

ANNUAL REPORT - 1999



CAPITAL MARKETS AUTHORITY

**Modernisation of Kenya's Capital Markets: Critical Reforms
for the Next Millennium and Vision for Success**

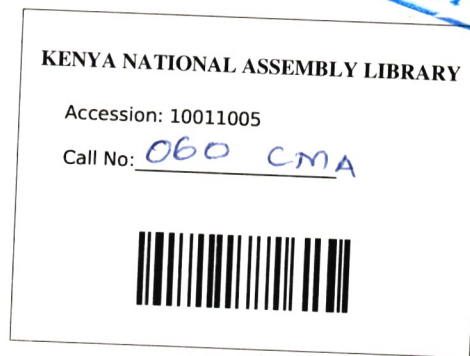
We promote and facilitate the development of orderly, fair and efficient capital markets in Kenya

60
DA



**SUBMISSION OF THE ANNUAL REPORT AND REVIEW OF THE
CAPITAL MARKETS OPERATIONS FOR THE PERIOD 1998/99 BY
THE CHIEF EXECUTIVE TO THE MINISTER FOR FINANCE**

Honourable Minister for Finance
Ministry of Finance And Planning
The Treasury
Nairobi



Dear Honourable Minister

I have the honour on behalf of the Authority to present to you the Capital Markets Authority's Annual Report for the period ended December 31, 1999, pursuant to the provisions of the requirements of Section 36(3) of the Capital Markets Authority Act Cap 485A. The report reviews the capital markets operations and outlines critical reforms and medium term action plan.

Respectfully submitted

Paul K Melly

CHIEF EXECUTIVE



Mission Statement

The mission of the Capital Markets Authority is to promote the development of orderly, fair, efficient, secure, transparent and dynamic capital markets in Kenya within a framework which facilitates innovation through an effective but flexible system of regulation for the maintenance of investor confidence and safeguards the interest of all market participants.

TABLE OF CONTENTS

1.	Board Members	5
2.	Senior Management	6
3.	Chairman's Statement	7
4.	Chief Executive's Report	10
	➤ An Overview of the Global Economic Trend	10
	➤ An Overview of Emerging Markets Performance	11
	➤ Kenya's Economic Outlook – Depressed During 1999, Albeit Optimistic Outlook for the Year 2000	13
	➤ Overview of Kenya's Stock Market Performance	15
	➤ Modernization of Kenya's Capital Markets – Critical Reform Measures and Vision for Success	17
	➤ A Seven-Pronged Reform Vision for the Period 2000 – 2003 ..	18
	* Market Infrastructure	18
	* Fundamental Re-organization of Kenya's Stock Market Into Independent Market Segments	19
	* Regulatory and Legislative Reforms	22
	* Institutional Development	23
	* Capital Markets Policy and Operating Environment ...	23
	* An Investor Education Program	24
	* Momentum Towards Building an Integrated East African Capital Market	25
	➤ Progress Review on Medium Term Action Plan: Year 2000 to 2001	25
	➤ Re-organization of Management Functions and Capacity Building	32
	➤ Compliance and Enforcement Actions	34

➤	Financial Performance and Audited Accounts for the Period Ended June 30, 1999	36
➤	Conclusion	38
5.	Progress Towards the Integration of the East African Capital Markets	39
6.	The Capital Markets Environment and Incentives	45
7.	CMA Disclosure Standards Committee	46
8.	Central Depository Project Gets Underway - A Robust Market Infrastructure For The 21 st Century	50
9.	Appendixes	63
❖	CMA's Audited Annual Accounts for 1998/99	63
❖	Market Statistics	78
❖	Notable Events in Pictures	94
❖	Overview of Management Functions	96
❖	List of CMA Licensees	99
❖	List of Enabling Legislation	105
❖	Guidelines for Dealers	107
❖	Guidelines for Credit Rating Agencies	114
❖	Guidelines for Audit Committees	120
❖	Guidelines for Corporate Bonds and Commercial Papers	132

MEMBERS OF THE CAPITAL MARKETS AUTHORITY



Denis Afande - Chairman



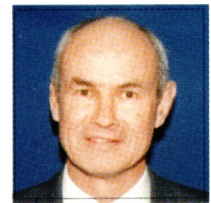
Paul K Melly - Chief Executive



Kimanathi Mutua - Member



Dr Edward Sambili - Member



James B McFie - Member



Isaac Awuondo - Member



Desterio Oyatsi - Member



Leonard Njagi - Member



Martin L Oduor-Otieno - Member



Micah Cheserem - Member



Amos Wako - Member



Mwaghazi Mwachofi - Alternate



Dr Thomas Kibua - Alternate



Dan Ameyo - Alternate

SENIOR MANAGEMENT



Paul K Melly
CHIEF EXECUTIVE



Catherine Kola
Head of Enforcement & Administration



Francis Omollo
Head of Compliance & Finance



Stephen Maina
Manager, Research



Simon P Ole Nkeri
Manager, Compliance & Finance



Michael N Nyamute
Manager, Corporate & Int. Affairs



Shamira Hussein
Manager, Enforcement & Legal Affairs



Wangui Mwaniki
Asst. Manager, Administration

STATEMENT OF THE CHAIRMAN



It is my pleasure to present the Capital Markets Authority's Annual Report covering the period ended December 31, 1999.



Denis Afande - Chairman

The Authority welcomes the signing of the Treaty for the establishment of the East African Community in November 1999 by the Heads of State of Kenya, Uganda and Tanzania. The endorsement in this milestone regional policy instrument of the objectives of the East African Member States Securities Regulatory Authorities (EASRA) towards the integration of the capital markets of the three East African countries is not subject to further protocol agreements.

The Capital Markets Authority as a member of EASRA takes seriously the challenge to harmonize capital market policies on cross border listings, foreign portfolio investors, taxation of capital market transactions, accounting, auditing and financial reporting standards and the regulatory and legislative structures as mandated in the Treaty. The Authority further takes the opportunity to commend the governments of the three countries for this major development.

The Chief Executive, Mr. Paul Melly, as EASRA's Chairman, has been active in both regional and international issues.

In the global arena, the Authority was honoured with the election of the Chief Executive, Mr. Melly, as the chairman of the Emerging Markets Committee of the International Organization of Securities Commissions (IOSCO) during its XXIVth Annual Conference held in Lisbon, Portugal in May 1999. The position offers great opportunity to exchange views first-hand with regulators from developed and emerging markets and chart the course of our capital markets in Kenya and the region in a manner that is consistent with global trends. As Chairman of the EMC, Mr. Melly represents the Organization in the Group of Seven Industrialized Nations, G7-established Financial Stability Forum. On behalf of Members and Staff of the Authority, I would like to congratulate Mr. Melly on his elevation to this high office in an international organization, which has brought honour not only to us but also to the rest of Africa, being the first occupant thereof to have come from Africa.

The Board of the Authority was reconstituted in July and the new Members Gazetted in Legal Notices Numbers 4239 and 4240 of Kenya Gazette Issue of July 30, 1999. I also take the opportunity to congratulate the Members of the Authority who were appointed to the Board of the Capital Markets Authority and in particular Mr. Desterio Oyatsi, who was appointed for the first time. On a sad note, the Authority lost one of its longest serving Members, Mr. George Ayino who passed away on April 20, 1999 after a long period of illness. We pay tribute to the late Mr. Ayino in this report, for his contribution to the work of the Authority. May God keep his soul in eternal peace.

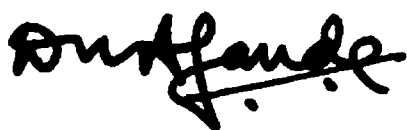
The transfer of the former Permanent Secretary in the Ministry of Finance and Planning Ms Margaret Chemengich and the former Financial Secretary Mr. Joseph Kinyua to the Ministry of Tourism, Trade and Industry and the Central Bank of Kenya, respectively, brought new faces to the Board of the Authority.

We wish to thank Ms Chemengich and Mr. Kinyua for their valuable contributions to our development, and congratulate and welcome their successors Mr. Martin Oduor-Otieno, the Permanent Secretary, as the substantive Member, and Mr. Mwaghazi Mwachofi, the Financial Secretary, as his alternate to the Board of the Capital Markets Authority.

As we look to the future, Members of the Authority are dedicated to the modernization of our market through the introduction of new products, new market players and new systems. Towards this end, I wish to commend and encourage Members and Management of the Authority on their continued efforts in the developmental and regulatory programmes of the domestic capital markets. We will continue to report on their progress, as you will note elsewhere in the Chief Executive's Report.

In concluding these remarks, may I express my appreciation to the Members and Management of the Authority for their dedication and commitment to the development and smooth running of both our institution and the entire capital markets.

Thank you one and all.

A handwritten signature in black ink, appearing to read "D. Afande". The signature is stylized and cursive, with a horizontal line underlining the name.

**Denis D Afande, CBS
Chairman**

THE CHIEF EXECUTIVE'S ANNUAL REPORT ON CAPITAL MARKETS OPERATIONS AND REFORMS



We are at a threshold of a new millennium and in this regard it is with great pleasure that I review the operations of the Capital Markets and to share some of the reform measures that are being considered by the Authority as part of efforts to modernize the capital markets.

Paul K Melly – Chief Executive

This report highlights the major achievements of the Authority during the year 1999, and outlines a development strategy and agenda, among others, for the next millennium. The report starts at the outset with an overview of the global economic trend; secondly, an overview of the emerging markets performance; thirdly, Kenya's economic outlook; fourth, an overview of Kenya's stock market performance; fifth, modernization of Kenya's capital markets and critical reform measures and sixth, progress review and medium term planned action.

An Overview of the Global Economic Trend

The world economic growth prospects have improved since 1997 following financial crises in the South East Asia economies, which were feared, could bring about recessionary pressures in the world economy. The South East Asian economies are expected to further strengthen the growth momentum during the year 2000.

The global economic growth rate for year 1999 is expected to be in the region of 3 percent, which is some 0.5 percent improvement, over 1998 level of 2.5 percent. A number of factors have been cited for the improvement in the world economy including faster economic recovery in the South East Asia as well as strong growth in advanced economies including Japan which returned to a positive economic growth during the first half of 1999.

According to the International Monetary Fund estimates during October 1999 the world economic growth projection is expected to record continued positive improvement to a level of about 3.5 percent growth rate during the year 2000. African economic growth prospect is also expected to record much improvement with South Africa and Nigerian economies recording marked improvement. The Kenyan economy is also expected to record modest growth. The growth of the emerging economies, which is estimated at 3.5 percent in 1999, is projected to grow to a level of 4.8 percent during year 2000. The growth in the advanced economies is also projected to maintain growth momentum at about 3.5 percent during the year 2000.

An Overview of the Emerging Markets Performance

An overview of the performance of the emerging markets during 1999 reveals that markets have recorded some marked improvement over the position that prevailed during 1998. The South East Asia markets and Latin America markets have for instance witnessed tremendous recovery during 1999.

According to the Institute of International Finance (IFF) the net total portfolio equity investment flows to emerging markets are estimated at US\$ 25 billion during 1999 from a low level of US\$ 6.6 billion during 1998.

The portfolio equity flows was significantly strong for the South East Asia markets which are estimated to have grown three-fold from a level of US\$ 5 billion in 1998 to about US\$15 billion during 1999.

The growth in the South East Asia markets also extended to Latin American markets during 1999. The Korean markets, for example, grew by over 56 percent by the end of October 1999 while the Singapore and Indonesia markets recovered by 49 percent.

The Malaysian market recorded a growth of 28 percent and India achieved 50 percent during the same period. The Latin America markets also recorded significant growth with the Brazilian market recording major recovery of 76 percent while the Argentinean market grew by 25 percent and Mexican market by 39 percent (All in local currencies). The direct equity investments in emerging markets during 1999 are estimated at about US\$ 117 billion in 1999 compared to some US\$ 120 billion in 1998, with China becoming the largest single destination for the equity investments of about US\$ 35 billion out of the total global flows into the emerging markets.

In Africa, South Africa is expected to attract equity flows to the tune of about US\$5.5 billion during 1999 and year 2000 following listings of a number of South African companies in the international exchanges. Kenya's stock market is expected to rebound as the economy improves during the year 2000.

Kenya's Economic Outlook – Depressed During 1999 Albeit Optimistic Outlook for the Year 2000

During 1998 and part of 1999 Kenya's domestic economy witnessed sustained slow down with most of the economic sectors recording marginal growth level and others recording a decline.

The 1999 Economic Survey cited a number of factors as contributing to the slow down of the economic growth, in particular the poor state of infrastructure, inadequate power supply, telecommunication services, depressed investments, declined level of tourism, depressed manufacturing production, rising costs of inputs and poor world commodity prices in addition to continued high level of interest rates.

According to preliminary estimates by the Central Bank it is significant that the average annual underlying inflation level for the period ended December 1999 was 5.1 percent lower than the level recorded during 1998 of 9.8 percent, which is within the targeted single digit level. The exchange rate however, came under pressure during 1999 as evidenced by the depreciation of the Kenya Shilling vis-à-vis the hard currency which saw the US dollar exchange rate depreciating to an average of Kshs.74.8 Kenya Shillings by December 1999 from the level of Kshs.61.8 in December 1998.

The real economic growth for the period 1999 is expected to be about 1.4 percent as compared to 1.8 percent achieved during 1998 and 4.6 percent recorded during 1996. The gross domestic saving rate which stood at 19.6 percent of Gross Domestic Product (GDP) during 1996 has continued to record sustained decline to 13.7 percent in 1998 and about 12.9 percent during 1999.

The gross domestic investments as a percentage of GDP declined from 20.4 percent during 1996 to 17.2 percent in 1998 and 16.9 percent during 1999. The per capita income also continued to decline from US\$ 284 in 1996 to US\$ 279 in 1998 and estimated US\$ 278 in 1999.

Interest rates on the benchmark 91 days treasury bills which had risen to 26.6 percent by January 1998 declined to 10.7 percent by January 1999. The rates have, however, continued to record an upward surge to a level of 18.1 percent in November 1999 and 20.0 per cent in December 1999. The erratic changes in both the exchange and the interest rates causes serious challenges to business and investment in terms of planning and prediction of market trend and undermines economic growth.

The economic outlook for the year 2000 is, however, characterized by some optimism in view of the radical measures that the Government has sought to implement during the second half of the year 1999 and seeks to implement during the year 2000. A critical measure that has bought in renewed optimism during the year 2000 is the recent reorganization of Government and measures being implemented to re-invigorate the civil service as well as expected improvement measures in management throughout the public sector.

The other encouraging measures include commitment for continued restructuring of Government services including the budgetary process, accounting and procurement systems as well as efforts to combat corruption. Among other positive measures include the demonstrated effort to build a regional market within East Africa following the signing of the Treaty establishing a common market within East African countries of Kenya, Uganda and Tanzania.

Another source of optimism is the recent announcement by the International Monetary Fund that it will commence negotiations with the Government of Kenya towards a new Poverty Eradication and Economic Growth Structural Facility.

A number of teething challenges, however, remain to be tackled, including continued high level of short-term domestic debt, high level of interest rates, poor state of infrastructure, insufficient power generation and distribution, privatization of the large state enterprises, low level of domestic savings, per capita income and alleviation of poverty, among others.

It is critical that positive reform measures are implemented on sustainable basis in order to re-establish investment confidence in the Kenyan economy.

Overview of Kenya's Stock Market Performance

The stock market has witnessed tremendous growth from 1990 in terms of annual turnover, capitalization and index level. The turnover level during the period 1990 was only KShs.230 million, which rose to a level of KShs.3.08 billion in 1994 and an all-time high level of KShs.6.15 billion in 1997. The annual turnover however declined in 1998 to a level of KShs.4.56 billion. The market turnover realized during 1999 was KShs. 5.1 billion. The market capitalization level has also grown from a level of KShs.10.9 billion in 1990 to KShs.136 billion in 1994. However, the level of capitalization during the period 1995 to 1999 ranged between KShs.100 billion and 128 billion. The index level rose from 915 in 1990 to an all-time high level of 4,559 by 1994. The index level, however, averaged between 3,000 and 3,400 between 1995 and 1997.

During 1997 and 1998 the index level significantly declined to below 3,000 and closed at about 2,300 level by end of December 1999.

The bond market is emerging as an important source of funding for both the Government of Kenya and the corporate sector. During the year 1999, the Government of Kenya issued Floating Rate (FR) Bonds amounting to Kshs 26.4 billion, which are listed on the Nairobi Stock Exchange.

The corporate sector has, however, concentrated on the issue of Commercial Paper (CP), which is also beginning to constitute a major source of working capital financing. The total amount of Commercial Papers issued since 1997, when the Authority issued guidelines on the same, is Kshs 11.6 billion.

The East African Development Bank (EADB) remains the only issuer of corporate bond which is benchmarked to the 91-day Treasury Bill, and has a tenor of three years.

The performance of the stock market is a mirror of the performance of the economy and hence the current level of performance during 1999 is attributed to economic downturn during the last two years that has continued to significantly affect corporate earnings, dividend payout and turnover. The high level of interest rates also continues to favour money market instruments especially Treasury bills. Another depressing factor for the capital markets is requirement in the Finance Act 1999 for insurance companies to invest 20 per cent of their assets in long-term Government securities. The market is however expected to improve during the year 2000 in response to a more positive investment climate. The detailed statistical information on market performance is contained elsewhere in this report.

Modernization of Kenya's Capital Markets: - Critical Reform

Measures and Vision for Success

Whilst tremendous achievement has been made in the development of Kenya's capital markets during the last decade it is now imperative that a comprehensive capital market reform programme for the new millennium be implemented. The reform programme constitutes a pragmatic approach towards building a regional financial centre.

Compelling Circumstances

The following global developments necessitate these urgent measures:

- The globalization of financial markets as well as developments at the international level has seen the emergence of global markets, global investors, and global operators.
- New innovation and technological advancements that have seen the emergence of an electronic economy or the so-called "E-Commerce" has brought in the power of the internet as well as new electronic trading and settlement systems.
- Increased competition for capital and global savings have resulted in sophistication of investors, which demands efficiency and cost-effective services at minimal risk.

- Need for strong institutional market operators such as brokers, dealers and specialist merchant banks that are well capitalized and adopt the best technological infrastructure to meet the demands of client service.
- Need for alternative securities market segments to respond to new methods of financing and sophisticated institutional players as well as venture capital requirements.
- Need to facilitate development of alternative saving vehicles such as collective investment schemes and an active fund or asset management industry.

A Seven-Pronged Reform Vision for the Period 2000-2003

In order to respond promptly to these challenges, the Capital Markets Authority will promote and implement a seven-pronged reform programme for the capital markets in collaboration with Nairobi Stock Exchange and other stakeholders during the period 2000 to 2003.

Firstly,

Market Infrastructure

The implementation of fundamental changes in the market infrastructure accomplished through adoption of a central depository trading and clearing system aimed at:

- Facilitating easy access of investors to the market through modern electronic order routing system that uses the power of the internet throughout the country through what will emerge as financial supermarkets.
- Improvement in the risk management process by ensuring elimination of systemic interruption or failures in the market system.
- Increase efficiency in the trading process at reduced cost.

In order to achieve this desired fundamental change in the market structure and meet capital outlay such necessary measures including a review of the market ownership structure of the Stock Exchange and possible demutualisation will be considered

Secondly,

Fundamental Reorganisation of Kenya's Stock Market into Independent Market Segments

In order to respond to the requirements of the issuers and special needs of the economy and investors as well as to ensure that the basic structure of the stock markets is not undermined during these formative stages of capital markets development, it is proposed that the market be reorganized into three distinctive market segments.

The market segments will operate independent of each other and will also have specific defined eligibility and disclosure requirements for the purpose of listing in each of the market segments.

Three-Tier Independent Market Segments

As part of the envisaged reorganization of the market it is proposed that the stock market operations be reorganized into three-tier independent market segments operated by Nairobi Stock Exchange.

The proposed three-tier market segments are as follows:

- (i) Main Investments Market Segment (MIMS)
- (ii) Alternative Investments Market Segment (AIMS)
- (iii) Fixed Income Securities Market Segment (FISMS)

The Main Investments Market Segment (MIMS)

The Main Investments Market Segment will represent the main quotation market which will have more stringent eligibility listing and disclosure requirements.

This market will also adopt the current listing requirements of Nairobi Stock Exchange with appropriate modification to take into account the reorganized market.

The current companies listed at the Nairobi Stock Exchange which do not satisfy the requirements of the MIMS will appropriately be categorized and listed in the Alternative Investments Market Segment.

Alternative Investments Market Segment (AIMS)

The Alternative Investments Market Segment is aimed at providing access to the capital markets to small and medium sized companies with high growth potential.

This market will therefore provide an alternative method of capital raising for those companies which find it difficult to meet the more stringent listing requirements of the MIMS.

The AIMS will also offer investment opportunity to sophisticated institutional investors as well as high net worth individuals.

In view of the underlying risks this market will not be opened to the participation of the general public.

The market will however have its own eligibility and listing requirements which shall be less stringent compared to those of the MIMS.

Fixed Income Securities Market Segment (FISMS)

The Fixed Income Securities Markets Segment is aimed at providing a separate independent market for fixed income securities such as treasury bonds, corporate bonds, preference shares and debenture stocks as may be applicable.

This market could also list other forms of short-term financial instruments such as treasury bills and commercial papers. This market will have its own eligibility and listing requirements.

Thirdly,

Regulatory and Legislative Reforms

- A comprehensive regulatory and legislative reform will be undertaken to improve the supervisory framework and ensure protection of market participants as well as facilitate market innovation.
- The regulatory reform will also seek to establish a simple but comprehensive regulatory requirements aimed at minimizing the cost of compliance and promoting fairness to the market participants, operators and other stakeholders as well as combating such unfair practices as price manipulation, insider trading, among others.
- The regulatory framework will therefore focus on issuance of comprehensive rules as well as guidelines on all aspects of the capital markets including such areas as regulation of collective investment schemes.
- The framework will also include the adoption of a comprehensive disclosure framework for initial public offering of securities. The framework will entail enhanced continued reporting obligation of publicly listed companies as well as adoption of new corporate governance practices.

Fourth,

Institutional Development

The strengthening of the institutional development will be accomplished through:-

- Strengthening the Nairobi Stock Exchange as an efficient market facility and a self-regulatory organization;
- Strengthening the research, compliance and enforcement capacity of the Authority;
- Strengthening the market operators' capitalization level and encouraging consolidation, mergers and acquisition of the brokerage firms as well as participation of other institutional players such as dealers.

Fifth,

Capital Markets Policy and Operating Environment

The establishment of a supportive capital markets environment will be accomplished through:-

- Review of policies that inhibit participation of both local and foreign investors;

- Elimination of double taxation in such areas as dividend income as well as consideration for fiscal incentives to encourage public listings of securities.
- Removal of legal impediments that constrain active use of the capital markets or fiscal distortion e.g. requirements for mandatory investment in Government Bonds by insurance companies where such requirement excludes equity investments in the capital markets.

Sixth,

An Investor Education Programme

The Investor Education Programme will be aimed at:

- Providing and sensitizing the public in simple language with the knowledge of basic principles of investments, opportunities and underlying risks in the capital markets.
- Promote understanding on the structure of the financial markets and roles of key institutional operators including the role of the Authority as a regulator and facilitator and that of the Stock Exchange.
- Promotion of savings in financial assets in the capital markets.
- Informing the investors on their rights as shareholders, dispute settlement procedures, recourse and resolution.

Seventh,

Momentum Towards Building an Integrated East African Capital Market

The building of an integrated regional capital market as envisaged in the treaty that established the East African Community will be pursued. This will include the promotion of appropriate infrastructure and cross-border listing of securities in the East African region.

Progress Review on Medium Term Action Plan Year 2000 to 2001

As part of progress review of these critical reform measures the following are the detailed highlights:

1. Market Infrastructure

a) Implementation of the Central Depository System Project

- The draft Central Depository System (CDS) Bill was tabled in the last Session of Parliament in December 1999 but Parliament went on recess before debating the Bill. The Bill is to be republished and tabled in March 2000 when Parliament is expected to resume.

- The Central Depository and Settlement Corporation Limited has been incorporated and core investors in the CDS project have been identified with the Nairobi Stock Exchange leading a consortium of banks, insurance and financial institutions, including the International Finance Corporation (IFC) who have expressed an interest to participate.
- The shareholders are expected to enter into a shareholders agreement by March 2000.
- The selection of suppliers on a turn-key basis is expected by April 2000.

b) Adoption of an Electronic Trading System at Nairobi Stock Exchange (NSE)

- The NSE will play a leading role in the development of an electronic trading market infrastructure.
- The Authority will hold discussion with the NSE on modalities for the implementation of an electronic trading system by March 2000.

2. *Capital Markets Regulatory Framework*

- An Amendment Bill to the Capital Markets Authority Act has been published and is expected to be tabled in Parliament during the next session commencing March 2000.

- Review of Capital Markets Authority Rules has commenced and is expected to be completed by August 2000.

3. *Reorganization of Nairobi Stock Exchange into Market Segments*

- A conceptual framework for reorganization of Nairobi Stock Exchange into market segments has been developed by the Authority and discussions with NSE have commenced on the same.
- The conceptual paper is to be released to the Nairobi Stock Exchange, Brokers and Disclosure Standards Committee members by February 2000.
- Details of the new market structure will be announced by April 2000.

4. *New Financial Disclosure Requirements Underway*

- A comprehensive disclosure framework and guidelines have been developed and considered by the Capital Markets Disclosure Standards Committee.
- New disclosure guidelines are being finalized and will be published by the Authority for an exposure period by May 2000.

- The Authority welcomes and supports the recent adoption by the Institute of Certified Public Accountants of Kenya of the International Accounting Standards as a basis of accounting reporting after January 1999.

5. *Measures to Enhance Liquidity through Dealers*

- Guidelines on licensing of dealers have been published for an exposure period and comments from stakeholders have been incorporated in the new guidelines released in December 1999.
- CFC Financial Services, a subsidiary of CFC Bank which is a public listed company, was approved in December 1999 as the first licensed Dealer at Nairobi Stock Exchange and is expected to commence operation by March 2000.
- Licensing of the other dealer(s) is expected in the first and second half of the Year 2000

6. *Policy Framework on Participation of Foreign Investors*

- New policy proposals on foreign portfolio investors have been developed and is receiving Government attention.
- The new policy is expected to take effect by July 2000

7. ***Regional Initiative under the East African Co-operation***

- Tremendous progress has been achieved by the East African Securities Regulatory Authorities (EASRA) on harmonization of requirements aimed at building East African capital markets.
- Further impetus to the co-operation has been given following the signing of the East African Community Treaty where capital and securities market co-operation has received prominence treatment in the treaty.
- An action programme has been developed by the East African Securities Regulatory Authorities (EASRA) and specific studies to facilitate further integration have been identified and funding is being sought.

8. ***Promotion of Collective Investment Schemes as a Means of Mobilizing Savings***

- Powers to regulate collective investment schemes included in the published Capital Markets Authority Amendment Bill.
- Guidelines and rules to govern operation of collective investment schemes are being developed and are expected to be published for an exposure period by May 2000.

9. *Strategy Towards a Consolidated Financial Services Regulatory Framework*

- Consultations with the Ministry of Finance and Planning and other relevant institutions on possible policy direction for a consolidated regulatory regime have commenced.
- The policy objective is aimed at addressing fragmentation and ensuring a consolidated framework with departmental specialty within such a regime.
- This is further aimed at building an appropriate regulatory regime for the financial service sector for the next millennium.
- A policy decision on the planned approach is expected by December 2000.

10. *Measures to Promote New Financial Instruments and Savings in Alternative Financial Assets*

- Guidelines on Asset-Backed Securities are being developed and will be discussed with stakeholders as well as other regulators including the Central Bank and the Ministry of Finance and Planning.
- Guidelines will be issued for an exposure period by September 2000.

- The Commercial Paper market is now becoming an active alternative source of financing for the corporate sector following the release of guidelines on corporate bonds and commercial paper.

11. Establishment of a Rating Agency

- Guidelines on establishment of a rating agency have been developed and published incorporating views of stakeholders during December 1999.
- Duff & Phelps African Rating Agency, an associate of Duff & Phelps International which is listed in New York Stock Exchange has announced that it will establish a branch in Kenya with a view to having a full fledged presence during the year 2000.
- Interested parties seeking to establish rating agencies in Kenya are encouraged to apply to the Authority in line with the guidelines.

12. Establishment of Capital Markets Annual Review Forum

- The forum serves as an important platform for a comprehensive review of capital markets development agenda.

- It also offers the stakeholders an opportunity to appraise the performance of the capital markets and more importantly to offer ideas and suggestions on necessary measures or strategies to stimulate capital markets development.
- The Forum has been established, and the first one held during December 1999. The Forum will be undertaken on an annual basis.

Reorganization of Management Functions and Capacity Building

The management philosophy we seek to build is structured on a core foundation of staffing with professionals of the highest ethical and performance standards. These performance standards represent continued improvement and moving targets, motivated by positive accomplishment and optimism.

The Authority also maintains a policy of attracting and retaining a small multi-discipline team of professionals and administrative staff necessary for the efficient and effective fulfillment of its mandate. To this end, management functions were reorganized in January 1999 for improved efficiency. The reorganized management functions are grouped under three core departments. These are as follows.

- *Enforcement and Administration Department* whose functions include enforcement, legal affairs and human resources management;

- *Compliance and Finance Department* whose functions include surveillance, compliance, financial analysis, and CMA accounts; and
- *Research and Corporate Affairs Department* whose functions are research, policy analysis, management of information systems as well as corporate and international affairs.

As part of management reorganization an optimum level of establishment was adopted and additional senior management positions were approved. In this regard each department has a Head and a Manager's position with other several senior support officers. This is aimed at ensuring and sustaining career progression of the staff and high level professional input on specialized areas.

The most valued resource of the Authority is the human capital. In this regard the Authority continues to spend significant resources on manpower development programmes both locally and overseas.

In 1999 alone the authority supported five staff to pursue part-time post-graduate studies in local universities and three others to attend parallel undergraduate programmes.

The Capital Markets Authority has, over the last five years, built a multi-discipline, dedicated and quality team of professional staff, and endeavors to improve their terms of service.

Compliance and Enforcement Actions

Compliance Actions

The Authority's regulatory structure entails the building of an effective system of market oversight including a mechanism for monitoring compliance with specific regulatory requirements. It also includes a strong enforcement programme, all of which are aimed at safeguarding the integrity of the market.

The regulatory framework also entails an annual licensing programme for all market practitioners in order to ensure they continue to comply with oversight regulations as well as the self-regulatory role of the stock exchange on stockbrokers and dealers.

The Authority's surveillance and compliance measures have been strengthened through regular and on-sight inspections and in depth investigations of market operators.

There is now an effective compliance and enforcement capability which is essential for enhancing investor confidence and maintenance of the integrity of the markets and market intermediaries. A certificate of compliance will be issued to all the licensed market operators who fulfill inspectorate requirements with effect from January 1, 2000.

Oversight measures that ensure improved continuous reporting obligations have also been enhanced.

The Authority has required the Nairobi Stock Exchange to enforce its mandate on the need for all operators to fulfill their reporting obligations to the exchange.

Enforcement Matters

During the period under review, the Authority had occasion to intervene in the operations of certain licensees whose activities appeared to put market confidence in jeopardy.

Regulatory action was taken against the following licensees:-

- **Town and Country Securities Limited**

The license to operate as a stockbroker granted to Town and Country Securities Limited was suspended on February 24, 1999 following an investigation and review of the company's operational and financial position, which revealed unsatisfactory state of affairs.

The company was given specific conditions to fulfill during the suspension, including strengthening its financial, operational and management position, as a condition to the lifting of the suspension.

- **Megraj Investment Services Limited**
Following a review of the operations of Megraj Investment Services Limited, the Authority established that the company was conducting activities outside the scope of the investment adviser license granted to it by the Authority. Consequently, the Authority suspended the investment adviser license granted to Megraj Investment Services Limited with effect from Thursday, August 12, 1999, pending further review of the company's operations. The company subsequently closed down its operations in Nairobi.
- **Sterling Securities Limited**
The license to operate as a broker granted to Sterling Securities Limited was suspended for a period of three (3) months effective Thursday, August 12, 1999. The suspension was as a result of operational and management constraints. The company has since been advertised for sale.

Financial Performance and Audited Accounts for the Period Ended June 30, 1999

This report includes the Authority's accounts for the period ended June 30 1999 and the management accounts for the period July 1999 to December 1999. The Authority adopts a 'zero-based' budgetary approach, which requires the expenditure and revenue levels to be justified afresh regardless of realized actual position during the previous years.

The Authority is also endeavoring towards self-sustaining in terms of revenues without imposing significant costs on the market that could become an impediment to development.

The following are the main highlights of the accounts:

- ❖ The Authority realized a total income of KShs.61.5 million for the financial year ended June 30, 1999 as compared to 46.9 million during 1998.
- ❖ Government grant during the period ended June 30, 1999 was KShs.18.6 million compared to Kshs. 21.3 million during 1998.
- ❖ The total expenditure dropped from KShs.76.5 million, including depreciation to Kshs.72.7 million during 1999.
- ❖ The Authority recorded a surplus of Kshs.7.4 million during the period ended June 1999 as compared to a deficit of KShs.8.2 million the previous year.

The details of the Authority's financial statement and accounts are shown in the subsequent pages of this report.

Conclusion

I wish to conclude by stating that the Capital Markets Authority will continue being pro-active in influencing the transformation of development of the capital markets. The architecture of the market development will reflect the growing globalization markets and adoption of the best international practices, all aimed at facilitating and deepening of the financial markets in an open, robust, secure and competitive environment.

The legal framework and prudential regulations will focus mainly on ensuring protection and fairness to all market participants, operators and other stakeholders. It will also be aimed at ensuring continued maintenance and building of investors' confidence in the market place.

Thank you.

A handwritten signature in black ink, appearing to read 'Paul K Melly', with a stylized, cursive script.

Paul K Melly
Chief Executive

PROGRESS TOWARDS THE INTEGRATION OF THE EAST

AFRICAN CAPITAL MARKETS

Background

As part of the efforts towards the integration of the economic activities in East Africa, the capital market regulatory authorities from the three states entered into a Memorandum of Understanding (MoU) in 1997. The MoU sets out the framework and objectives of cooperation in the securities market. The MoU also established the *East African Member States Securities Regulatory Authorities* (EASRA) as the coordinating body for the integration and cooperation activities in the capital markets.

In addition to the MoU, EASRA is also now recognized under Article 80 of the Treaty for East African Cooperation, which was signed in Arusha in November 1999. Article 80 provides for, among other things:-

- ❖ The harmonization of capital markets policies;
- ❖ The harmonization of regulatory and legislative frameworks governing capital markets;
- ❖ The promotion of cooperation among the three stock exchanges;
- ❖ The promotion of cross-border listing and trading of securities; and
- ❖ The development of regional rating system for listed companies.

Membership of EASRA

The membership of EASRA consists of the three regulatory authorities and stock exchanges (i.e. Capital Markets Authority, Kenya; Capital Markets Authority, Uganda; and Capital Markets and Securities Authority, Tanzania, Nairobi Stock Exchange, Uganda Securities Exchange and Dar es Salaam Stock Exchange).

The MoU also allows for representation from the Central Banks of the three states, as well as from the Secretariat to the Commission for East African Cooperation as may be necessary.

Operating Framework of EASRA

EASRA operates through two main organs, namely the Consultative Committee and the Technical Committee.

The Consultative Committee, which meets every quarter, is the main decision making body of EASRA. It is made up of the Chief Executives and Chairmen of both the regulatory authorities and the stock exchanges, as well as the members of the Technical Committee.

The Technical Committee is comprised of the professional staff of the member organizations of EASRA who have specialized expertise in the areas of EASRA operation (i.e. finance, law, accounting and economics).

The Technical Committee has a number of specialized sub-committees.

The Capital Markets Authority of Kenya currently hold the Chairmanship and the Secretariat of EASRA.

Current Projects of EASRA

At its 8th consultative meeting held in Mombasa from the 7th to the 9th of October, 1999, the East African Member States Securities Regulatory Authorities (EASRA) reviewed the progress made so far towards harmonization and integration of the East African capital markets, and agreed on the following projects.

1. Harmonization of Regulatory and Legal Framework

The consultative meeting noted that a lot of work has already been done by EASRA committees in the process of harmonization of the legal and regulatory framework of the three countries.

The meeting, however, resolved that a study be commissioned to further speed up the work already done in developing a comparative position on the various aspects of regulation and legislation in the three markets with a view to recommending the area that require harmonization.

The consultative meeting also underscored the important role played by collective investment schemes in the mobilization of savings for investments. In this regard, therefore, the study on regulatory and legal framework would also consider ways of harmonizing the legislations relating to collective investment schemes.

The Terms of Reference for this study have already been prepared, and identification of consultants and sourcing of funding is underway.

2. Disclosure Standards Framework

It was resolved and agreed that a study already commissioned by CMA(K) on Disclosure Standards Framework be adopted as an East African project, and subsequently, the study be expanded to cover the other two countries. The consultants will be asked to refine the study to include a new section on “Disclosures for Cross-Border Listings”.

3. Market Infrastructure and Institutional Development

EASRA has agreed on the need and objective of an integrated East African capital markets with appropriate infrastructure that links up the three stock exchanges on a virtual basis.

In this regard, therefore, the consultative meeting agreed on terms of reference for study to provide a robust infrastructure for a trading, clearing, settlement and payment system that will facilitate remote linkages and integration of the three stock exchanges. This infrastructure will give access to investors and market players to participate in all the three markets without necessarily having physical presence in each market.

The Terms of Reference for this study have already been prepared, and identification of consultants and sourcing of funding is underway.

4. Fiscal and Monetary Policy Environment

EASRA recognizes the fact that fiscal and monetary policies followed by governments have an impact on capital market operations. It is therefore, essential that those aspects of fiscal and monetary policy that impact on capital markets, are analyzed and understood to enable EASRA to make the necessary recommendations and proposals to the government policy makers.

In this regard, therefore, the consultative meeting agreed that a study already done for CMSA(T) on fiscal policy impediments will be expanded to cover Kenya and Uganda, with a view of recommending the fiscal and monetary policy changes required to facilitate harmonization.

The study is also expected to recommend the policy incentives required to attract more companies to list, and to enhance more investor participation in capital markets.

The Terms of Reference for this study have already been prepared, and identification of consultants and sourcing of funding is underway.

5. Public Education and Awareness

In an effort to enhance professionalism and increase public awareness of the opportunities and risks in capital markets, the consultative meeting resolved that:

- ❖ EASRA will develop a certification program for market professionals; and
- ❖ a public education campaign will be developed using the appropriate means including video shows, TV and radio programs. These programs will be developed in the most appropriate languages including being translated into Kiswahili wherever possible.

6. Credit Rating Agencies

The consultative meeting agreed that the Credit Rating Agencies guidelines issued by CMA Kenya be adopted for use by all the three countries.

It was further agreed that the role of the regulators be facilitative and limited to only providing the framework for registration, as well as accreditation of the credit rating agencies.

CAPITAL MARKETS ENVIRONMENT AND INCENTIVES

The following incentives are available for investments in capital markets.

Taxation Measures

- ❖ Withholding tax on dividend income has been reduced from a high of 15% to 7.5% (for foreign investors) and 5% (for local investors). It has also been made the final tax.
- ❖ Expenses of companies issuing shares to the public are now tax deductible.
- ❖ Expenses incurred by companies in having their financial instruments rated by an independent rating agency are also tax deductible.
- ❖ Registered and approved venture capital funds now enjoy a 10-year tax holiday.
- ❖ Income accruing to registered collective investment schemes is also tax-free
- ❖ Licensed dealers also enjoy tax benefits, as long as they turn their portfolios according to laid down guidelines.
- ❖ Transfer of listed securities is exempt from stamp duty and VAT.

Policy Measures

- ❖ Since January 1995, foreign investors can now participate in the stock market, but with a ceiling of 5% for an individual investor and 40% aggregate in any locally controlled company.
- ❖ In order to encourage the transfer of technology and skills, foreign investors are now allowed to acquire up to 49% of local brokerage firms; and up to 70% of local fund management companies.

CMA DISCLOSURE STANDARDS COMMITTEE

Introduction

The Capital Markets Authority Board approved the establishment of a committee known as Disclosure Standards Committee for a period of three years pursuant to section 14(1) of the Capital Markets Authority Act.

The committee has held six meetings and developed the Guidelines for the Issuance of Corporate Bonds and Commercial Paper released in August 1997 and the Guidelines on Audit Committees released by the Authority in April 1998, as the first part of the Committee's task to develop guidelines on corporate governance.

The Committee is composed of a highly respected team of professionals of diverse background drawn from senior executives from the private sector and representatives of listed companies, accounting and legal professions.

Mandate of the Committee

- (i) The broad mandate of the Committee will include review of the existing disclosure requirements and making recommendations on the formulation of its minimum disclosure standards.
- (ii) The Committee will also act as an important interface between the Authority and issuers of securities as well as other private sector operators in the capital markets.

- (iii) Review and make recommendations on minimum capacity requirements and reporting obligations for auditors of public listed companies.
- (iv) Review and make recommendations on good corporate governance practices by public listed companies.
- (v) It will also serve as a useful forum for building consensus on matters of mandating on good practice disclosure requirements as well as good corporate governance requirements.
- (vi) It shall also undertake any action or measure including development of appropriate strategies towards effective execution of its mandate with due regard to the cost implication of its recommendations.

Composition of the Committee.

The following persons were appointed to be members of the Capital Markets Disclosure and Standards Committee with effect from September 1, 1999.

- | | |
|-----------------------------------------------------------------------------|-------------------------------------------------------------------|
| 1. Daniel M Ndonye
Managing Partner
Deloitte & Touché | 2. Charles Muchene
Country Leader
PricewaterhouseCoopers |
| 3. Robin Mason
Executive Director
Barclaytrust Investment
Services | 4. George Oraro
Senior Partner, Oraro and Company
Advocates |

- | | |
|-------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------|
| <p>5. Zulfiker Alibhai
Partner
Kaplan & Stratton
Advocates</p> | <p>6. Gerald Mahinda
Finance Director
East African Breweries Limited</p> |
| <p>7. Eric Chabanne
Finance Manager
Total Kenya Limited</p> | <p>8. Sheila M’Mjibiwe
Finance Director
Standard Chartered Bank</p> |
| <p>9. Jackson K Maingi
Asst. General Manager
British American
Insurance</p> | <p>10. Chief Executive
Nairobi Stock Exchange</p> |
| <p>11. Chief Executive
Institute of Certified
Public Accountants of
Kenya</p> | <p>12. Chairman
Institute of Certified Public
Secretaries of Kenya</p> |
| <p>13. Representative of the
Central Bank of Kenya</p> | <p>14. Chief Executive
Capital Markets Authority</p> |

Committee’s Chairman and Secretary

The members will elect one among non-institutional members to serve as its Chairman. Mr. Daniel M Ndonge was elected chairman of the Committee for the second time.

The Authority designates a suitable senior CMA staff as the Committee's Secretary. Mr. Simon Peter Ole Nkeri, Manager, Compliance and Finance has been appointed Secretary of the Committee.

The Committee may co-opt any other person whenever it becomes necessary to draw on the person's expertise for a limited period as may be determined by the Committee from time to time.

Term and Frequency of the Meetings

The Committee shall determine its meeting schedules in order to discharge its business.

The members of the Committee shall serve for a period of three years from the date of its constitution.

CENTRAL DEPOSITORY PROJECT GETS UNDERWAY - A ROBUST MARKET INFRASTRUCTURE FOR THE 21ST CENTURY

Project Background

The Central Depository System Project has emerged from a need to establish a robust infrastructure for clearing, settlement and registration activities within Kenya's and the East African region's capital markets. The Project has been driven to date by a Steering Committee set up under the auspices of the Capital Markets Authority (CMA) of Kenya in response to the need to move away from the paper based settlement systems currently in existence within both the equity and debt market.

Growing Global Trend

The establishment of central depositories has been a very significant trend in both developed and emerging countries capital markets over the last ten years. The rapid growth in trading volumes in these markets has driven the need to develop settlement systems that are faster and more efficient than the traditional paper based systems that had historically been in place. Central depositories address this need by acting as "banks" for equity and debt securities.

In the simplest form of transaction, securities are lodged with the depository. Subsequent transfer of ownership of the security are effected by means of "book entry" transactions within the ledgers of the depository, without physical movement of the security taking place.

Highlights of Key Benefits

Some of the key benefits a modern clearing, settlement and central depository system can provide are:

- ❖ Improvement of the infrastructure supporting the capital markets in the region
- ❖ Improvement of the liquidity of the capital markets, thus increases turnover of equity shares in the market
- ❖ Improves transparency in the market and reduction in instances of fraud
- ❖ Lowers the costs of clearing and settlements
- ❖ Faster and less risky settlement of securities, which should make the market more attractive for investors
- ❖ Improved and timely communication from the issuer to the investor, includes reduced delay in receiving dividends and rights and improved information dissemination of critical company information.

The success of depositories in a wide range of markets has been driven by the many other powerful economic benefits they can generate in these markets. In particular, depositories typically bring substantial reductions in the lead times required for settlement of transactions, allowing mandatory trade-to-settlement windows (i.e. the amount of time allowed between a trade and the settlement of that trade) to be shortened. Shorter trade-to-settlement windows in turn generate greater liquidity within the market, which in turn can lead to lower spreads and transaction costs.

Furthermore, because depositories remove the need for physical transfer of securities, they can generate significant cost savings in terms of the average settlement cost of a trade. These cost savings, if passed on, even in part, to investors, will once again improve liquidity and lead to a host of associated benefits.

Current Systems and Risks

The current clearing, settlement and registration infrastructure in Kenya will become increasingly inadequate as Kenya's capital markets continue to develop. Significant increases in transaction volumes and liquidity would raise systematic risk within the existing paper based settlement system to levels, which would be unacceptably high.

Systemic risk represents the degree of risk inherent where outstanding settlement values are sufficiently high for a settlement default in one market segment to result in a knock-on ripple effect through other capital markets and potentially on to the banking system.

Accordingly, this project gives Kenya the opportunity to take a critical look at the current clearing and settlement environment and implement a robust and modern clearing, settlement and central depository environment for the whole East African region.

What is a Central Depository System ("CDS")

A central depository system (CDS) is for securities what a bank is for cash. In its simplest form, a CDS is a computerized "ledger" system that enables the holding and transfer of securities without the need for physical movement. Hence, ownership of a security would be via book entry, rather than by physical exchange.

A simple example best demonstrates how a CDS operates. Company X issues some shares, which are subscribed by party A and party B. Rather than the shares being delivered to A and B, company X delivers the shares to the CDS, who holds those shares in safe custody for A and B. If A decides to sell to B, then in a non-CDS environment, A would deliver the shares to B in exchange for payment via a broker. A manual registration process would then follow this. However, with the CDS the shares would remain in safe custody with a book entry debit to A's account and a credit to B's account. Simultaneously, B will pay A. Thus the CDS plays an important role in bringing together issuers (e.g. corporates), investors (e.g. institutions), intermediaries (e.g. brokers) and interested third parties (e.g. regulators).

How Will the CDS Operate in Practice?

In order to understand the CDS infrastructure, three areas need to be distinguished.

i. Corporate Framework

The CDS will be a separate legal entity to be incorporated and licensed in Kenya to provide central clearing, settlement and depository services for securities held in electronic form. It will be licensed under a law defining all the powers, duties and responsibilities of the company.

ii. Management

The importance of the CDS to the broader objective of capital market development and the fact that the CDS is a start-up Project implies that the quality of the management team will be a critical element of success for the Project.

iii. Functional Structure

The CDS will replace many of the manual paper based procedures that currently exist. For example, it will replace the manual trade settlement process currently in place at the NSE and will replace some of the existing manual corporate actions (e.g. dividend distribution, distribution of rights etc).

Functions of a CDS

The typical functions of a CDS are:

- i) *Immobilization of securities* - this means the storage of securities certificates in a vault in order to eliminate physical movement. The objective is to minimize physical movement of securities, where complete elimination of physical movements is not achievable.
Dematerialized Securities - which means the elimination of physical certificates or documents of title, so that these securities exist only as computer records.
- ii) *Providing book entry accounts* - this means an accounting system for securities and cash, which electronically facilitates the exchange of ownership of securities and the movement of cash. Thus, the securities move between parties without the need for movement of physical documents. The cash moves with aid of cash clearing mechanisms.
- iii) *Delivery Versus Payment (DVP) or Effective DVP* - this means that the exchange of securities and cash payment between counter parties in a transaction occurs simultaneously. In an environment where DVP is possible, cash settlement and beneficial ownership can be transferred intra-day. This requires an electronic link between the CDS and the national central payment system. In Kenya, it is likely that settlement will be on an effective DVP basis. This is whereby the cash settlement element is transferred into the Kenyan banking system.

- iv) Distribution of dividends, interest and redemption monies, handling of corporate actions, notably rights and bonus issues.
- v) Provision of detailed listings of investor holdings by security types.

Why is CDS a Good Idea?

The introduction of the CDS service will serve several goals. When implementing the goals many new business standards will be introduced to the Kenyan capital markets, all of which will have a significant benefit to the domestic and international attractiveness of the markets. These business development goals and associated benefits are described below.

Goal 1 - Achieve electronic straight through processing and eliminate outdated certificate processes

The immediate goal of CDS is to implement a complete end-to-end electronic clearing, settlement and central depository service for immobilized (and ultimately dematerialized) securities. This means all back office securities processing transaction will be undertaken through electronic means. The only exception being company secretarial matters.

The ability to achieve straight through processing ("STP") for pre-settlement, settlement and post settlement transactions means all transactions will be captured electronically and wherever possible will be automated. Thus achieving electronic processing of the pre-settlement, settlement and post settlement ranges of transactions means lower transaction, settlement and market risk.

Electronic STP avoids many of the problems and risks associated with the legacy processes as encapsulated in the current certificated environment (which are from the bygone era of the old UK style 1948 Companies Act). For example, currently settlement problems can prevent an investor re-selling securities due to settlement and re-registration delays.

If a stock goes down in price in the meantime, then the manual processes that are in existence today can prove to create a significant opportunity cost for the investor. An inability to liquidate a position due to re-certification problems is potentially very costly.

The CDS should lower transaction costs by lowering both risk and opportunity costs.

Goal 2 - Immobilize all traded securities

Initially, the majority of securities handled by the CDS will be equities already listed on the NSE. However the proposed CDS legislation has been carefully prepared to allow the sponsors and users of the CDS to provide CDS services for other types of securities. There are three benefits arising from this flexibility:

- i) An opportunity exists to immobilize securities traded on another exchange, especially regionally - by capturing cross-border immobilization of securities, improve liquidity of the local market
- ii) An opportunity exists to immobilize impending privatization securities - this will result in cost efficiencies for issuers and investors

- iii) CDS has the opportunity to immobilize and provide book entry transfer settlement services for government bonds and treasury bills - simplifies the settlement process in the market.

It should be noted that the Central Bank of Kenya (CBK) has recently established its own CDS for the immobilization of government bonds and treasury bills. Once the CDS has been established, CBK may use this for settling and clearing.

Goal 3 - Implementing a CDS will assist national economic development and progress

At the heart of the CDS service will be a high performance central message-processing engine for NSE securities. The engine is the central CDS system. All back office transactions will be processed across this engine in the form of messages and no longer by moving paper/certificates and transfer forms. Access to the CDS settlement engine will be across a secure network with relevant levels of cryptographic protection between central system and its users.

Cryptographic security: means the digital security of electronic messages. This means that every time a participant decides to transmit a message on an immobilized security, the cryptography will ensure that the messages meet certain security standards - for example non-repudiation.

The benefit of this will be that no user will be able to deny that the message was sent from their gateway and similarly any attempts to interfere in the process of message transmission will be prevented and detected.

This electronic packaging or enveloping of messages will significantly improve the quality of security transfers, transaction movements and in practice is infinitely more secure than the certificate equivalents that exist in Kenya today.

A potentially wide range of products can be built on the CDS solution and assuming these are factored into the solution that is ultimately selected. The CDS infrastructure can be used in subsequent phases to implement other message driven services. Examples of such services would include credit cards and loan approval information.

Goal 4 - Ensure CDS operates within modern, fair, transparent and secure rules

Surrounding the CDS technology and procedures will be a comprehensive of CDS rules within which participants will operate. These rules will provide for improved depositor and user protection suitable for a range of electronic commerce transactions. These laws and rules will introduce a range of new standards to Kenya migrating the Kenyan capital markets from a legal infrastructure that was previously developed in the late 1940's. Once Kenya passes the laws and rules for the CDS it will embrace a set of concepts that are more relevant to the next millennium.

At the simplest level the electronic message has a greater business benefit in law when compared to the certificate - under the current law a holder of a certificate has only prima facie evidence of ownership. An investor who has an electronic record within a secure CDS account (and is therefore recorded on the list of depositors) is however deemed to be a member/shareholder of the company.

Enhanced Market Turnover

The benefit of this deeming principle is that the investor will receive dividends more quickly, settlement will be real time and therefore portfolio turnover and therefore liquidity can improve.

In addition, the deeming provision will remove the huge wasted effort in broker back offices, at the NSE and at registrars, chasing overdue settlements, claims on corporate actions, record date cut off problems and the like.

Therefore, in the immediate term as soon as CDS is implemented and the law enacted, it will reduce the evidence of ownership risk associated with certificate holdings. Over the longer term, the presence of the CDS will add significant and much needed infrastructure developments to the Kenyan banking and commercial community which will expedite the time to market for future electronic settlement developments.

This infrastructure will not only improve the efficiency of local commercial transactions, but they will curtail the threats of settlement dis-intermediation whilst attracting additional business to Kenya.

The benefits associated with the business development goals and other benefits to Kenya of the CDS can be summarized in the context of the benefits accruing to the key market participants, as summarized in the table below:

Core Benefits to various Stakeholders

Interested Party	Benefits
1. Economy/Government	<ul style="list-style-type: none">• Improvements of the infrastructure supporting the capital markets will attract more foreign portfolio investment, as this will mean, at a minimum, reduced settlement time and counterpart/settlement risk• Potentially greater mobilized domestic savings Significantly improve liquidity of the capital markets• Lower the cost of capital as a result of improved liquidity
2. CMA and NSE	<ul style="list-style-type: none">• Reduces the systemic risk arising from current clearing and settlement processes• Improves the transparency of the market• Reduction in the instance of fraud as a result of immobilized securities• Establishment of the infrastructure, ensures that any types of securities that may be introduced, such as options, can be cleared safely• Greater market turnover due to improved liquidity Lowers transactions costs• Reduction of settlement risk with introduction of DVP or effective DVP• Improves transparency of the markets

3. Investors
(institutions,
market
professionals and
private investors)

- Faster settlement with associated reduction in funding costs
- Lowers cost of clearing/transfers, through reduced paper work and labor intensive activities
- Improved liquidity as cash flows will be more accurately known and as a result of greater stock turnover
- Elimination of financial loss due to misplacement, forgery or loss of scrip and reduces the evidence of ownership risk
- Improves back office efficiency through standardized procedures and controls (with CDs, brokers, registrars and investors)
- Improved and timely communication from the issuer to the investor, includes reduced delay in receiving benefits and rights and improved information dissemination of company meeting
- Transparency ensures improved investment decisions

APPENDIXES

CMA'S AUDITED FINANCIAL STATEMENTS FOR THE FINANCIAL YEAR ENDED JUNE 1999

CAPITAL MARKETS AUTHORITY

FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 1999

CONTENTS	PAGES
Authority members and advisors	64
Report of the members of the Authority	65
Report of the auditors	66
Income and expenditure account	67
Balance sheet	68
Cash flow statement	69
Notes to the financial statements	70 – 74

CAPITAL MARKETS AUTHORITY

AUTHORITY MEMBERS AND ADVISORS

MEMBERS OF THE AUTHORITY

The present members of the authority are:

Mr. Denis D Afande	-	Chairman
Mr. Isaac Awuondo		
Mr. Desterio Oyatsi		
Mr. James Boyd McFie		
Mr. Kimanthi Mutua		
Mr. Leonard Njagi		
Dr Edward Sambili		
Mr. Martin Oduor-Otieno	-	Permanent Secretary to the Treasury
Mr. Micah Cheserem	-	Governor, Central Bank of Kenya
Hon Amos Wako	-	Attorney General
Mr. Mwachazi Mwachofi	-	(Alternate to the Permanent Secretary, Treasury)
Dr Thomas Kibua	-	(Alternate to Governor, Central Bank of Kenya)
Mr. Dan Ameyo	-	(Alternate to Attorney General)
Mr. Paul K Melly	-	Chief Executive

CHIEF EXECUTIVE

Mr. Paul K Melly
P O Box 74800
Nairobi

BANKERS

Kenya Commercial Bank Limited
Harambee Plaza
P O Box 58166
Nairobi

Savings and Loans Kenya Limited
Mama Ngina Street
P O Box 49129
Nairobi

AUDITORS

Deloitte & Touché
"Kirungii", Ring Road, Westlands
P O Box 40092
Nairobi

CAPITAL MARKETS AUTHORITY

REPORT OF THE MEMBERS OF THE AUTHORITY

The members of the authority have pleasure in presenting their report and audited financial statements for the year ended 30 June 1999.

INCORPORATION

Capital Markets Authority is a body corporate established under the Capital Markets Authority Act, Cap 485A, 1989, which became operational on 15 December 1989.

ACTIVITIES

The Authority promotes and facilitates the development of an orderly, fair and efficient capital market in Kenya. It licenses, regulates and supervises the operators in the capital market.

RESULTS

	1999 Sh
Total income from services for the year	61,506,846
Total expenditure for the year	(72,734,949)

Gross deficit from services	(11,228,103)
Government grants	18,644,500

Surplus transferred to the general fund	7,416,397
	=====

AUTHORITY MEMBERS

The present members of the authority are shown on page 64

AUDITORS

The auditors, Deloitte & Touché, have expressed their willingness to continue in office.

BY ORDER OF THE BOARD



PAUL K MELLY

Chief Executive

Nairobi

17 December 1999



REPORT OF THE AUDITORS TO THE MEMBERS OF
CAPITAL MARKETS AUTHORITY

We have audited the financial statements on pages 67 to 74 and have obtained all the information and explanations considered necessary for our audit.

The financial statements are the responsibility of the members of the authority. Our responsibility is to express an opinion on the financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. These standards require that we plan and perform the audit to obtain reasonable assurance as to whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by the members, and evaluating the overall financial statement presentation.

In our opinion, proper books of account have been kept by the Authority and the financial statements, which are in agreement therewith, comply with the Capital Market Authority (CMA) Act and give a true and fair view of the Authority’s state of affairs at 30 June 1999 and of its surplus and cash flows for the year ended on that date.

Deloitte & Touche

17 December

CAPITAL MARKETS AUTHORITY

INCOME AND EXPENDITURE ACCOUNT FOR THE YEAR ENDED 30 JUNE 1999

	Note	1999 Sh	1998 Sh
FEE INCOME	2	57,306,033	40,678,184
INTEREST INCOME		3,398,764	3,957,452
OTHER INCOME		802,049	2,356,456
		<hr/>	<hr/>
TOTAL INCOME FROM SERVICES		61,506,846	46,992,092
EXPENDITURE	3	(72,734,949)	(76,557,967)
		<hr/>	<hr/>
GROSS DEFICIT FROM SERVICES		(11,228,103)	(29,565,875)
GOVERNMENT GRANTS	1	18,644,500	21,328,700
		<hr/>	<hr/>
SURPLUS/(DEFICIT) FOR THE YEAR	10	7,416,397	(8,237,175)
		<hr/> <hr/>	<hr/> <hr/>

CAPITAL MARKETS AUTHORITY

BALANCE SHEET 30 JUNE 1999

	Note	1999 Sh	1998 Sh
FIXED ASSETS	4	6,044,260	9,803,211
STAFF CAR LOANS - LONG TERM		4,139,391	3,226,403
CURRENT ASSETS			
Debtors	5	16,929,590	9,242,133
Investors Compensation Fund bank balance		15,435,625	13,603,130
Staff Housing Loan Fund bank balance	6	12,850,000	12,850,000
Staff Benevolent Fund bank balance		805,199	531,552
Fixed deposits		12,540,721	12,000,000
Bank and cash balances		1,034,476	1,379,601
		59,595,611	49,606,416
CURRENT LIABILITIES			
Creditors	7	4,589,640	7,942,460
Investors' Compensation Fund	8	17,655,032	14,839,522
Staff Benevolent Fund		738,197	474,052
		22,982,869	23,256,034
NET CURRENT ASSETS		36,612,742	26,350,382
		46,796,393	39,379,996
Financed by:			
CAPITAL FUND	9	29,884,508	29,884,508
GENERAL FUND	10	16,911,885	9,495,488
		46,796,393	39,379,996

The financial statements on pages 67 to 74 were approved by the members of the authority on 17 December 1999 and were signed on its behalf by:

DENIS D AFANDE

) CHAIRMAN

) 

PAUL K MELLY

) CHIEF EXECUTIVE

CAPITAL MARKETS AUTHORITY

CASH FLOW STATEMENT
FOR THE YEAR ENDED 30 JUNE 1999

	Note	1999 Sh	1998 Sh
NET CASH INFLOW/(OUTFLOW) FROM OPERATING ACTIVITIES	11(a)	376,870	(8,567,433)
		<hr/>	<hr/>
RETURNS ON INVESTMENTS AND SERVICING OF FINANCE			
Interest received		3,564,476	4,887,671
		<hr/>	<hr/>
INVESTING ACTIVITIES			
Purchase of fixed assets		(1,704,608)	(511,101)
Proceed of sale of fixed assets		65,000	-
		<hr/>	<hr/>
NET CASH OUTFLOW FROM INVESTING ACTIVITIES		(1,639,608)	(511,101)
		<hr/>	<hr/>
INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS	11(c)	2,301,738	(4,190,863)
		<hr/> <hr/>	<hr/> <hr/>

CAPITAL MARKETS AUTHORITY

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 30 JUNE 1999

1 ACCOUNTING POLICIES

(a) BASIS OF ACCOUNTING

The financial statements have been prepared under the historical cost basis, modified to include the revaluation of certain fixed assets.

(b) GOVERNMENT GRANTS

Government grants are accounted for when received.

(c) FEES, INTEREST AND OTHER INCOME

Fees, interest and other income are accounted for on the accruals basis.

(d) DEPRECIATION

Depreciation is calculated on the straight-line basis to write off the cost of fixed assets over their estimated useful lives at the following rates:

Furniture and fittings	12.5%
Equipment	20.0%
Motor vehicles	25.0%

	1999 Sh	1998 Sh
2 FEE INCOME		
Capitalization, rights and new issues fees	37,237,198	21,347,080
NSE - Transaction fees	15,002,335	14,341,604
Application and licensing fees	5,066,500	4,989,500
	<u>57,306,033</u>	<u>40,678,184</u>
3 EXPENDITURE		
Personnel costs	33,911,636	32,527,328
Rent	8,281,411	10,034,534
Training and conferences	8,715,977	11,173,730
Depreciation expense	4,748,569	4,894,385
Public Education, printing and stationery	2,704,501	4,862,907
Medical Scheme and Insurance expenses	2,114,833	1,934,599
Entertainment and public relations	1,938,688	1,624,368
Telephone and postage	1,879,498	1,764,356
Computer and equipment operating expenses	1,470,664	1,509,184
Motor vehicle running expenses	1,423,483	1,092,074
Subscriptions	1,038,646	1,117,876
Miscellaneous expenses	968,986	-
Utilities	866,638	842,422
Authority members allowances	865,000	1,174,626
Loss on disposal of assets	649,990	-
Professional and Market Development Services	540,376	1,550,328
Staff uniforms	371,053	212,384
Audit fees - current year	250,000	210,000
- prior year	(5,000)	32,866
	<u>72,734,949</u>	<u>76,557,967</u>

Included in training and conferences expenses is Sh 2,527,550 being the Authority's contribution in hosting the 1998 IOSCO conference.

CAPITAL MARKETS AUTHORITY

NOTES TO THE FINANCIAL STATEMENTS (Continued)

4 FIXED ASSETS

	Motor vehicles Sh	Office equipment Sh	Furniture and fittings Sh	Total Sh
COST				
At 1 July 1998	6,419,737	9,051,863	14,218,681	29,690,281
Additions at cost	-	1,704,608	-	1,704,608
Disposals	-	(4,574,939)	-	(4,574,939)
As at 30 June 1999	6,419,737	6,181,532	14,218,681	26,819,950
COMPRISING:				
At cost	4,420,737	6,181,532	14,218,681	24,820,950
1996 valuation	1,624,000	-	-	1,624,000
1998 valuation	375,000	-	-	375,000
At 30 June 1999	6,419,737	6,181,532	14,218,681	26,819,950
DEPRECIATION				
At 1 July 1998	3,563,527	5,942,202	10,381,341	19,887,070
Charge for the year	1,601,700	1,830,539	1,316,330	4,748,569
Eliminated on disposals	-	(3,859,949)	-	(3,859,949)
As at 30 June 1999	5,165,227	3,912,792	11,697,671	20,775,690
NET BOOK VALUE				
At 30 June 1999	1,254,510	2,268,740	2,521,010	6,044,260
At 30 June 1998	2,856,210	3,109,661	3,837,340	9,803,211

CAPITAL MARKETS AUTHORITY

NOTES TO THE FINANCIAL STATEMENTS (Continued)

	1999 Sh	1998 Sh
5	DEBTORS	
	6,612,387	1,762,945
	2,458,166	2,690,245
	3,940,000	1,500,000
	1,432,320	1,012,654
	1,153,220	114,500
	958,183	748,536
	200,000	200,000
	175,314	341,026
	-	36,954
	-	835,273
	<u>16,929,590</u>	<u>9,242,133</u>

6 STAFF HOUSING LOAN FUND BANK BALANCE

This represents the amount deposited as security with Savings and Loans (K) Limited for staff mortgage scheme which was established in 1996.

	1999 Sh	1998 Sh
7	CREDITORS	
	2,106,623	5,501,706
	1,163,531	278,308
	1,069,486	851,394
	250,000	250,000
	-	1,061,052
	<u>4,589,640</u>	<u>7,942,460</u>

CAPITAL MARKETS AUTHORITY

NOTES TO THE FINANCIAL STATEMENTS (Continued)

8 INVESTORS' COMPENSATION FUND

Under Section 18 of Capital Markets Authority Act, Cap 485A, the Authority is required to maintain a Fund to be known as the Investor Compensation Fund for the purpose of granting compensation to investors' who may suffer pecuniary loss resulting from the failure of a licensed broker or dealer to meet its contractual obligations. This requirement was implemented in July 1995.

The fund derives its income from the following sources:

- (i) 35% of the interest accruing on funds received from subscribers to public issues, between the day of closing the issue and making of the refunds.
- (ii) 0.01% of the consideration from sale and purchase of shares through the Nairobi Stock Exchange.
- (iii) Interest earned from investment of the funds

The Authority charges the fund management fees as follows:

The fees are charged at the rate of 6% of the Fund balance at the end of each financial year subject to a minimum of Sh 600,000 and a maximum of Sh 800,000 per year.

The movement in the fund balance during the year is as shown below:

	1999 Sh	1998 Sh
New shares issued	207,383	163,918
Nairobi Stock Exchange transactions fees	1,123,080	947,848
Interest on investments	2,285,047	1,020,290
Management fees - 1998 charge represented three years charge to 30 June 1998	(800,000)	(2,160,000)
	<u>2,815,510</u>	<u>(27,944)</u>

9 CAPITAL FUND

At 1 July	29,884,508	29,509,508
Revaluation surplus	-	375,000
	<u>29,884,508</u>	<u>29,884,508</u>

10 GENERAL FUND

At 1 July	9,495,488	17,732,663
Surplus/(deficit) for the year	7,416,397	(8,237,175)
	<u>16,911,885</u>	<u>9,495,488</u>

CAPITAL MARKETS AUTHORITY

NOTES TO THE FINANCIAL STATEMENTS (Continued)

	1999	1998
	Sh	Sh
11	NOTES TO THE CASH FLOW STATEMENT	
(a)	Reconciliation of surplus/(deficit) for the year to net cash inflow/(outflow) from operating activities	
	Surplus/(deficit) for the year	(8,237,175)
	Depreciation	4,894,385
	Interest receivable	(3,957,452)
	Loss on disposal of assets	-
	Increase in debtors	(3,993,216)
	(Decrease)/increase in creditors	1,843,251
	Increase/(decrease) in investors compensation fund	(27,944)
	Increase in staff benevolent fund	187,200
	Increase in staff car loans	723,518
	<u>Net cash inflow/(outflow) from operating activities</u>	<u>(8,567,433)</u>
(b)	Analysis of cash and cash equivalents	
	Bank and cash balances	1,379,601
	Staff house loan fund bank balances	12,850,000
	Staff benevolent fund bank balance	531,552
	Investors compensation fund bank balance	13,603,130
	Fixed deposits	12,000,000
	<u>42,666,021</u>	<u>40,364,283</u>
(c)	Analysis of changes in cash and cash equivalents	
	At 1 July	44,555,146
	Increase/(decrease) in cash and cash equivalents	(4,190,863)
	<u>At 30 June</u>	<u>40,364,283</u>

**CMA UN-AUDITED INCOME AND EXPENDITURE STATEMENT
FOR SIX MONTHS TO DECEMBER 31, 1999**

	1999 <u>Ksh</u>	1998 <u>Ksh</u>
Fees Income	18,681,954.10	23,165,168.00
Interest Income	1,563,161.90	2,875,664.00
Other Incomes	<u>87,948.00</u>	<u>159,445.00</u>
<i>Total Income From Services</i>	<i>20,333,064.00</i>	<i>26,200,277.00</i>
Less Expenditure	<u>(37,905,925.75)</u>	<u>(27,276,649.00)</u>
<i>Gross Deficit</i>	<i>(17,855,251.75)</i>	<i>(1,076,372.00)</i>
Government Grants	<u>15,000,000.00</u>	<u>7,976,250.00</u>
<i>Surplus (Deficit)</i>	<i>(2,572,861.75)</i>	<i>6,899,878.00</i>
	=====	=====

FIVE-YEAR FINANCIAL REVIEW

INCOME AND EXPENDITURE ACCOUNT FOR THE YEAR ENDED 30 JUNE

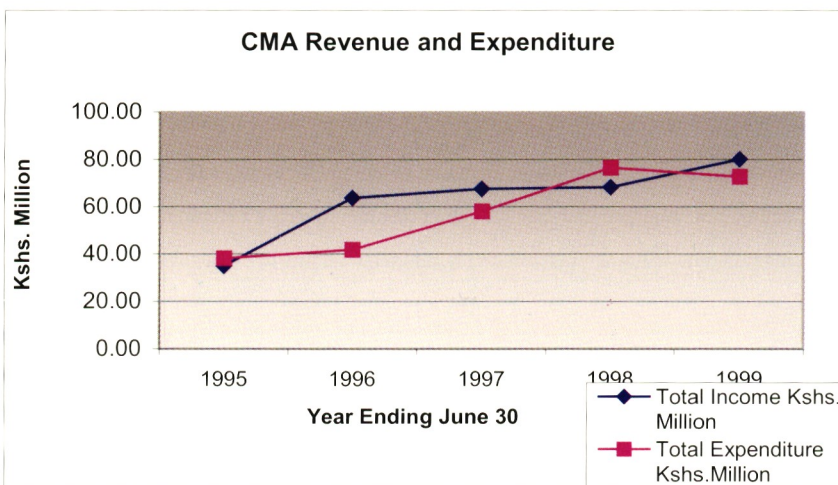
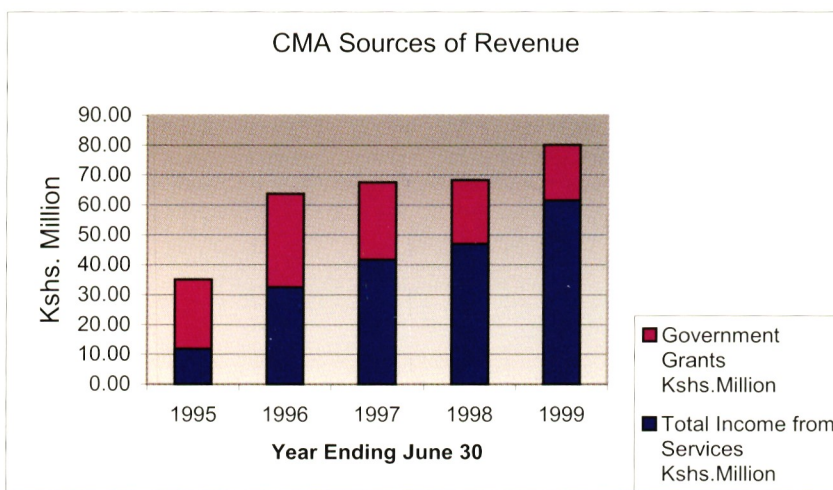
	1999	1998	1997	1996	1995
	<u>Sh</u>	<u>Sh</u>	<u>Sh</u>	<u>Sh</u>	<u>Sh</u>
Fees Income	57,306,033	40,678,184	34,678,550	28,041,621	1,690,000
Interest Income	3,398,764	3,957,452	5,773,175	1,988,505	2,021,740
Other Incomes	802,049	2,356,456	1,219,359	2,542,105	8,140,972
Total Income from Services	<u>61,506,846</u>	<u>46,992,092</u>	<u>41,671,084</u>	<u>32,572,231</u>	<u>11,852,712</u>
Total Expenditure	<u>(72,734,949)</u>	<u>(76,557,967)</u>	<u>(57,971,431)</u>	<u>(42,027,242)</u>	<u>(38,280,600)</u>
Gross (deficit)/surplus from Services	<u>(11,228,103)</u>	<u>(29,565,875)</u>	<u>(16,300,347)</u>	<u>(9,455,011)</u>	<u>(26,427,888)</u>
Government Grants	<u>18,644,500</u>	<u>21,328,700</u>	<u>25,853,980</u>	<u>31,106,820</u>	<u>23,263,786</u>
Surplus/(Deficit) for the Year	<u>7,416,397</u>	<u>(8,237,175)</u>	<u>9,553,633</u>	<u>21,651,809</u>	<u>(3,164,102)</u>

BALANCE SHEET AS AT 30 JUNE

Fixed Assets	6,044,260	9,803,211	13,811,495	16,976,664	11,002,221
Staff Car Loans – Long term	4,139,391	3,226,403	3,949,921	3,238,441	-
	<u>10,183,651</u>	<u>13,029,614</u>	<u>17,761,416</u>	<u>20,215,105</u>	<u>11,002,221</u>
Current Assets					
Debtors	16,929,590	9,242,133	6,179,136	4,319,984	6,407,789
Investors Compensation Fund bank balance	15,435,625	13,603,130	12,748,168	4,635,310	-
Staff Housing Loan Fund bank balance	12,850,000	12,850,000	7,850,000	-	-
Staff Benevolent Fund bank balance	805,199	531,552	344,352	15,900	-
Fixed deposits	12,540,721	12,000,000	20,533,555	17,290,256	4,000,000
Bank and cash balances	1,034,476	1,379,601	3,079,071	416,258	915,866
	<u>59,595,611</u>	<u>49,606,416</u>	<u>50,734,282</u>	<u>26,677,708</u>	<u>11,323,655</u>
Current Liabilities					
Creditors	4,589,640	7,942,460	6,099,209	4,213,997	6,299,849
Investors' Compensation Fund	17,655,032	14,839,522	14,867,466	4,751,778	-
Staff Benevolent Fund	738,197	474,052	286,852	238,500	-
	<u>22,982,869</u>	<u>23,256,034</u>	<u>21,253,527</u>	<u>9,204,275</u>	<u>6,299,849</u>
Net Current Assets	<u>36,612,742</u>	<u>26,350,382</u>	<u>29,480,755</u>	<u>17,473,433</u>	<u>5,023,806</u>
	<u>46,796,393</u>	<u>39,379,996</u>	<u>47,242,171</u>	<u>37,688,538</u>	<u>16,026,027</u>
Financed by:					
Capital Fund	29,884,508	29,884,508	29,509,508	29,509,508	20,829,908
General Fund	16,911,885	9,495,488	17,732,663	8,179,030	(4,803,881)
	<u>46,796,393</u>	<u>39,379,996</u>	<u>47,242,171</u>	<u>37,688,538</u>	<u>16,026,027</u>

Summary of Revenues and Expenditure (Kshs Million) : 1994/95 – 1998/99

	1994/95	1995/96	1996/97	1997/98	1998/99
Revenue from Services	11.8	32.6	41.7	47.0	61.5
Govt. Grants	23.3	31.1	25.9	21.3	18.6
Total Revenues	35.1	63.7	67.6	68.3	80.1
Total Expenditure	38.3	42.0	58.0	76.6	72.7

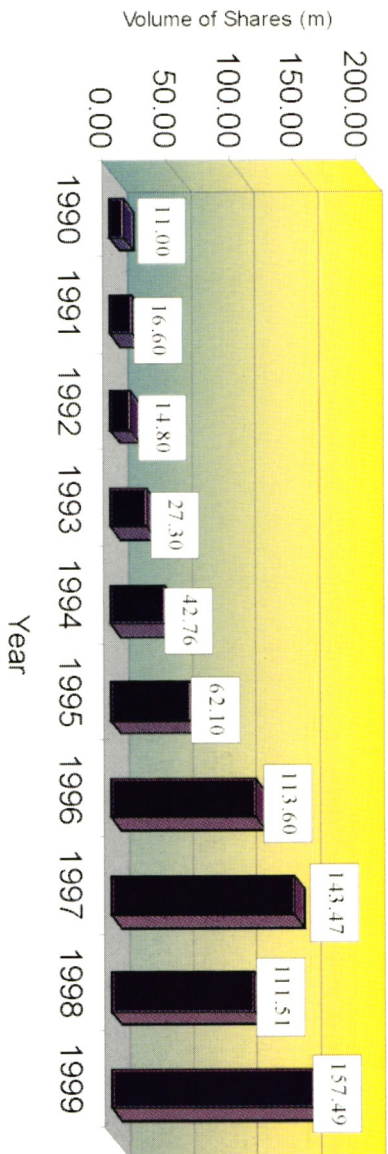


MARKET STATISTICS

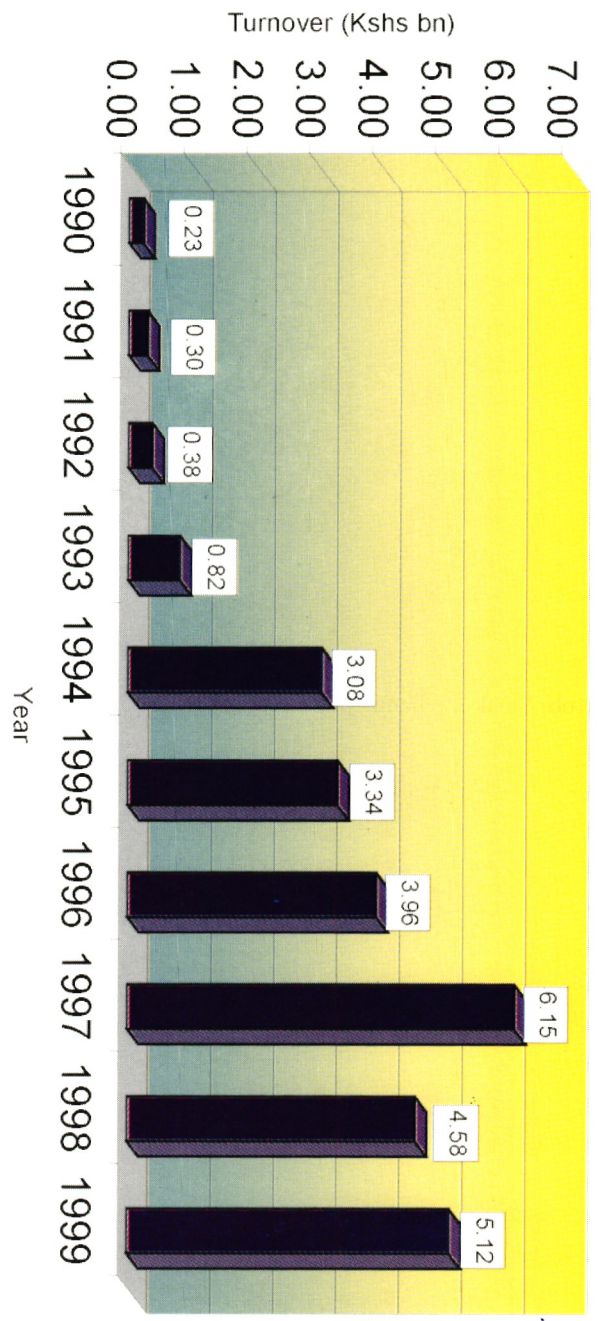
Table 1: Gross Market Statistics (Equities)

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Shares Vol. (m)	11.00	16.60	14.80	27.30	42.76	62.10	113.60	143.47	111.11	157.49
Turnover (Kshs bn)	0.23	0.30	0.38	0.82	3.08	3.34	3.96	6.15	4.58	5.12
Mkt. Cap. (Kshs bn)	10.90	12.71	23.00	72.00	136.83	107.20	98.68	114.31	128.94	106.74
Index (End of Year)	915	958	1167	2514	4559	3469	3114	3115	2962	2303

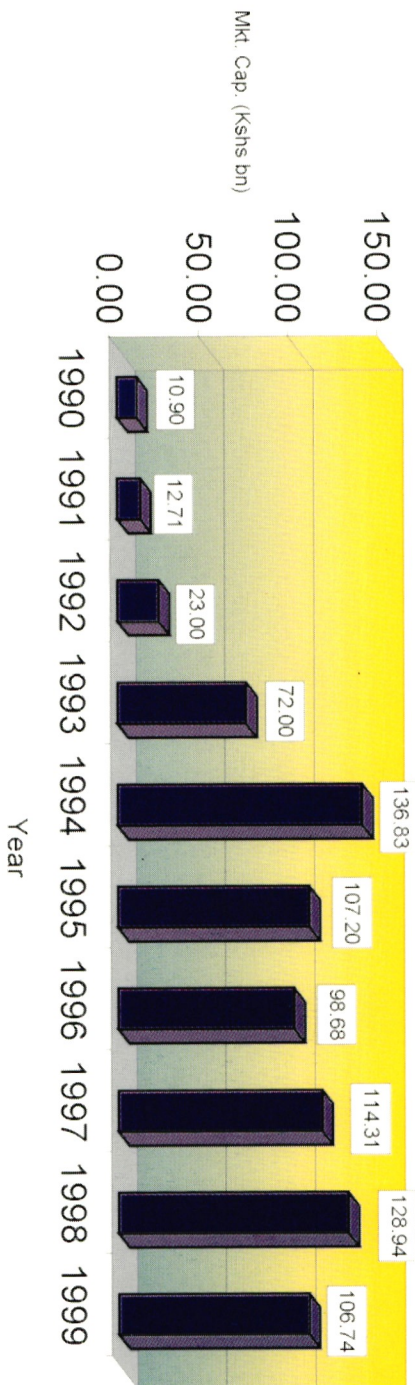
Volume of Shares Traded, 1990 - 1999 (million)



Value of Shares Traded (Turnover), 1990 - 1999 (Kshs billion)



Market Capitalisation, 1990 - 1999 (Kshs billion)



NSE 20-Share Index, 1990 - 1999 (End of Year, 1966 = 100)

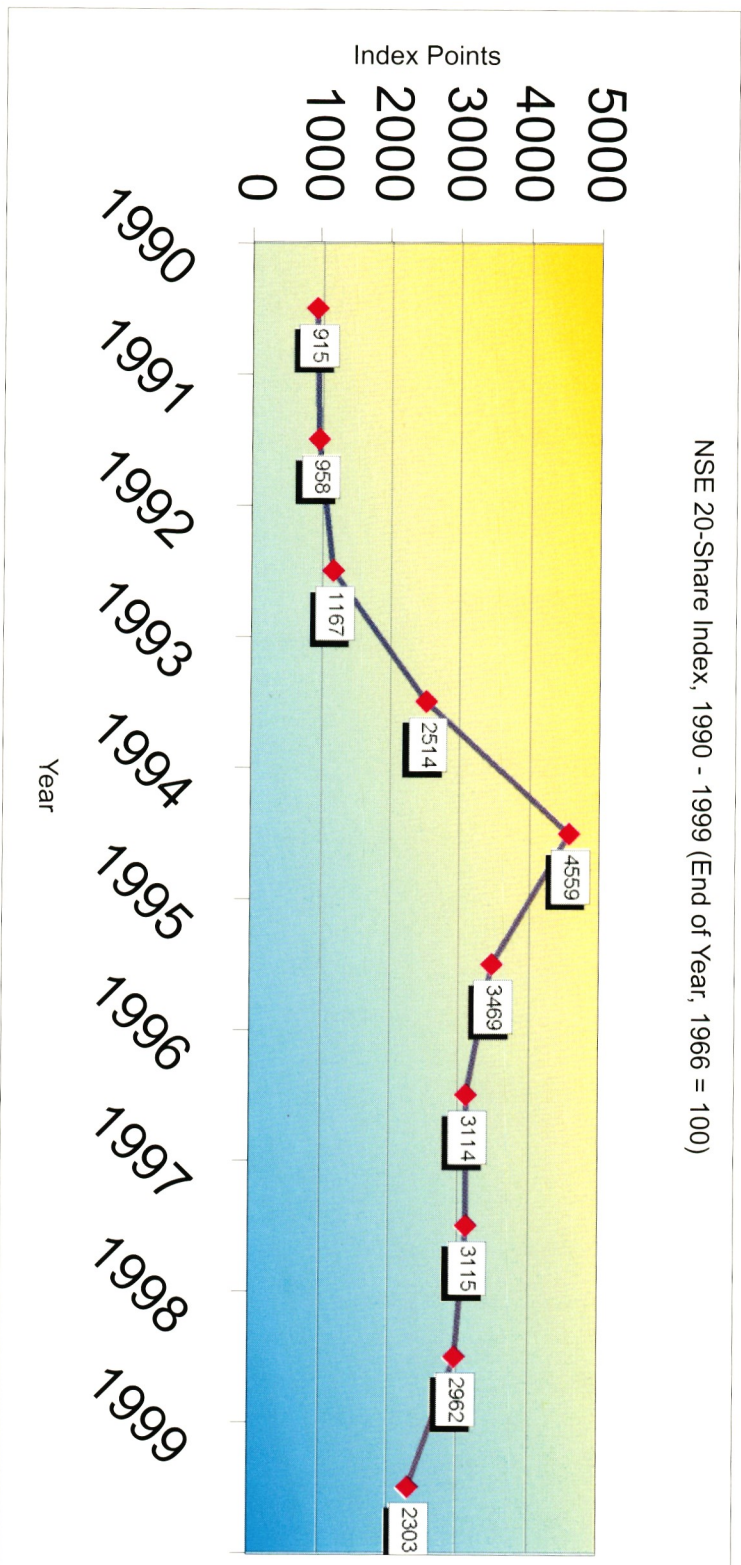


Table 2 (a): Sectoral Statistics (Equities), 1995 - 1999

	1995	1996	1997	1998	1999
Market Cap. (Kshs bn)					
Agricultural	14.50	13.62	11.74	14.88	10.50
Commercial	7.25	12.50	13.81	15.23	12.64
Financial	50.85	41.78	43.93	48.01	40.64
Industrial	34.61	30.80	44.83	50.82	42.93

Sectoral Market Capitalisation, 1995 - 1999 (Kshs billion)

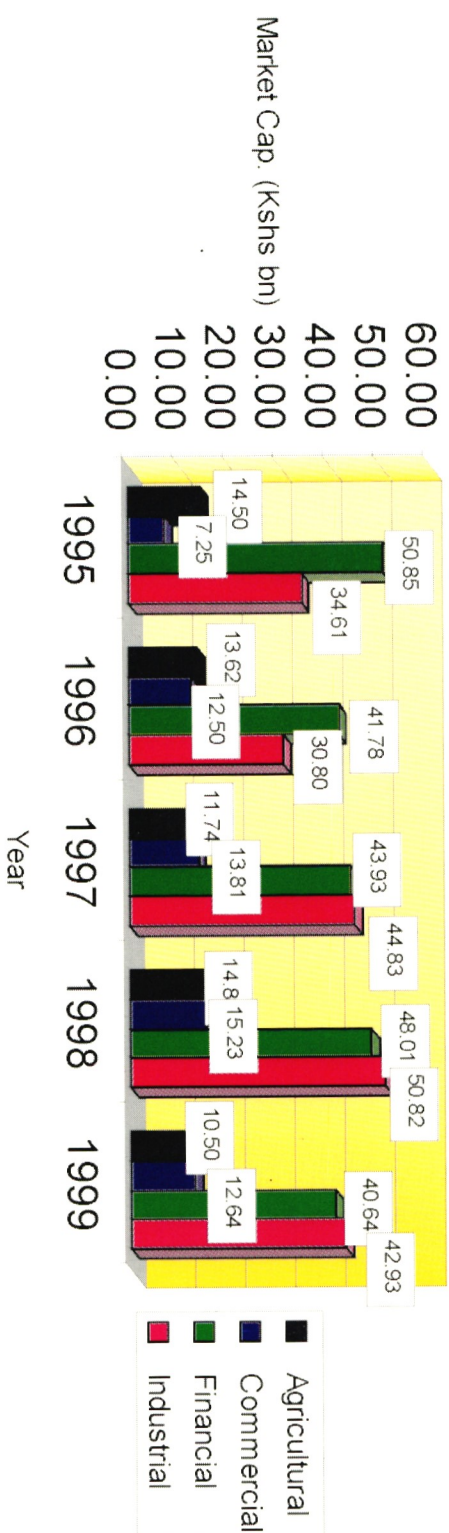


Table 2 (b): Sectoral Statistics (Equities), 1995-1999

	1995	1996	1997	1998	1999
Turnover (Kshs bn)					
Agricultural	0.25	0.20	0.59	0.45	0.26
Commercial	0.50	0.83	0.97	0.65	1.09
Financial	1.53	1.75	2.50	1.87	1.63
Industrial	1.06	1.18	2.09	1.61	1.83

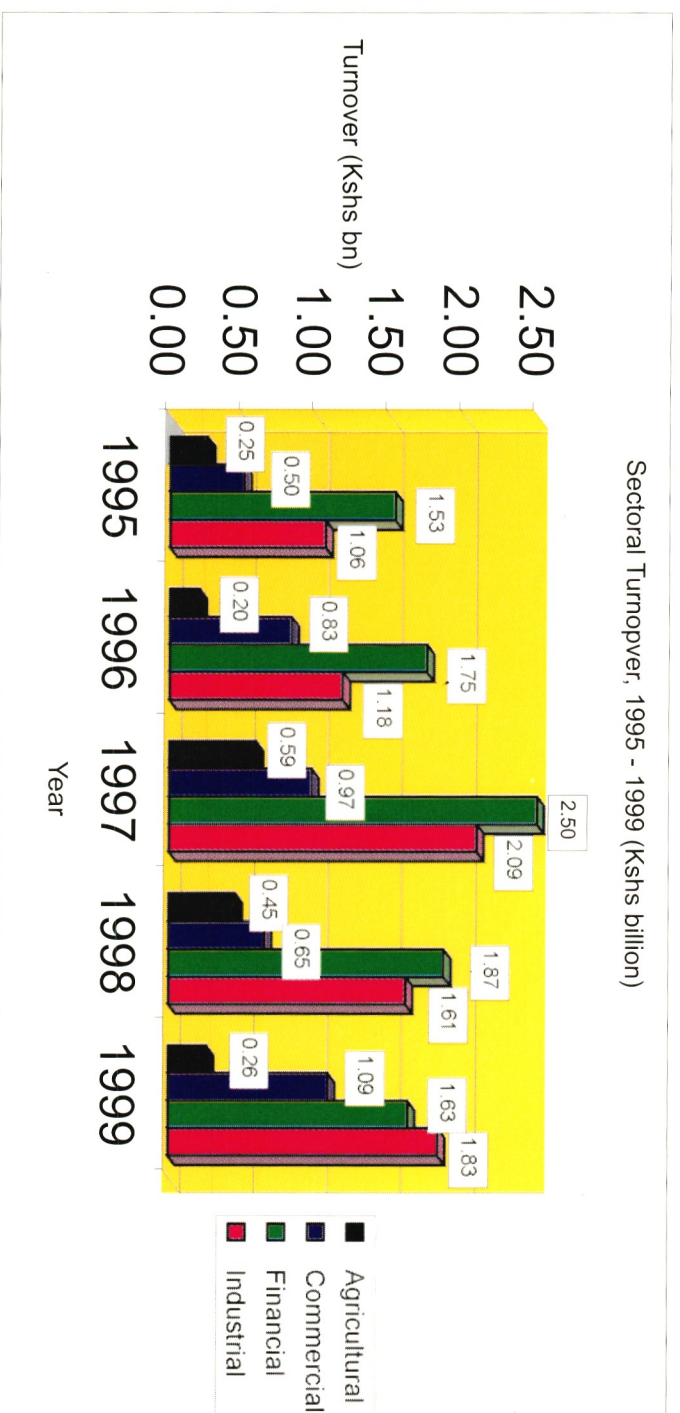


Table 3: Foreign Investors Statistics (Equities), 1995 - 1999

	1995	1996	1997	1998	1999
Gross Turnover (Kshs bn)	0.22	0.99	2.23	1.16	1.13
Net Inflow (Kshs bn)	0.17	0.60	1.58	0.08	0.013

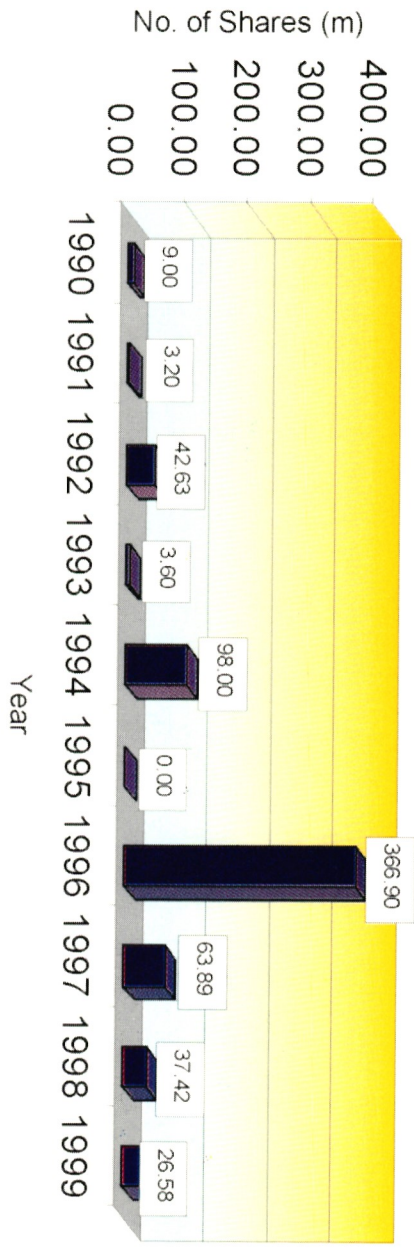
Table 4: Bond Statistics, 1997 - 1999

	1997	1998	1999
Turnover (Kshs bn)	15.08	8.22	8.07

Table 5: New Public Offerings and Rights Issues, 1990 - 1999

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	Cum. Total
No. Of New Issues	1	1	3	2	3	0	5	3	2	1	21
No. Of New Shares (m)	9.00	3.20	42.63	3.60	98.00	0.00	366.90	63.89	37.42	26.58	651.22
Value of New Shares (Kshs bn)	0.30	0.04	0.50	0.06	2.80	0.00	4.93	1.94	2.10	0.37	13.04

Number of Shares from IPOs and Rights Issues, 1990 - 1999 (millions)



Value of Shares from IPOs and Rights Issues, 1990 - 1999 (Kshs billion)

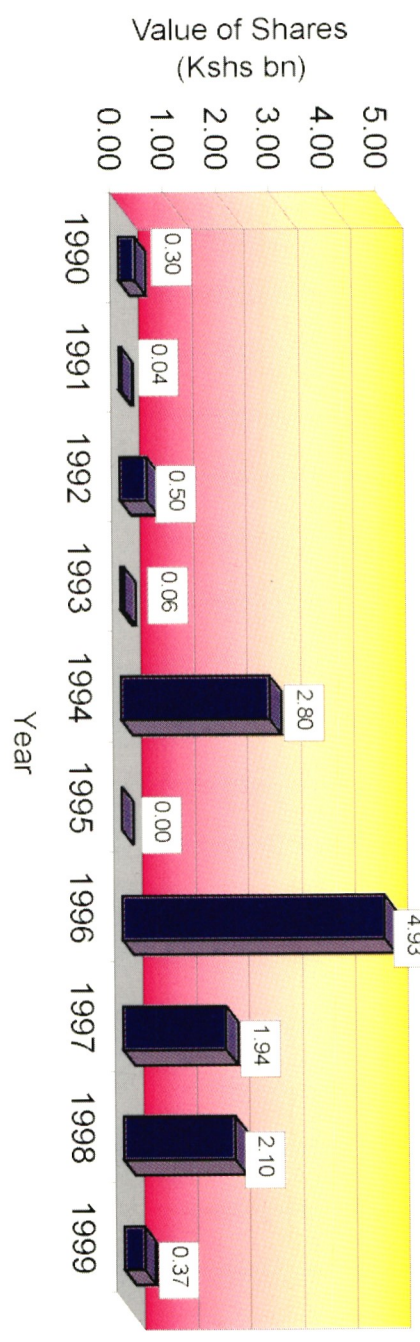
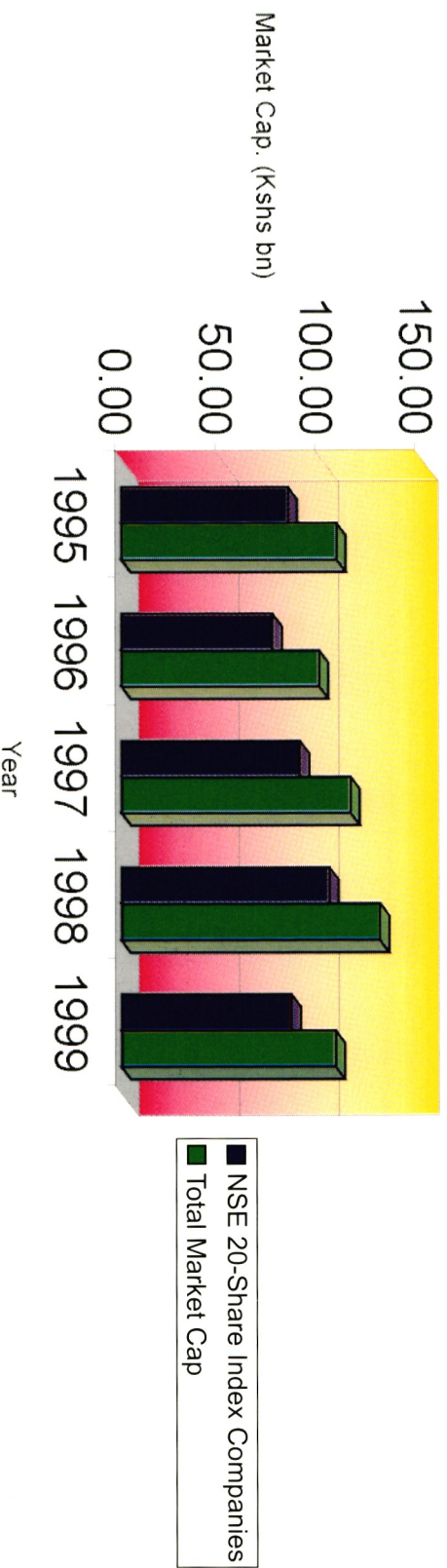


Table 6: NSE 20-Share Index Companies (Market Capitalization Kshs billion)

	1995	1996	1997	1998	1999
Brooke Bond	9.29	8.21	5.38	6.89	5.08
George Williamson	0.75	0.61	0.75	1.23	0.81
Kakuzi	1.84	1.91	1.88	2.76	1.71
Sasini	1.62	1.50	2.38	2.66	1.71
Kenya Airways/CMC**	0.72	3.95	3.46	3.76	3.62
Lonrho Motors	2.34	2.74	2.49	1.40	0.85
Nation Media	1.16	1.30	2.34	4.88	3.57
Uchumi Supermarkets	1.60	2.14	2.34	2.64	2.40
Barclays Bank	16.82	12.79	14.79	20.06	15.89
Diamond Trust	4.13	2.54	1.73	1.75	2.07
Kenya Commercial Bank	7.15	8.08	8.64	6.90	3.53
Standard Chartered Bank	8.74	7.99	7.58	8.32	9.31
Bamburi Cement	5.73	4.72	13.16	13.07	9.53
British American Tobacco	6.68	4.73	3.75	5.74	5.81
BOC Gases	1.42	1.05	1.28	1.39	1.26
East African Breweries	3.52	3.31	3.18	6.27	6.55
East African Packaging	0.53	0.53	0.38	0.12	0.80
Kenya National Mills	1.03	0.91	1.00	1.14	0.64
Kenya Power & Lighting	3.08	2.48	9.50	9.89	6.56
Total Kenya	4.79	3.64	2.94	2.74	2.70
Total	82.94	75.13	88.95	103.61	84.40
As % of Total Mkt. Cap.	77.37%	76.13%	77.81%	80.36%	80.15%
Total Market Cap. (Kshs bn)	107.20	98.68	114.31	128.94	106.74

*** In 1995 CMC Holdings was a constituency company of the Index before being replaced by Kenya Airways from 1996 onwards.*

Market Capitalisation (Total vs NSE 20-Share Index Companies), 1995 - 1999



Market Capitalisation, 1990 - 1999 (Kshs billion)

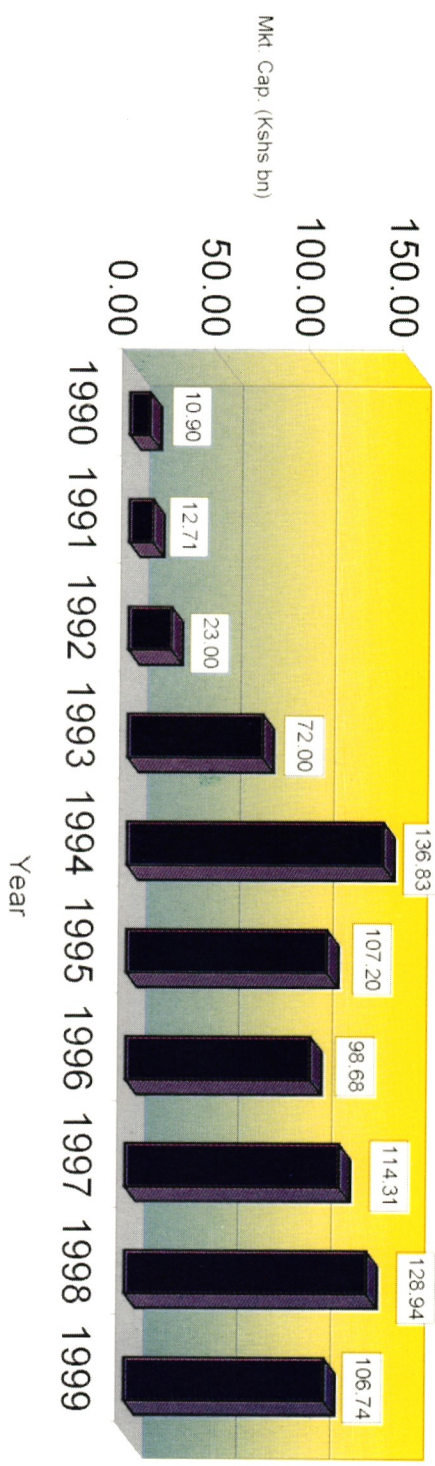


Table 7: NSE Top Ten Companies in Market Capitalization, 1995 – 1999

Company	1995	1996	1997	1998	1999
Barclays Bank	16.82	12.79	14.79	20.06	15.89
Brooke Bond	9.29	8.21	5.38	6.89	5.08
Standard Chartered Bank	8.74	7.99	7.58	8.32	9.31
Kenya Commercial Bank	7.15	8.08	8.64	6.90	
British American Tobacco	6.68	4.73	3.75	5.74	5.81
Bamburi Cement	5.73	4.72	13.16	13.07	9.53
Total	4.75	3.64			
National Bank	4.65				
Firestone	4.59	5.10	4.36	4.48	4.45
Diamond Trust Bank	4.13				
Kenya Airways		3.95	3.46		3.62
East African Breweries		3.31	3.18	6.27	6.55
Kenya Power & Lighting			9.50	9.89	7.56
Nation Media				4.88	3.56
Total	72.53	62.52	73.80	86.50	71.36
<i>As % of Total Mkt. Cap</i>	67.66%	63.36%	64.56%	67.09%	66.85%
Total Market Cap. (Kshs bn)	107.20	98.68	114.31	128.94	106.74

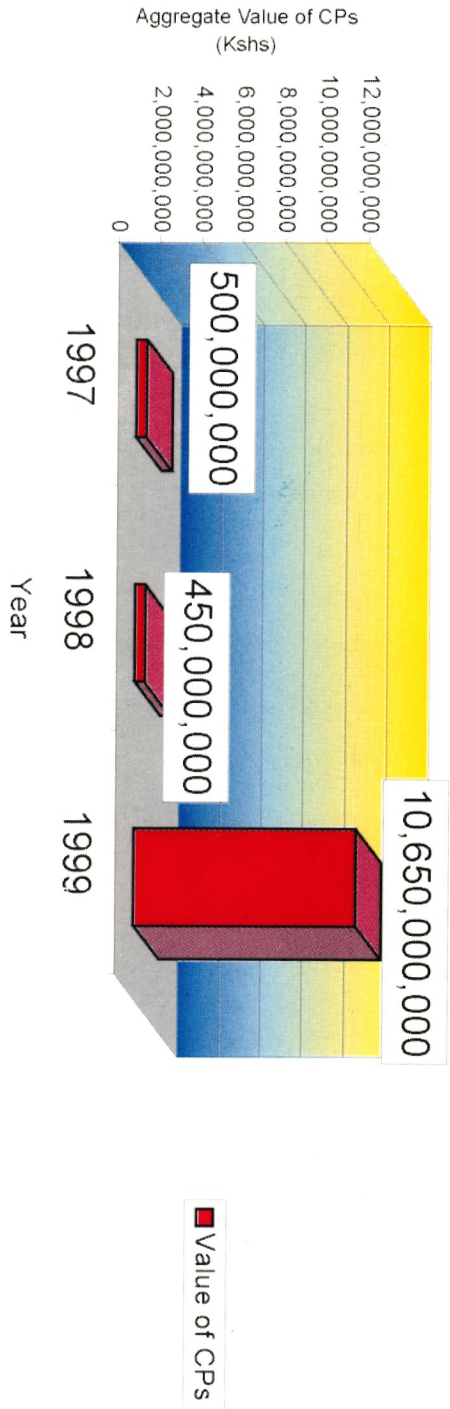
Table 8a
Approved Commercial Paper Issues: 1997 - 1999

Name of Issuer	Date of Approval	Max. Face Value (Kshs)
Mabati Rolling Mills	Sep-97	500,000,000.00
Athi River Mining	Jun-98	100,000,000.00
Agip (K)	Jan-98	350,000,000.00
East Africa Industries	Feb-99	500,000,000.00
Industrial Promotion Services	Feb-99	100,000,000.00
CMC Holdings	Mar-99	250,000,000.00
General Motors	Mar-99	500,000,000.00
Nation Media Group	Mar-99	500,000,000.00
Caltex Oil	Apr-99	500,000,000.00
Kenya Shell	Apr-99	1,000,000,000.00
Lonrho Motors	Jun-99	1,500,000,000.00
Mabati Rolling Mills (Renewal)	May-99	500,000,000.00
CMC Holdings	Jul-99	100,000,000.00
Total-Fina	Aug-99	1,200,000,000.00
Bidco Oil	Sep-99	300,000,000.00
TPS Serena	Sep-99	100,000,000.00
Express (K)	Sep-99	150,000,000.00
Mabati Rolling Mills (Renewal)	Oct-99	500,000,000.00
Kenya Power & Lighting	Nov-99	1,500,000,000.00
Agip (K) (Renewal)	Nov-99	350,000,000.00
Athi River Mining (Renewal)	Nov-99	100,000,000.00
East Africa Industries (Renewal and Increase)	Nov-99	1,000,000,000.00
Cumulative Total		11,600,000,000.00

Table 8b
Approved Commercial Paper Issues: 1997 - 1999

Year	Number of Issues	Total Max. Face Value (Kshs)
1997	1	500,000,000.00
1998	2	450,000,000.00
1999	19	10,650,000,000.00
Cumulative Total	22	11,600,000,000.00

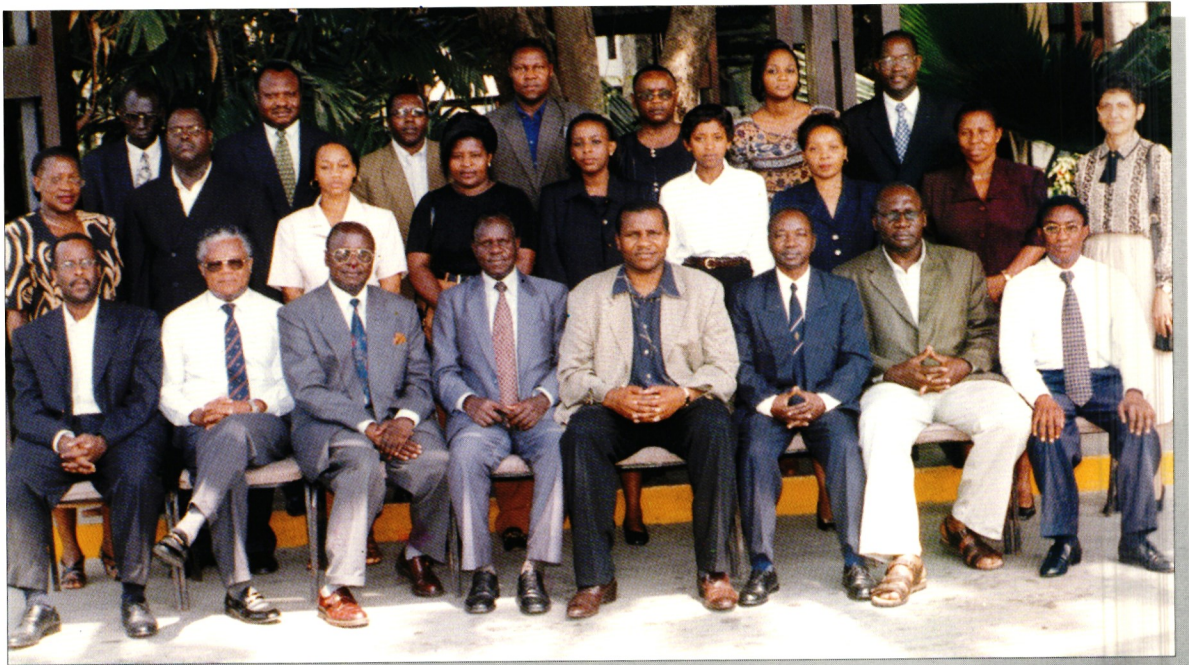
Approved Commercial Paper Issues, 1997 - 1999 (Kshs)



NOTABLE EVENTS IN PICTURES



The Chief Executive, Mr. Paul K Melly (on the far right) at the 24th Annual Conference of IOSCO, held in Lisbon, Portugal in May 1999. At the meeting, Mr. Melly was elected Chairman of the Emerging Markets Committee (EMC) of IOSCO.



The East African Member States Securities Regulatory Authorities (EASRA) held its 8th Consultative Meeting in Mombasa in October, 1999. Participants pose for a group photograph.



The Chief Executive, Mr. Melly (Chairman of EMC) addresses the Inauguration Ceremony of the mid-term EMC Meeting in New Delhi, India on November 25, 1999. Also in the picture are (from left): Hon. Yashwant Sinha (Finance Minister of India), Mr. G Hartneck (Chairman of IOSCO Executive Committee), Mr. EAS Sarma (from the Securities and Exchange Board of India – SEBI) and Mr. Jean P Cristel (Deputy Secretary General of IOSCO).



From left: Mr. Kibe Kariithi (Chief Executive, Nairobi Stock Exchange), Mr. Paul K Melly (Chief Executive, Capital Markets Authority), Mr. Denis Afande (Chairman, Capital Markets Authority) and Mr. Jimnah Mbaru (Chairman, Nairobi Stock Exchange) during the 1st Capital Markets Annual Review Forum held on December 7, 1999.

OVERVIEW OF MANAGEMENT FUNCTIONS

Research and Corporate Affairs Department

The Research and Corporate Affairs Department has three main functions, with the following main activities.

Research Function

- Economic policy analysis and review
- Economic research
- Statistical analysis
- Maintenance of databases of market statistics and economic data

Information Technology Function

- Maintenance of IT facilities
- Implementation of IT policy
- IT training
- Maintenance of Corporate Website

Corporate and International Affairs

- Information exchange
- Public relations
- Press matters
- Preparation of Annual Reports
- Preparation of newsletters
- Public education and awareness campaigns

Enforcement and Administration

The following are the major duties and responsibilities of this department.

Enforcement Section

- All legal matters of the Authority and concerning the market;
- Rule making
- Legal research
- Enforcement of rules and regulations
- Prosecutions of offenders

Administration Section

- Day-today administration
- Staff matters
- Staff welfare
- Office facilities and supplies
- Recruitment and training
- Salaries and benefits

Compliance and Finance

The main duties and responsibilities of the department include the following:

Compliance and Surveillance Section

- Market Surveillance
- Ensuring compliance of rules and regulations
- Inspection of licensees
- Investor complaints investigations
- Fraud investigations

Finance Section

- Financial analysis of licensees reports
- Ensuring compliance with financial limits
- Preparation and overseeing of CMA financial reports
- Budgeting and accounting for CMA finances.

LIST OF CMA LICENCEES

SECURITIES EXCHANGES

1. Nairobi Stock Exchange
Nation Centre
P O Box 43633
Telephone: 230692
Fax: 224200

STOCKBROKERS

1. Ashbhu Securities Ltd Ambank House P O Box 41684 NAIROBI Tel: 210178/211088 Fax: 210500	2. Crossfields Securities Ltd Vedic House PO Box 34137 NAIROBI Tel: 246036 Fax: 245971
3. Discount Securities Ltd Phoenix House PO Box 57746 NAIROBI Tel: 219538/244468 Fax: 336553	4. Dyer & Blair Ltd Reinsurance Plaza PO Box 45396 NAIROBI Tel: 227803 Fax: 218633
5. Equity Stockbrokers Ltd Queensway House PO Box 47198 NAIROBI Tel: 221452 Fax: 221672	6. Faida Securities Ltd Nanak House PO Box 40100 NAIROBI Tel: 243811/2/3 Fax: 243814

<p>7. Francis Drummond & Co. Ltd Hughes Building PO Box 45465 NAIROBI Tel: 334533 Fax: 223061</p>	<p>8. Francis Thuo & Partners Ltd International House PO Box 46524 NAIROBI Tel: 226531 Fax: 228498</p>
<p>9. Hak Securities Ltd Rehani House PO Box 678 NAIROBI Tel: 331891/220517 Fax: 215554</p>	<p>10. Kenya Wide Securities Ltd Kimathi House PO Box 43858 NAIROBI Tel: 251001/2 Fax: 246197</p>
<p>11. Kestrel Capital (EA) Ltd Hughes Building PO Box 40005 NAIROBI Tel: 251815/251893 Fax: 243264</p>	<p>12. Ngenye Kariuki & Co. Ltd Travel (UTC) House P O Box 12185 NAIROBI Tel: 224333/220052 Fax: 217199</p>
<p>13. Nyaga Stockbrokers Ltd IPS Building PO Box 41868 NAIROBI Tel: 332783/4 Fax: 332785</p>	<p>14. Reliable Securities Ltd Eagle House PO Box 50338 NAIROBI Tel: 241350/54/79 Fax: 241392</p>
<p>15. Shah Munge & Partners Ltd Nation Centre PO Box 14686 NAIROBI Tel:227300/230672 Fax: 213024</p>	<p>16. Solid Investment Securities Ltd 20th Century Plaza PO Box 63046 NAIROBI Tel: 244272/9 Fax: 244228</p>

17. Standard Stocks Ltd
Hazina Towers
PO Box 13714
NAIROBI
Tel: 220225
Fax: 240297

18. Suntra Stocks Ltd
Commonwealth House
PO Box 74016
NAIROBI
Tel: 337220/223294
Fax: 224327

INVESTMENT ADVISERS

1. ABN AMRO Investment
Services Ltd
ABN AMRO Building
P O Box 30262
NAIROBI
Tel: 710455/6
Fax: 713391

2. AIG Global Investment Co.
(EA) Ltd
ICEA Building
P O Box 67262
NAIROBI
Tel: 249444-7
Fax: 249451

3. Alico Asset Management Ltd
Alico House
P O Box 30364
NAIROBI
Tel: 711242
Fax: 723146

4. Amicable Investments Ltd
Embassy House
P O Box 44033
NAIROBI
Tel: 243001
Fax: 243055

5. Barclaytrust Investment
Services Ltd
Barclays Plaza, Mez 3
P O Box 30356
NAIROBI
Tel: 713800/ Fax: 218207

6. Bridges Capital Ltd
No 209/362, Lenana Rd
P O Box 62341
NAIROBI
Tel: 714372
Fax: 714657

<p>7. CBA Capital Limited Commercial Bank Building P O Box 30437 NAIROBI Tel: 228881 Fax: 335827</p>	<p>8. Citibank, NA. Citibank House P O Box 30711 NAIROBI Tel: 711211 Fax: 714811</p>
<p>9. Co-optrust Investment Services Ltd International House P O Box 48231 NAIROBI Tel: 222871/2/3 Fax: 219821</p>	<p>10. Co-optrust Merchant Bank Ltd International House P O Box 48231 NAIROBI Tel: 222871/2/3 Fax: 219821</p>
<p>11. Dry Associates Limited Old Mutual Building P O Box 20541 NAIROBI Tel: 227948 Fax: 227966</p>	<p>12. Endeavour Securities Ltd NSSF Building P O Box 62420 NAIROBI Tel: 720848 Fax: 721425</p>
<p>13. Genesis (K) Inv. Mngt. Ltd Lonrho House P O Box 79217 NAIROBI Tel: 251012 Fax: 250716</p>	<p>14. Kenya Capital Partners Ltd Norfolk Towers P O Box 43233 NAIROBI Tel: 228870/337828 Fax: 330120/219744</p>
<p>15. Loita Asset Management Ltd Ambank House P O Box 39466 NAIROBI Tel: 219015/033 Fax: 218992</p>	<p>16. Merchant Bank of Kenya Ltd View Park Towers P O Box 30664 NAIROBI Tel: 248912/243315 Fax: 244203</p>
<p>17. Natbank Inv. Services Ltd National Bank Building P O Box 72866 NAIROBI Tel: 339690 Fax: 330784</p>	<p>18. Old Mutual Asset Managers (K) Ltd Old Mutual Building P O Box 30059 NAIROBI Tel: 221187/8/ Fax: 340718</p>

<p>19. Stanbic Investment Management Services Ltd Stanbic Building P. O. Box 30550 NAIROBI Tel: 335888 Fax: 330227</p>	<p>20. Tradition Security (K) Ltd Fedha Towers P O Box 49584 NAIROBI Tel: 331709/218360/1 Fax: 225694</p>
<p>21. Venture Capital Investment Management Ltd Corner House P O Box 62213 NAIROBI Tel: 222550/1 Fax: 222553</p>	<p>22. Zimele Asset Management Co. Ltd Bishop's Garden Towers P O Box 76528 NAIROBI Tel: 729078 Fax: 722953</p>
<p>23. Meghraj Investment Services Ltd* Fuji Plaza P O Box 66290 NAIROBI Tel: 440148/440372 Fax: 447189</p>	

*Note: * Currently under suspension*

DEALERS

<p>1. CFC Financial Services Ltd.* CFC Centre P O Box 72833 NAIROBI Tel: 741861/340091 Fax: 223032</p>	
---------------------------------------------------------------------------------------------------------------------------------	--

*Note: * Approved for Licensing in December 1999*

AUTHORISED DEPOSITORIES

<p>1. Barclays Bank of Kenya Barclays Plaza P O Box 30120 NAIROBI Tel: Fax:</p>	<p>2. Barclaytrust Investment Services Ltd Barclays Plaza P O Box 30356 NAIROBI Tel: Fax:</p>
<p>3. Kenya Commercial Bank Ltd Kencom House P O Box 52290 NAIROBI Tel: 339441 Fax: 336422</p>	<p>4. National Bank of Kenya Ltd National Bank Building P O Box 72866 NAIROBI Tel: 339690 Fax: 330784</p>
<p>5. Stanbic Bank of Kenya Ltd Stanbic Building P O Box 30550 NAIROBI Tel: 335888 Fax: 330227</p>	

LIST OF ENABLING LEGISLATION (ACT, RULES, REGULATIONS AND GUIDELINES)

1. The Capital Markets Authority Act, CAP 485A (December, 1989)
2. The Capital Markets Authority (Amendment) Act, 1994, Kenya Gazette Supplement No 4 of January, 1995
3. The Capital Markets Authority regulations, 1992, Legislative Supplement, Legal Notice No 428 of December, 1992
4. The Capital Markets Authority Rules, 1992, Legislative Supplement No 69, Legal Notice No 429 of December, 1992
5. The Capital Markets Authority (Amendment) Regulations, 1994, Legislative Supplement No 35, Legal Notice No 233 of July, 1994
6. The Capital Markets Authority (Amendment) Rules, 1994, Legislative Notice No 35, Legal Notice No 232 of July, 1994
7. The Capital Markets Authority (Amendment) Regulations, 1995, Legislative Supplement No 28, Legal Notice No 212 of June, 1995
8. The Capital Markets Authority (Foreign Investors) (No 2) Regulations, 1995, Legislative Supplement No 39, Legal Notice No 291 of August, 1995

9. The Capital Markets Authority (Amendment) Rules, 1996, Legislative Supplement No 40, Legal Notice No 286 of September, 1996
10. The Capital Markets Authority Guidelines on the Issue of Corporate Bonds and Commercial Paper of April 1997 (Revised January 2000)
11. The Capital Markets Authority Guidelines on Audit Committees of April 1998
12. The Capital Markets Authority Guidelines on Establishment and Operation of Credit Rating Agencies of December, 1999
13. The Capital Markets Authority Guidelines on the Licensing and Operation of Dealers of December, 1999

GUIDELINES FOR THE ESTABLISHMENT, LICENSING AND OPERATION OF DEALERS

1. Preamble

These guidelines have been prepared by the Capital Markets Authority for the purpose of promoting the licensing of dealers at the Nairobi Stock Exchange.

Dealers are expected to play a major role in improving liquidity, price stability and the demand and supply of securities listed at the Nairobi Stock Exchange.

Definitions

Dealer

A dealer means a person who carries on the business of buying, selling, dealing, trading, underwriting or retailing of securities as principal.

Investment Capital

Unimpaired reserves forming part of the share-capital of the dealer, which shall be dedicated to dealing in securities.

2. Requirements for Licensing

2.1 Constitution of Applicant

2.1.1 An applicant for a license to operate as a dealer shall be incorporated as a limited liability company under the Companies Act (Cap 486) of the Laws of Kenya solely for the purposes of dealing in securities and incidental purposes.

2.1.2 Shareholders of a dealer company may be individuals or institutions save that any person carrying out business as a collective investment scheme, co-operative society or fund manager may not be a shareholder of a company licensed or applying to be licensed as a dealer.

2.1.3 Companies licensed as banks, insurance companies and stockbrokers are eligible to set up subsidiary companies to operate as dealers. In the case of stockbrokers, the direct interest in such a subsidiary may not exceed 25% but the shareholders of the stockbroker company are not precluded from investing in such a subsidiary in individual capacity.

2.2 Capacity

2.2.1 An applicant for license to operate as a dealer shall demonstrate that he has financial capability to invest in a dealer company and conduct the business of dealing in securities.

2.2.2 For purposes of this guideline, an applicant shall show evidence that he has and shall at all times:

- ❖ Set aside investment capital of not less than Shs.25 million in cash of which may be enhanced by borrowings not exceeding 50% of the prescribed minimum investment capital.
- ❖ Furnish the stock exchange with a guarantee from a commercial bank of KShs.1.5 million.
- ❖ Sufficient working capital, which shall not fall below a sum equivalent to three times its monthly management and other overhead costs.

2.2.3 In the case of a dealer company promoted by a stockbroker the minimum investment capital must be at least Shs.7 million in cash, to be raised to Shs. 10 million within two years from the date of grant of license as a dealer from the Authority.

The capital may be enhanced by borrowings not exceeding 50% of the prescribed minimum investment capital.

2.2.4 An applicant for license to operate as a dealer shall demonstrate that it has management capacity to operate as a dealer through recruitment of qualified persons as chief executive, portfolio manager/analyst and floor traders and installation of appropriate accounting/portfolio management systems. In the case of a dealer company promoted by a stockbroker it will be sufficient for the broker to demonstrate that he has adequate accounting and portfolio management capacity PROVIDED that the dealer maintains records on all transactions and activities pertaining to the dealership including floor trading activities at the Nairobi Stock Exchange independent from those of the broker.

3.0 Portfolio Requirements

3.1 A dealer shall not hold more than 10% of the total portfolio in any one security, or invest not more than 30% in any one sector PROVIDED that the dealer shall not invest more than 20% in Fixed Income Securities.

3.2 Every equity security held by a dealer shall be turned over at least once every eighteen months, and at least 20% of the portfolio should be turned over once every quarter.

4.0 Reports and Records

- 4.1 Every dealer shall at all times maintain a record of all securities in his portfolio including the date of purchase, price, quantities the sector and date of disposal.
- 4.2 Every dealer shall maintain and preserve for a period of seven years the following books of accounts and documents or other accepted accounting documents and, if so required, produce the same for inspection by the securities exchange and by the Authority.
- (a) computerized journals (or other records of original entry) containing an itemized daily record of all purchases and sales of securities, all receipts and deliveries of securities (including certificate numbers), all receipts and disbursements of cash and all debits and credits; and the records shall show the account for which each such transaction was effected, the name and amount of securities, the unit and aggregate purchase or sale price, the trade date, and the name or other designation of the person from whom purchased or received or to whom sold or delivered;
 - (b) computerized ledgers, (or other records) reflecting all assets and liabilities, income, expense and capital accounts;

- (c) all chequebooks, bank statements, cancelled cheques and bank reconciliation accounts;
- (d) ledger accounts (or other records) itemizing separately each account of a customer, all purchases, sales, receipts and deliveries of securities and all other debits and credits;

4.3 Every dealer shall submit to the Authority the following periodic reports in such form as may be prescribed by the Authority.

- ❖ Audited Annual reports within three months of the end of the dealer's financial year, which shall be the calendar year.
- ❖ Half yearly reports within thirty days of the end of each half-year.
- ❖ Quarterly reports within thirty days of the end of each calendar quarter.

5.0 Fees Charges

5.1 A dealer shall pay annually to the Authority the prescribed application and annual fee for license to operate as a dealer.

5.2 A dealer shall also pay to the Authority and the Exchange the fees prescribed to be paid by every buyer and seller of a security on every transaction as the case may be, and shall pay to the Investor Compensation Fund the fees prescribed for each buying and selling broker.

GUIDELINES FOR THE ESTABLISHMENT, LICENSING AND OPERATION OF CREDIT RATING AGENCIES

1. Introduction

The Capital Markets Authority is seeking to promote the establishment of credit rating agencies as part of measures aimed at building an active corporate securities debt market and impetus to deepening of the domestic capital markets.

These are guidelines on the requirements for approval and registration of credit rating agencies in Kenya.

1.1 Credit Rating and Objective

Credit rating is an objective and independent opinion on the general creditworthiness of an issuer of a debt instrument, and its ability to meet its obligations in a timely manner over the life of the financial instrument based on relevant risk factors including the ability of the issuer to generate cash in the future. Ratings rank the debt issue within a consistent framework to compare risk among the different debt instruments in the market and assign a risk grade.

As it pertains assessment of future likely position on the basis of both quantitative and qualitative judgement and past performance credit rating is necessarily subjective.

The goal of the rating process is to arrive at a reasoned judgement on credit risk not through a set formula but rather through a careful review and analysis of the critical issues surrounding a specific debt and the issuer.

This in particular includes the ability of the management to sustain future cash generation in face of adverse changes in the business and economical environment. A rating is therefore an informed opinion of future outcomes based on known qualitative and quantitative factors.

A rating does not constitute a recommendation to purchase, sell or hold a particular security. In addition, a rating does not comment on the suitability of an investment for a particular investor.

The objective of a credit rating is to provide independent, high quality, impartial, value-added quantitative and qualitative review as well as analytical information on the risk profile assessment of issuers of financial installments.

It therefore serves to promote confidence in the capital markets and enhance transparency by facilitating investors' awareness on underlying risks of an issuer or issued financial investment through assignment of ratings.

2. *Core Professional Capacity*

2.1 The applicant must make evident its capacity to perform the role of a rating agency

- 2.2 The applicant must have a background and experience as well as professional expertise to provide service of a rating agency
- 2.3 The applicant must either be in the process of appointing or has appointed professionals including economic, financial and research analysts, and other relevant quantitative and qualitative analysts who have the relevant background in the rating business.

3. *Objectivity and Independence*

- 3.1 The applicant must demonstrate its independence and objectivity.
- 3.2 The applicant must not be associated directly or indirectly with group(s) who have conflicting interests in the area of the rating business.
- 3.3 The applicant must also demonstrate that it has a proven rating methodology
- 3.4 The rating process must have sufficient internal checks and balances to safeguard objectivity in particular where qualitative judgement also plays an important role in the rating process.
- 3.5 The rating process must be based on quantitative and qualitative review of facts and must not rely on hearsay or rumours to downgrade or upgrade a particular issuer or issued financial instrument.

4. Ownership

- 4.1 In order to ensure independence and objectivity, the applicant must be a body corporate with a preponderance of an institutional shareholding of repute.
- 4.2 The shareholders, board of directors and management and its professional analytical staff should all be persons of impeccable character.
- 4.3 The applicant should partly be owned by an internationally recognized rating agency or have a contractual arrangement with an internationally recognized rating agency that provides technical and strategic support drawn from international experience.
- 4.4 For purposes of this guideline, an internationally recognized agency shall be a rating agency, which has been in the business of providing credit ratings for debt securities or any securities of interest to investors, which obligates the issuer to pay back to the principal amount raised, in more than two markets for at least five years.
- 4.5 The ownership structure or association and capital level shall not be the only basis or criteria of determining the independence and integrity of a rating agency.

5. ***Capital Requirements***

The applicant shall have a stable financial base with a minimum paid up capital of Kshs. 1.5 million (or USD 150,000)

6. ***Disclosure of Information by Rating Agency***

The rating agency must disclose to the Authority, issuers and the general public the following:

- ❖ General fee structure or any change thereof
- ❖ Downgrades of ratings
- ❖ Disclosure of mandatory ratings of commercial paper or corporate bonds as applicable.

7. ***Confidentiality***

The rating agency must have a system of maintaining on a confidential basis the information supplied strictly for the purpose of rating by issuers in order to safeguard and promote confidence in the rating process.

8. *Documents to accompany the application for approval and registration of credit rating agency in Kenya*

Application for approval and registration should be made to the Capital Markets Authority accompanied by the following:

- ♦ Certificate of Incorporation, Memorandum and Articles of Association;
- ♦ Business plan (to include resumes of the top management staff, management structure, brief on the rating methodology, rating grades, fee structure);
- ♦ Technical agreement between the applicant and an internationally recognized rating agency where applicable;
- ♦ A sample of a standard agreement between the rating agency and its clients and
- ♦ Draft sample “letter of request” for rating accompanied by a draft of the “information requirements for rating securities”.

GUIDELINES ON AUDIT COMMITTEES

1. Introduction

The appointment of properly constituted audit committees is a common international practice viewed as an important step in raising standards of corporate governance. If they operate effectively, audit committees can bring significant benefits. They can improve the quality of financial reporting, strengthen the respective positions of the external and internal auditors and increase public confidence in the credibility and objectivity of financial statements.

The boards of directors of all public companies should be required to establish audit committees.

2. Code of Conduct

Audit Committees should:-

- ◆ be informed, vigilant and effective overseers of the financial reporting process and the company's internal controls.
- ◆ review annually the program management established to monitor compliance with the code of conduct.

- ♦ have adequate resources and authority to discharge their responsibilities.
- ♦ oversee the interim reporting process.
- ♦ review management's evaluation of factors related to the independence of the company's independent auditor. Both the audit committee and management should assist the independent auditor in preserving his independence.
- ♦ ensure that the internal auditors' involvement in the audit of the financial reporting process is appropriate and properly co-ordinated with the independent auditor.
- ♦ develop a written charter setting forth the duties and responsibilities of the audit committee. The board of directors should approve the charter, review it periodically and modify it as necessary
- ♦ be required to include in their annual reports to shareholders a letter signed by the chairman of the audit committee describing the committee's responsibilities and activities during the year.
- ♦ advise the audit committee when it seeks a second opinion on a significant accounting issue.

3. Composition of Committee

- (a) There shall be a committee of the board of directors to be known as the audit committee. The audit committee shall be composed of directors who are independent of the management of the corporation and are free of any relationship that, in the opinion of the board of directors, would interfere with their exercise of independent judgement as committee members.

- (b) It is recommended that the composition of the committee should not be fewer than three independent non-executive directors. The committee should be small enough so that each member is an active participant. Many audit committees find it valuable for their members to have diverse, broad based and complimentary backgrounds. Fewer than three members may not provide enough diversity of backgrounds and ideas. More than five may be unnecessary for all but very large companies.

4. (a) Attributes of Committee Members

Important attributes of committee members should include:-

- ◇ there should be no conflict of interest

- ◇ broad business knowledge

- ◇ keen awareness of the interests of the investing public
- ◇ familiarity with basic accounting principles

(b) Term of Office

The term of audit committee members should be tied to their board term and be similar to those of the other company directors. Appointment should be by a specific board resolution. Rotation of audit committee members may keep members interest high. A rotation policy for a three-member committee may be to have three-year terms with one expiring each year.

5. Statement of Policy

The audit committee shall provide assistance to the corporate directors in fulfilling their responsibility to the shareholders, potential shareholders, and investment community relating to corporate accounting, reporting practices of the corporation, and the quality and integrity of the financial reports of the corporation. In so doing, it is the responsibility of the audit committee to maintain free and open means of communication between the directors, the independent auditors, the internal auditors, and the financial management of the corporation.

6. Core Functions of Audit Committees

The audit committee policies and procedures should remain flexible, in order to best react to changing conditions and to ensure to the directors and shareholders that the corporate accounting and reporting practices of the corporation are in accordance with all requirements and are of the highest quality.

Functions of audit committee will include but not limited to the following:-

- (a) meet with the independent auditors and the corporate financial management to review the scope of the proposed audit for the current year and the audit procedures to be utilized, and at the conclusion thereof review such audit including any comments or recommendations of the independent auditors,
- (b) review and make recommendations on the internal audit functions of the corporation including the independence and authority of its reporting obligations, the proposed audit plans for the coming year, and the co-ordination of such plan with the independent auditors,
- (c) review and make recommendations on the financial statements contained in the annual report to shareholders with management and the independent auditors to determine that the independent auditors are satisfied with the disclosure and content of the financial statements to be presented to the shareholders.
- (d) review and make recommendations on utilization of financial and human resources of the company and ensure efficiency and effectiveness are achieved,

- (e) assist in overseeing the financial reporting process and the company's internal controls,
- (f) review and recommend to the directors the independent auditors to be selected to audit the financial statements of the corporation,
- (g) review and make recommendations on annual management programmes established to monitor compliance with the code of conduct,
- (h) to review and make recommendations on the half-year and annual financial statements before submission to the Board, focusing particularly on:
 - ◆ any changes in accounting policies and practices
 - ◆ major judgmental areas
 - ◆ significant adjustments resulting from audit
 - ◆ the going concern assumption
 - ◆ compliance with accounting standards
 - ◆ compliance with stock exchange and legal requirements.
 - ◆ compliance with any other regulatory requirement.

- (i) investigate any matter brought to their attention within the scope of their duties, with the power to retain outside counsel for this purpose if, in their judgement, that is appropriate.

Audit committees should be complimentary to management and be part of good governance and an oversight process in a public company. Provided that in discharging its functions the Audit Committee shall have power to exercise such functions as specifically delegated to it by the Board.

7. Reporting Procedures

The committee should report its activities to the full board on a regular basis, (and should be incorporated in the organization's structure) after their private regular meetings with the internal auditor and the independent auditor, so that the board is kept informed of its activities. Audit Committees should be part of the main Board but with specific oversight responsibility on behalf of the main Board to deal with such matters as:-

- i) systems development
- ii) internal control system
- iii) code of conduct for directors and employees
- iv) review of audit reports

8. Committee Meetings

The audit committees should have at least three (3) meetings in a year. The number of meetings should be dictated by committee's objectives, the scope of its activities and the needs of the company. The minutes of the committee meetings should be taken and kept and the same should be included as part of the report to the full board.

9. Relationship with the Internal Auditor

The internal auditor's function is a valuable resource to the audit committee. In addition to providing assurances to the committee about the adequacy of the system of internal control and participating in the annual independent audit, the internal audit function can help the audit committee by evaluating compliance with corporate policy and by performing audits for operating efficiencies. The audit committee should periodically review the internal audit function and evaluate it against the committee's expectations and needs. This review should help assure internal audit that company resources are used to the best advantage. The internal audit may also assist the committee with special investigations. The Head of Internal Audit should attend all audit committee meetings or may meet privately with the committee.

10. Relationship with the Independent Auditors

- a) The audit committee should maintain open lines of communication with the independent auditor.

- b) The audit committee should inquire about the proposed audit scope and approach, any suggestions or recommendations management receives from the independent auditors, and the results of the annual audit.
- c) The audit committee determines that the scope of the independent auditors services is appropriate based on the needs of the company. Although the audit committee might inquire as to the independent auditor's fees and total audit costs (internal and independent auditors), the audit committee's primary concern is to ensure that management has not inadvertently restricted the audit scope (internal and independent) in its desire to control costs. It remains management's responsibility to negotiate fees with the independent auditors.

11. Glossary of Terms

Accounting Principles

The specific policies, rules, methods, procedures, conventions and bases adopted by reporting entities to be most appropriate to their circumstances in preparing their financial statements. Any material diversion from the principles should be disclosed and reasons therefore explained.

Accounting Standards

These describe methods of accounting deemed mandatory by the council of the Institute of Certified Public Accountants of Kenya (ICPAK) for application to all financial statements other than those prepared for exclusively internal use.

Where no Kenyan Accounting Standard applies, the International Accounting Standard will apply.

Auditors Report

A report of the independent auditor addressed to the owners of the company after examination of the organization, its records and its financial statements in which the auditor expresses his opinion of the truth and fairness and sometimes other aspects of the financial statements.

Code of Conduct

A set of rules and regulations that govern how directors, management and staff conduct the business of the company.

Companies Act

Refers to the Companies Act (cap 486) of the Laws of Kenya. This is an Act of Parliament to amend and consolidate the law relating the incorporation, regulation and winding up of companies and other associations, and to make provision for other matters relating thereto and connected therewith.

Going Concern Assumption

The reporting entity is assumed to be a continuing one for the foreseeable future. It is assumed that it has neither the intention nor the necessity of liquidation or of curtailing materially the scale of its operation.

Independent Auditor

This is an independent person who is appointed to investigate the organization, its records, and the financial statements prepared from them, and thus form an opinion on the accuracy and correctness of the financial statements.

Independent Director

A director who has no shareholding interest in a company, mainly a non- executive director and one who makes decisions independent from the management therefore representing effectively the shareholders interest.

Internal Audit

An appraisal function established by the management of an organization for the review of the internal control system as a service to the organization. It objectively examines, evaluates and reports to the top management on the adequacy of the internal control as a contribution to the proper, economic, efficient and effective use of resources.

Internal Controls

A system of controls, financial and otherwise, established by the management in order to carry on the business of the enterprise in an orderly and efficient manner, ensure adherence to management policies, safeguard the assets and secure as far as possible the completeness and accuracy of the records.

Listing Rules

Are requirements, which apply to applicant companies for admission to the official list of the Stock Exchange

Management

These are top members of an organization including those appointed by the shareholders or owners of the resources to manage through planning, organizing, staffing, directing and controlling of the resources and activities to achieve desired organizational objectives.

Nairobi Stock Exchange Rules

These are rules by Nairobi Stock Exchange approved by the Capital Markets Authority for the management of operations and trading requirements.

Public Companies

Defined under the Companies Act (cap 486) as a company that does not prohibit any invitation to the public to subscribe for shares and debentures.

GUIDELINES FOR THE ISSUANCE OF CORPORATE BONDS AND COMMERCIAL PAPER

PART 1 BACKGROUND

1.1 Introduction

Corporate bonds and commercial papers are issued for the purpose of raising funds direct from investors without the intermediation by banks or other financial institutions. This is for working capital requirements in the case of commercial paper and for long-term financing requirements in the case of corporate bonds. The time horizon of the financial institutions determines whether it is a corporate bond or commercial paper. The issuance of these financial instruments are critical to the deepening of the capital markets which is presently mainly characterized with the issuance of equity stocks.

1.2 Regulatory Oversight and Jurisdictions of Central Bank of Kenya and Capital Markets Authority

- (i) The issuance of debt financial instruments by the corporate sector is traditionally a capital markets activity and in most countries falls under the regulatory jurisdiction of CMA.
- (ii) The issuance of Treasury Bills and Treasury Bonds are the responsibility of the CBK or assigned Monetary Authorities on behalf of the Treasury.

- (iii) Commercial banks and other financial institutions licensed under the Banking Act must obtain CBK clearance before seeking to issue any financial instrument. Insurance companies must also seek clearance from the Commissioner of Insurance.
- (iv) In order to ensure proper and appropriate information disclosure, the issuance of corporate bonds and commercial paper must be subject to regulator clearance of CMA.
- (v) CMA has developed internal expertise and capacity to enable it deal with the issuance of corporate debt financial instruments.
- (vi) It is important however that an effective liaison and consultation framework exists between CBK and CMA.

1.3 Rationale for the Guidelines

The absence of an independent rating agency in the local money and capital markets poses a major constraint to the issuance of both commercial paper and corporate bonds.

In view of the risk and credit-worthiness assessment of the issuers of these financial instruments, CBK and CMA agreed to initially restrict the issuance of commercial paper to listed companies which are subject to continuous disclosure and reporting obligations.

Following further consultation between CMA, CBK and other market players it as now become necessary to develop these guidelines. This is in order to take into account the financial soundness of the issuers of these securities and to ensure compliance with prescribed disclosure requirement.

These guidelines have therefore been developed in order to streamline the regulatory framework for the issuance of debt instruments and to address the needs of the investors.

PART 2 GUIDELINES AND CONDITIONS

The guidelines outlined herein are intended to govern the issuance of corporate bonds and commercial paper whether issued through private placement or general offer to the public until such time that a rating agency has been developed in the local market.

New guidelines will be issued in future once a rating agency is established. In the meantime, only companies which meet the prescribed conditions in these guidelines may issue corporate bonds and commercial paper.

Prospectus or Offering Memorandum.

The issuer of corporate bonds or commercial paper shall publish a prospectus or Offering Memorandum which complies with all the requirements for issue of debt securities as prescribed under Part XI of the Capital Markets Authority Rules, 1992 and subject to the Laws of Kenya.

Approval and Fees

The Authority shall approve any issue of bonds or commercial papers which satisfies the requirements given in these guidelines and on payment of the fees prescribed by the Capital Markets Authority Amendment Regulations, 1995.

2.1 Issuance of Corporate Bonds

Companies satisfying the following requirements will qualify to issue corporate bonds.

2.1.1

(a) Share Capital

The paid-up share capital and reserves should not be less than Kenya Shillings fifty million (Kshs. 50 million) and be maintained at that level during the period the bond remains outstanding.

In the event that the issuer does not have the minimum paid up capital and reserves of Kshs. 50 million the issuer must obtain from a bank or any other approved institution a financial guarantee to support the issue.

(b) Track Record

An issuer should have made profits in at least two of the last three financial periods preceding the application for the issue.

2.1.2

(a) Debt Ratios

Total indebtedness, including the new issue of bonds shall not exceed 400% of the company's net worth (or gearing ratio of 4:1) as at the latest balance sheet.

- (b)** The funds from operations to total debt for the three trading periods preceding the issue shall be maintained at a weighted average of 40% or more.

The conditions as provided in 2.1.1 and 2.1.2 must be maintained as long as the corporate bonds remain outstanding.

2.1.3

(a) Offer Document

The offer document must be accompanied by an accountants report covering at least three years audited accounts preceding the issue.

The Accountants Report shall disclose the following ratios for the last three financial years preceding the issue and a Performa balance sheet and profit and loss account following the issue.

- Earnings before interest and taxes interest cover
- Funds from operation to total Debt percentage
- Free cash flow to total Debt repayment cover
- Total free cash flow to short-term debt obligation
- Net profit margin
- Post-tax return (before financing) on capital employed
- Long Term Debt to Capital employed ratio
- Total Debt to Equity ratio

(b) Cash Flow Projection

A cash flow projection for the next 12 months (following the issue) for regulatory purposes shall be prepared and submitted to CMA.

2.1.4 Publication of Accounts

The issuer shall publish in two daily English newspapers half-yearly management accounts in a manner acceptable to the Authority provided one set of audited annual accounts are submitted each year during the period the Corporate Bond remains outstanding.

2.1.5 Size of Issue

(i) The Minimum size of the issue shall be:

Kenya Shillings Fifty million (Kshs. 50 million)

(ii) The Minimum issue lots shall be:

Kenya Shillings One hundred thousand (Kshs. 100,000)

2.1.6 Timing

The offer period shall not exceed ten working days or such other period as may be approved by CMA.

2.1.7 Announcement

The issuer shall make a public announcement at least one week before the issue opens in the print and electronic media.

2.1.8 Advisers

The issuer shall appoint the advisers for the issue among banks, licensed investment advisers and stockbrokers.

2.1.9 Placing Agents

The issuer shall appoint placing agents among licensed investment adviser, stockbrokers and banks.

2.1.10 Receiving Bank

The issuer shall designate one receiving bank. Payments shall be in the issuers name and banked in designated account.

2.1.11 Registrar

The issuer shall designate a registrar for the issue.

2.1.12 Guaranteed Bond

Where there is a guarantor the issuer may be exempted from the requirements outlined under item 2.1.1, 2.1.2, 2.1.3 and 2.1.4 above but the guarantor shall fulfill these conditions. In the event the guarantor is a bank or an insurance company licensed to operate in Kenya, the consent of the Central Bank of Kenya or the Commissioner of Insurance, as the case may be, will be required. In addition the guarantor will provide CMA with a financial capability statement duly certified by its auditors. The consent mentioned in this guideline will not apply where the guarantor is an off-shore bank or insurance company not subject to the regulation of the Central Bank of Kenya or the Commissioner of Insurance.

2.2 *Issuance of Commercial Paper*

Companies satisfying the following requirements will qualify to issue commercial paper.

2.2.1 (a) Share Capital

The paid-up share capital and reserves should not be less than Kenya Shillings fifty million (Kshs. 50 million) and be maintained at that level during the period the commercial paper the commercial paper remains outstanding.

In the event that the issuer does not have a minimum paid up capital and reserves of Kshs. 50 million the issuer must obtain a bank or any other approved institution a financial guaranteed to support the issue.

(b) Track Record

The company should have made profits in at least two of the last three years preceding the issue.

2.2.2 (a) Debt Ratios

Total indebtedness, including the new issue of commercial paper shall not exceed 400% of the company's net worth (or a gearing ratio of 4:1) as at the date of the latest balance sheet.

(b) The funds from operations total debt for the three trading periods preceding the issue shall be maintained at a weighted average of 40% or more.

The conditions as provided in 2.2.1 and 2.2.2 must be maintained as long as the commercial paper remain outstanding.

2.2.3 (a) Offer Document

The offer documents must be accompanied by an Accountants Report and at least three years audited accounts preceding the issue. The Accountants Report shall disclose the following ratios for the last three financial years preceding the issue and a Performa balance sheet and profit and loss account following the issue.

- Earnings before interest and taxes interest cover
- Funds from operations to total Debt percentage
- Free cash flow to total Debt percentage
- Total free cash flow to short-term debt obligations
- Net profit margin
- Post-tax return (before financing) on capital employed
- Long term Debt to Capital employed ratio
- Total Debt to Equity ratio

(b) Cash Flow Projection

A cash flow projection for the next 12 months for regulatory purposes shall be prepared and submitted to CMA.

2.2.4 Publication of Accounts

The issuer shall publish in two daily English newspapers half-yearly management accounts in a manner acceptable to the Authority provided one set of audited annual accounts are submitted each year during the period the commercial paper remains outstanding.

2.2.5 Commercial Paper Size Programme

(i) Minimum Programme Size of the issue shall be:

Kenya Shillings Fifty million (Kshs. 50 million)

(ii) Minimum denomination shall be in multiples of

Kenya Shillings one million (Kshs. 1 million)

2.2.6 Announcement

The issuer shall make a public announcement at least one week before the issue opens in the print and electronic media.

2.2.7 Advisers

The issuer shall appoint the advisers for the issue among banks, licensed investment advisers and stockbrokers.

2.2.8 Placing Agents

The issuer shall appoint placing agents among licensed investment advisers, stockbrokers and banks.

2.2.9 Receiving Bank

The issuer shall designate one receiving bank. Payment shall be in issuers name and banked in designated account.

2.2.10 Registrar

The issuer shall designate a registrar for the issue.

2.2.11 Guaranteed Paper

Where there is a guarantor the issuer may be exempted from the requirements outlined under item 2.2.1, 2.2.2, 2.2.3 and 2.2.4 above but the guarantor shall fulfill these conditions. In the event the guarantor is a bank or an insurance company licensed to operate in Kenya, the consent of the Central Bank of Kenya or the Commissioner of Insurance, as the case may be, will be required. In addition the guarantor will provide CMA with a financial capability statement duly certified by its auditors. The consent mentioned in this guideline will not apply where the guarantor is an off-shore bank or insurance company not subject to the regulation of the Central Bank of Kenya or the Commissioner of Insurance.

2.2.12 Validity and renewal of the Approval

Approval granted by CMA for the commercial paper program shall be valid for a period of twelve months from the date of approval and may be renewed on expiry.

Application for renewal shall be made to CMA at least three months prior to the expiry date and shall be accompanied by:-

- (a) an updated information memorandum and
- (b) fee of 0.05% of the value of the commercial paper.

2.2.13 Reports

The Issuer shall make a quarterly return on the outstanding position of the commercial paper programme to CMA.

The quarterly return shall include the following information:

- (i) date of issue
- (ii) amounts outstanding by:-
 - total amount in issue
 - category of investors e.g. banks, individuals, foreign investors;
- (iii) the yield of each issue/tenor
- (iv) redemption/maturity date
- (v) ten largest holders, by:
 - value
 - percentage

GLOSSARY

This glossary is designed to provide clarity to the terms used in the guidelines and the computation of the financial ratios.

Adviser

In relation to an issue of securities means an institution engaged in the provision of financial services which deals in securities whether debt or equity and has been contracted by an issuer as a lead adviser to an issue of securities.

Average over the period

This is defined as the average of the opening and closing balances for that period. Alternatively, where the debt profile changes significantly during the year, it would be more appropriate to compute a weighted average over the period using month-end or quarter-end balances. The basis of computation should be disclosed.

Bond

A bond is commonly referred to as a 'debt instrument' since it is evidence of a loan made by a lender to a borrower. The terms of the loan may be specified in the bond instrument or referred to in an associated agreement, or bond indenture. A bond shall have a term/tenor of one year or more, and may be secured by specified assets pledged to the lender by and/or on behalf of the borrower.

The bond shall specify the principal amount of the loan, and the basis upon which the borrower shall pay to the lender interest and other fees charged on the principal amount. All amounts of principal interest and fees due under the bond shall be paid by the maturity date of bond. Bonds do not entitle any party to an equity or ownership interest in the borrower. A lender may also be referred to as an ‘investor’ or ‘bondholder’. A borrower will generally be a Limited Liability Company, but could also be a Sovereign Entity, State Corporation or Local Authority.

CBK

The Central Bank of Kenya

CMA

Capital Markets Authority

Commercial Paper

Commercial paper is a debt instrument with a maturity of year and is evidence of loan extended by a creditor to a corporation.

Free Cash Flow

This is defined as operating cash flow for the period less income taxes paid and net capital investment.

Guarantor

Means any person who guarantees to bond or commercial paper holders payment or interest and repayment of principal due under a guaranteed bond or paper respectively.

Guaranteed Bond

Means a bond which is guaranteed as to payment of interest and repayment of principal by a third party who may or may not be related to the issuer but is usually larger, better known or more credit worthy than the issuer, or guaranteed by means of a contract of insurance.

Guaranteed Paper

Means a commercial paper which is guaranteed as to payment of interest and repayment of principal by a third party who may or may not be related to the issuer but is usually larger, better known or more credit worthy than the issuer or guaranteed by means of a contract of insurance.

Net worth (equity)

This represents the worth of the company after all obligations are met. Thus it may be defined as paid-up share capital plus all reserves (i.e., revenue and capital reserves, including revaluation reserves).

Net profit

This is defined as the net profit for the period after tax and extraordinary and exceptional items.

Offer Document

This is a document prepared by the issuer to provide information about the issue and in compliance with disclosure requirements whether in the form of a prospectus or an information memorandum.

Operating cash flow (funds generated from operations)

Following IAS7, this is defined as net profit (see below) for the period as adjusted for the effects of:

- changes in working capital (stocks, trade debtors and creditors) during the period;
- Non-cash items such as depreciation, foreign exchange (gain)/loss(gain)/loss on disposal of fixed assets, provisions, deferred taxes, etc;
- All other items for which the cash effects are investing or financing cash flows or returns on investment or servicing of finance, such as dividend income, interest paid, or interest received.

Paid-up Share Capital

This represents ordinary shares (equity shares) which have been issued and fully paid for but excludes all non-equity shares except for non-redeemable preference shares.

Period

The term is defined as the period for which the financial statements are made up. This must not exceed 18 months and must not be less than 3 months. For example, the longest period would be 1 January 1996 to 30 June 1997 and the shortest period would be 1 January 1996 to 31 March 1996.

Profit for the purpose of determining eligibility for issuing debt

Profit for this purpose is the net profit before minority interests, as disclosed in the financial statements (i.e. profit after tax and extraordinary items).

The latest available balance sheet date

Where the latest annual audited financial statements are made up to a date more than six months prior to launch date e.g. latest audited financial statements are for 12 months to 30 June 1996 for a bond issue to be launched on 31 March 1997, then:

- (1) management should disclose the un-audited balance sheet date to a date less than six months prior to the launch date (say 31 December 1996) and financial results and cash flows for the period from the last audited financial statements to that date (6 months to 31 December 1996).
- (2) disclose the financial ratios for that period (6 months to 31 December 1996) on a 12-month equivalent basis. The balance sheet, profit & loss and cash flows for the “notional” first six months should be extrapolated. The extrapolation should be on a straight-line basis where there are not significant seasonal trends. Where there are significant seasonal trends identified in the previous period, then the extrapolation should be weighted accordingly.

Total Indebtedness

This is represented by both long-term debt and short-term debt.

One-term debts are any amounts outstanding on commitments that are repayable after more than one year. Examples include:

- term loan
- bonds issued
- non-equity shares outstanding e.g. redeemable preference shares
- long-term lease obligations
- parent company loan/director loan/shareholder loan**

For these items, analyze the amounts as:

- amounts falling due within 1 year (classified as short term debt)
- amounts falling due within 2-5 years
- amounts falling due after 5 years

Short-term debts are any amounts owed that have a maturity period of less than a year or which are repayable on demand but exclude normal trade creditors and other creditors. Example include:

- overdrafts
- current portion of long term debt
- commercial paper
- certificate of deposit (CDs) issue
- parent company loans/director loans/shareholder loans
- trade credit facilities from related parties which are in excess of normal industry credit terms ***

** these amounts would be classified as long-term debt provided that there is an agreed repayment schedule for interest and principal that is being adhered to, otherwise the amounts would be classified as short-term debt.

***for example, if the amount outstanding on a trade credit from a related party is equivalent to 90 days worth of purchases while normal industry terms are 30 days. An amount equivalent to 60 days worth of purchases should be classified as short-term debt.

Disclosure should also be provided of future significant/material cash obligations that are not already reflected on the balance sheets as a liability (i.e. off-balance sheet items) such as:

- contracted obligations, commitments for the next 12 months;
- capital commitments that have been contracted for but not provided for on the balance sheet and those authorized but not contracted.
- Contingent liabilities
- Contracted amounts payable under sale and repurchase agreements not recognized in the balance sheet, e.g. sale and leaseback of fixed assets;

The disclosure of these future obligations should also be classified as those falling due within one year and those falling due after one year.

Financial Ratios

The financial ratios have been defined below to ensure that all issuers prepare them on a consistent and comparable basis.

Earnings before interest and taxes (EBIT) interest cover

EBIT interest cover = $\frac{\text{EBIT for the period}}{\text{interest payable for the period} - \text{any preference dividend payable for the period}}$

This is the extent to which interest is covered by profits before interest (payable) and taxes.

EBIT is after interest earned and income from investments during the period.

Interest payable for the period is defined as interest payable on all long-term and short-term debts for the period (i.e. interest paid and accrued).

Operating cash flow to total debt percentage

Operating cash flow to total debt ratio = (funds generated from / average
Operations in the period total debt
during the
period) x 100%

This is the extent to which debt is covered by the cash generated from operations during the period.