick-starting the proposed reform of the financial regulatory system. The purpose of the review was to assess South Africa's financial sector for any gaps and weaknesses. This review was expanded in 2009 to take into account the lessons learnt from the 2008 GFC.<sup>161</sup> This work culminated in the Minister of Finance publishing a policy document, 'A safer financial sector to serve South Africa better' commonly referred to as the 'Red Book'. The Red Book comprised of a wide-ranging set of proposals to reform the financial regulatory system in South Africa. This reform policy was approved by the cabinet in 2011.<sup>162</sup> The Red Book was followed by another policy document, "Implementing a Twin Peaks model of Financial Regulation in South Africa (2013)" ('the Roadmap'), which provided more detailed proposals on implementing the reform of the financial regulatory system set out in the Red Book.<sup>163</sup> One of the primary proposals, and integral to South Africa's regulatory reform, was a shift to a Twin Peaks model of financial regulation. Cabinet approved this proposed shift to a Twin Peaks model in July 2011.<sup>164</sup>

In 2012 the Financial Markets Act updated securities laws, regulations for derivatives whilst the Credit Ratings Services Act regulated agencies.<sup>165</sup> In 2013 the Bank Act was amended in line with Basel III principles on Banking Supervision to increase capital and liquidity requirements.<sup>166</sup> In December 2014 the National Treasury

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<sup>161</sup> Financial Regulatory Reform Steering Committee (2013): Implementing twin peaks model of financial regulation in South Africa 1 February 2013 6

<sup>162</sup> *Ibid* .

<sup>163</sup> Available at <http://www.kpmg.com/za/en/issuesandinsights/articlespublications/financial-services/pages/market-conduct.aspx> accessed 11th Aug 2015.

<sup>164</sup> See <http://www.sanews.gov.za/business/finance-minister-tables-financial-sector-regulation-bill> accessed on 30 October 2015

<sup>165</sup> Financial Markets Act No.19 of 2012, Credit Ratings Services Act No. 24 of 2012

<sup>166</sup> On 1 January 2013 South Africa implemented the Basel III principles which were proposed in December 2009 by the Basel Committee on Banking Supervision (BCBS). The BCBS proposed a set of bank supervision reforms herein referred to as Basel III. These principles require banks to hold sufficient amounts of high-quality capital and liquid assets to see them through both a solvency and funding crisis. These reforms are envisaged to strengthen micro prudential regulation and supervision as well as adding a macro prudential overlay that includes capital buffers. This is available at

published the discussion paper entitled, “Treating Customers Fairly in the Financial Sector: A Draft Market Conduct Policy Framework in South Africa” (“the Market Conduct paper”), together with the second draft of the Financial Sector Regulation Bill (“FSR Bill”).<sup>167</sup> The two publications reflect important developments in the proposed reform of the financial regulatory system in South Africa that began in 2007

### 4.3. African Bank Limited synopsis

The above policies could not be formulated at a better time for South Africa especially after the failure of African Bank that ensued in 2014. In August 2014, the Minister of Finance placed South Africa’s largest unsecured lender, African Bank, a subsidiary of African Bank Investments Limited (ABIL) under curatorship.

#### 4.3.1. Brief history

As of 2012, there were concerns expressed, particularly focussing on African Bank’s impairment and provision policy, their rapid credit growth and the need for a strategic rethink of their business model.<sup>168</sup> This was against the backdrop of African Bank’s parent company African Bank Investment Limited’s (ABIL’s) trade update.<sup>169</sup> Given these concerns, regular discussions were held by the erstwhile Governor of the Reserve Bank, Gill Marcus with the banking supervision department to ensure closer monitoring of developments affecting African Bank.<sup>170</sup>

In the six month period to March 2014, ABIL posted a headline loss of R3.1billion and its trading statement for the third quarter released on 6 August 2014 was worse than what the market expected. It recorded a loss of R6.4billion.<sup>171</sup> To fully comprehend African Bank’s predicament, one must view African Bank in light of the

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<https://www.resbank.co.za/RegulationAndSupervision/BankSupervision/TheBaselCapitalAccord%28Basel%20I%29/Pages/AccordImplementationForum%28AIF%29.aspx> accessed 20 September 2015.

<sup>167</sup> Available at <http://www.kpmg.com/za/en/issuesandinsights/articlespublications/financial-services/pages/market-conduct.aspx> accessed 11th Aug

<sup>168</sup> SARB 2014 *Remarks by the Governor of the SARB, Gill Marcus Press Conference* August 10<sup>th</sup> 2014: African Bank Limited 2

<sup>169</sup> *Ibid.*

<sup>170</sup> *Ibid.*

<sup>171</sup> SARB 2014 *Remarks by the Governor of the SARB, Gill Marcus Press Conference* August 10<sup>th</sup> 2014: African Bank Limited 3

acquisition of furniture retailer Ellerine Holdings Ltd. Ellerine Holdings Ltd, like African Bank, is a wholly owned subsidiary of ABIL.<sup>172</sup> Just before the 2008 GFC, African Bank made an acquisition of the Ellerine Furniture Holdings Ltd for the amount of 800 Million dollars but after the GFC and subsequent years, the acquisition proved to be a significant drain on ABIL requiring funding support of a minimum of R70 Million a month.<sup>173</sup> As a result of this strain, the ABIL board announced its decision to sell Ellerine and endeavoured to find a buyer. Ellerine Furniture Holdings Ltd was placed into a business rescue process on 7 August 2014 and in so doing the significant monthly financial support required from ABIL and African Bank ended.<sup>174</sup>

### 4.3.2. Reasons for failure

As mentioned earlier the acquisition of Ellerine Holdings Ltd proved to be consequential for African Bank. Ellerine Holdings Ltd acquisition coupled with the GFC at the time triggered the downfall of African Bank. Also, African Bank failed to respond strategically to the worsening economy by not adjusting its credit policy and standards, and they did not see the credit-crunch coming. Further, African Bank underestimated the value of non-performing loans and they made insufficient provisions for bad debt, thereby impairing their ability to identify problems and adequately manage capital requirements.<sup>175</sup>

### 4.3.3. Curatorship

The financial woes of African Bank caused it to be placed under curatorship in terms of Section 69 of the Banks Act. Curatorship is defined as the procedure to be implemented in the event that a bank is unable to repay, when legally obliged to do so, deposits made with it or will probably be unable to meet any other of its obligations.<sup>176</sup> This is usually ascertained by the Registrar.<sup>177</sup> Curatorship provides

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<sup>172</sup> SARB 2014 *Remarks by the Governor of the SARB, Gill Marcus Press Conference August 10<sup>th</sup> 2014*: African Bank Limited 3

<sup>173</sup> SARB 2014 *Remarks by the Governor of the SARB, Gill Marcus Press Conference August 10<sup>th</sup> 2014*: African Bank Limited 3

<sup>174</sup> SARB 2014 *Remarks by the Governor of the SARB, Gill Marcus Press Conference August 10<sup>th</sup> 2014*: African Bank Limited 3

<sup>175</sup> *Ibid.*

<sup>176</sup> Section 69 of the Banks Act 94 of 1990.

<sup>177</sup> Section 69(1)(a) Banks Act 94 of 1990.

the legal framework within which the necessary initiatives to enable resolution can take place. According to the SARB Governor, the problems of African Bank were largely attributed to their current business model which neither included a diversified set of products and income streams nor offered transaction banking services. This resulted in African bank as well as ABIL group being vulnerable to challenging business environment.<sup>178</sup>

Given this unique position African Bank found itself in, some measures were undertaken by the Registrar of Banks with the first measure being to place African Bank under curatorship commencing 10 August 2014. Curatorship is a protection procedure which gives the SARB legal means to create the necessary space to implement a resolution plan capable of ensuring that the business of African Bank gains a secure perspective for the future as a lending institution with a transformed business model.<sup>179</sup>

According to Section 69 (2) (B) of the Banks Act, the curator has the following powers:

“The curator shall—

(a) subject to the supervision of the Registrar, conduct the management contemplated in subsection (2A) (a) in such a manner as the Registrar may deem to best promote the interests of the creditors of the bank concerned and of the banking sector as a whole and the rights of employees in accordance with relevant labour legislation;

(b) comply with any direction of the Registrar;

(c) keep such accounting records and prepare such annual financial statements, interim reports and provisional annual financial statements as the bank or its directors would have been obliged to keep or prepare if the bank had not been placed under curatorship;

(d) convene the annual general meeting and any other meeting of members of the bank provided for by the Companies Act and, in that regard, comply with all the requirements with which the directors of the bank would in terms of the Companies Act have been obliged to comply if the bank had not been placed under curatorship; and

(e) have the power to bring or defend in the name and on behalf of the bank any action or other legal proceedings of a civil nature and, subject to the provisions of any law relating to criminal proceedings, any criminal proceedings.

(2C) (a) Notwithstanding the provisions of subsection (3), the curator may dispose of any of the bank’s assets in the ordinary course of the bank’s business.

(b) Except in the circumstances contemplated in paragraph (a) the curator may not, notwithstanding the provisions of section 112 of the Companies Act—

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<sup>178</sup> SARB 2014 *Remarks by the Governor of the SARB, Gill Marcus Press Conference August 10<sup>th</sup> 2014*: African Bank Limited 4.

<sup>179</sup> *Ibid.*

(i) dispose of any of the bank's assets otherwise than in accordance with the provisions of section 54;  
(ii) effect a disposal referred to in subparagraph (i) unless a reasonable probability exists that such disposal will enable the bank to pay its debts or meet its obligations and become a successful concern.  
(2D) If at any time the curator is of the opinion that there is no reasonable probability that the continuation of the curatorship will enable the bank to pay its debts or meet its obligations and become a successful concern, the curator shall forthwith in writing inform the Registrar of such opinion."

This highlights the important role of a curator during the curatorship process and most importantly that the curator is empowered to conduct affairs of the institution under curatorship as he/she deems fit but in the same breadth his authority is limited to a certain extent which can be seen as a check-and-balances mechanism.

#### **4.4. ROLE OF THE SOUTH AFRICAN RESERVE BANK**

Section 224 of the Constitution provides that the primary objective of SARB is the protection of the monetary currency. SARB's independence is entrenched in the Constitution. SARB has its primary functions and unique responsibilities.<sup>180</sup> Its primary functions amongst others is to monitor financial risks that banks undertake and to ensure that sufficient bank notes and coins in circulation. The SARB is also a lender-of-last-resort assistance and it is as a system for clearance and settlement of bank claims between banks

The SARB's unique responsibilities include ensuring that South Africa's money, banking and financial system as a whole is sound.<sup>181</sup> The SARB also assists in the formulation and implementation of macroeconomic policy.<sup>182</sup> The SARB informs about monetary policy and economic situation, to formulate and execute monetary policy in such a way that primary goal of bank can be achieved in interest of community.<sup>183</sup>

Under the Twin Peaks Model of Financial Regulation, the SARB has been identified as the resolution and financial stability function. SARB ensures financial stability by ensuring a high quality currency, developing and maintaining an efficient national payment system, monitoring the financial risks of banks, providing assistance to

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<sup>180</sup> The Constitution of the Republic of South Africa, 1996.

<sup>181</sup> See 'Functions of SARB' available at <https://www.resbank.co.za/AboutUs/Functions/Pages/default.aspx> accessed 10 October 2015.

<sup>182</sup> *Ibid.*

<sup>183</sup> *Ibid.*

banks through its accommodation policy, supporting and developing the efficient functioning of the money, capital and foreign markets.<sup>184</sup>

#### 4.4.1. ROLE OF SARB IN AFRICAN BANK'S RESCUE

The role of SARB in relation to rescuing African Bank cannot be underestimated. As mentioned earlier, SARB is mandated and is lender-of-last-resort assistance which was quite evident in African Bank's case. After placing African Bank under curatorship, SARB split the bank into a 'good bank' and a 'bad bank'.<sup>185</sup> This follows the amendments to the Banks Act whereby instead of winding up of a failing bank, such a bank would be transferred to another bank but only if the bank is able to become a successful going concern.<sup>186</sup> In this case, the bad banks assets and liabilities are to be transferred into the good bank.

A good bank separates viable and profitable elements of a bank from distressed and non-performing assets, allowing the viable entity to continue to generate new business and support the wider economy through new lending.<sup>187</sup> The good bank capitalised with a share capital of R10 billion underwritten by a consortium and the Public Investment Corporation (PIC).<sup>188</sup>

The curatorship and resolution process of African Bank was aimed at:<sup>189</sup>

- Ensuring that regular operations and collections of African Bank continue effectively and efficiently
- Identifying performing loans and assets to be maintained in a good book
- Involving the purchase of SARB of a substantial portion of non-and-under performing assets and other high risk loans from African Bank in order to

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<sup>184</sup> National Treasury (2011) *A safer financial sector to serve South Africa better* 2011

<sup>185</sup> SARB 2014 *Remarks by the Governor of the SARB, Gill Marcus Press Conference* August 10<sup>th</sup> 2014: African Bank Limited

<sup>186</sup> See Section 69 (2C) of the Banks Amendment Act No 3 of 2015 .

<sup>187</sup> 'African Bank's top shareholders apologize after loss' available at <http://www.bloomber.com/news/articles/2014-08-12/african-bank-s-top-shareholder-apologizes-after-loss> accessed 28 October 2015.

<sup>188</sup> This consortium comprises of Absa Bank Limited, Capitec Bank, FirstRand Bank Limited, Standard Bank Limited, Investec Bank Limited, Nedbank Limited and the Public Investment Corporation

<sup>189</sup> SARB 2014 *Remarks by the Governor of the SARB, Gill Marcus Press Conference* August 10<sup>th</sup> 2014: African Bank Limited 5.

separate them from the good bank. This can also be seen as the first step towards resolution of the challenges associated with these assets and loans.

- Recapitalising the new entity by a capital raising of R10 billion underwritten by a consortium.
- Providing current shareholders an opportunity to participate in the recapitalisation of the new entity and thereby of good bank.

It is worth noting that the SARB Governor reiterated that the above proposed measures/procedures were in the best interest of all stakeholders (depositors, shareholders, creditors and clients alike).<sup>190</sup>

From the above it is evident that SARB came to the rescue by extending a 'bail-out' to African Bank therefore a few lessons could be learnt from the African Bank failure namely: there is a need for a stronger system of financial regulation and there is a need for a consistent and comprehensive approach to regulating conglomerates (or groups with a number of subsidiary companies) as was the case with African Bank. As indicated many of the difficulties faced by African Bank were as a result of the acquisition of Ellerine Furniture Limited which impacted negatively on the holding company, African Bank Investments Limited (ABIL). It is worth noting that there was limited scope for the regulators to intervene at group holding level.<sup>191</sup> Although regulated by the SARB, FSB and NCR, it is questionable whether the regulatory system was as effective as it should have been. The ideal lesson from the African Bank scenario was that indeed an effective regulatory system should ideally identify problems as early as possible.

The African Bank crisis further highlighted the need for an effective regulatory system.

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<sup>190</sup> *Ibid*

<sup>191</sup> SARB 2014 *Remarks by the Governor of the SARB, Gill Marcus Press Conference August 10<sup>th</sup> 2014*: African Bank Limited

## CHAPTER FIVE: CONCLUSION

On 27 October 2015, the Financial Sector Regulation Bill was tabled before parliament. This is a step in the right direction towards implementation of the Twin Peaks model of financial regulation. Kenya, as was shown, follows an integration model of financial regulation. The question arises whether a Twin Peaks model of regulation will suit Kenya? The proposed Twin Peaks model of financial regulation for South Africa scraps this fragmented nature and makes the financial system holistic, vesting the regulation of the financial system under the two pillars of prudential supervision and market conduct supervision. Implementing a Twin Peaks model of financial regulation in South Africa was seen to be the least disruptive option that would be able to leverage off existing strengths in both the SARB and FSB. From the work illustrated above, there have been calls for Kenya to have a more integrated approach towards its financial sector. The following excerpt by F.Mwega perhaps best describes why a shift to a Twin Peaks form of financial regulation will be the way forward for the Kenyan financial sector

“Among other regulatory issues, Kenya has increasingly moved into universal banking reflected in increasing share of net commissions and fees in the banks' total income. The country now has banks that own insurance companies, others have set up insurance agencies to push forward their concept of bank-assurance; while others own stock brokerage firms. Hence there have been increased synergies between the banking, insurance and securities sectors with removal of regulatory barriers between the different segments of the financial sector. This poses regulatory challenges as different financial sector entities are subject to different regulatory regimes. Given the convergence and consolidation of the financial services, some players have called for the established of an overall services regulatory authority”.<sup>192</sup>

It follows thus that countries have much to learn from each other as different countries adapt different integration approaches.<sup>193</sup> It is also worth noting that delivery of Kenya's Vision 2030 objectives requires implementation of policies that would contribute to stable macro and fiscal positions aimed at lower inflation and

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<sup>192</sup> Mwega, F.M “ Financial Regulation in Kenya: Balancing inclusive growth with financial stability” *ODI Working paper* 407 2014 33.

<sup>193</sup> Beck, T et al ‘Banking sector stability, efficiency and outreach in Kenya’ *Policy Research Working Paper* WPS 5442 2010.

financial sector liability.<sup>194</sup> Kenya's financial system continues to face challenges in that the banking system is still fragmented, with many small banks serving specific niches but not contributing to competition in the sector whilst the outreach of the financial system is still limited.<sup>195</sup>

Also it is worth noting that the determinant of which integration supervision model to adapt will depend on:<sup>196</sup>

- Macroprudential surveillance
- Microprudential surveillance.
- Business conduct (consumer protection) supervision.
- Competition policy.

Based on these four principles, a country's financial sector can breed or adapt the appropriate financial regulation model. As seen from the studies South Africa has made a tremendous leap towards implementing the Twin Peaks model of regulation.

It is submitted that a Twin Peaks Model of Financial Regulation would seem appropriate for Kenya given its fragmented nature of its financial regulation. Better market conduct will result in improved consumer confidence in financial services which will in turn result in an enhanced financial sector that will ensure sustainability and foster economic growth, development and employment. A strengthened regulatory focus on financial stability will help prevent crises from developing easily. Such focus shall easily resolve those crises that do occur at a lower cost to consumers and the taxpayer.

Ultimately, it is submitted that a shift towards a Twin Peaks Model of Financial Regulation has the potential to result in the financial sector being made safer.

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<sup>194</sup> *Ibid.*

<sup>195</sup> *Ibid.*

<sup>196</sup> Cihak M and Podpiera, R "Integrated financial supervision: which model?" *North American Journal of Economics and Finance* 19 (2008) 136.

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