CAPITAL
MARKETS AUTHORITY
Promoting the Integrity and Growth of the Capital Markets

Capital Markets Soundness Report (Kenya)

October – December 2016

Volume I

"Market Resilience in a Persistent Bear Run"

A Quarterly publication of the Capital Markets Authority (K)

1.0 Global Economic and/or Capital Markets Stability Performance, Challenges and Forecasts

According to World Bank's Global Economic Prospects report 2017, global economic growth is set to accelerate moderately to 2.7% in 2017.

a. Global Events: The year witnessed two key global events: Brexit and the US elections. The UK Government intends to invoke Article 50 of the Treaty on European Union by the end of March 2017, which would put it on a course to leave the EU by March 2019. Further, Donald Trump was voted in as President of the US raising uncertainty over the likely direction of foreign policies targeted towards developing nations and the rise of protectionism, a key concern for Kenya, as with many African nations.

These uncertainties may result to increased volatility in financial markets and higher borrowing costs, or even trigger a cut-off in capital flows to emerging and frontier markets. This is likely to affect economies of both emerging and frontier markets as capital flow from the Diaspora, foreign aid and debt have over the years played a significant role in shaping the economic landscape of these countries.

b. China Economic Slowdown: China has also experienced an extended slowdown in its Gross Domestic Product (GDP) in the last twelve months leading to December 2016 coupled with rising credit levels. From 2008 to 2015, China's overall debt jumped from 164% to 247% of GDP and has shown no signs of slowing down in 2016.Through aggressive debt creation and money printing, the People's Bank of China (PBOC) has created the largest money supply and total banking system assets of any country. Due to an unprecedented and aggressively accommodative monetary policy, China's total banking system assets stand at $31 trillion as of 2016, increasing by 210% over the past seven years. These factors have helped create an absurdly overvalued yuan. As a key financier of Kenya's major infrastructural projects, such as the Standard Gauge Railway (SGR)) through loans, coupled with being a key import destination for Kenyans, a slowdown in China's economy may ultimately translate to reduced advancements of such credit facilities to the country, especially if this trend continues.

It is thus necessary for frontier and emerging markets to ensure more prudent implementation of monetary and fiscal policies aimed at cushioning their economies from potential shocks that may arise amidst these uncertainties. There is also a compelling case for such economies to consider other more practical options for financing development projects, especially infrastructure financing through: either engaging a broader range of international development partners on financing or strongly considering raising private and public funds through domestic and global capital markets to finance huge development projects. In our view, the Governments of frontier and emerging markets should make strong policy pronouncements on their intentions rather than adopting a "wait and see" approach. The London Stock Exchange (LSE) provides a perfect example of individual jurisdictions' initiatives towards leveraging the capital markets to raise capital outside their borders, with more than 6,380 listed bonds, issued by 971 international issuers, from 64 countries raising $4.1Trillion, in 43 countries currently. These include Green Bonds and Sukuks that are available to a broad spectrum of sophisticated debt investors. Policy pronouncements would include dual listing of sovereign bonds (Eurobonds) and domestic currency issued bonds in local and international exchanges. Recent sovereign issuances in various currency domestic currencies, listed at the LSE include China (Yuan 3 billion), Abu Dhabi (US$ 2.5 billion) and Hungary (Chinese Yuan 1 billion) in 2016; as well as Cyprus (Euro 1 Billion) and Kazakhstan (USD 2.5 Billion) in 2015

Back home in Kenya, the Government has the opportunity to leverage capital markets financing to fund flagship Vision 2030 projects which could serve as one of the key areas of focus in the third Medium Term Plan (MTP3), currently under development. This could further be backed by quick wins through addressing bottlenecks to long-term capital raising through capital markets, such as delays in gazettement of the relevant regulatory instruments and provision of a full bouquet of tax incentives or at a minimum tax neutrality to support roll out of structured capital markets products to support vision 2030 flagship projects both at National and County levels. The Government should require that all its subsequent Eurobond issuances as well as both public and private debt issued in Kenya shillings, be subsequently dual listed at the Nairobi Securities Exchange and other International Exchanges, such as the LSE and the Irish Stock Exchange..

c. Increases in the US Fed Reserve Interest Rates: During the 2008 Global Financial Crisis (considered the worst economic disaster since the Great Depression of 1929) the Fed slashed rates to zero to revive the collapsed housing market. However, in the recent years, with improving economic trends, the Fed has announced steps towards increasing the rates over time with the first increase witnessed in December 2016. Higher interest rates have in the past strengthened the US Dollar against other global currencies and attracted capital away from emerging markets, which saw about $US 4.5 Trillion in gross inflows between 2009 and 2013.[1] This, as was seen with the 2013 "[2]Taper Tantrum" can have extremely detrimental impacts on capital availability to emerging markets. In Kenya this may translate to an outflow of capital by some foreign

[1] http://www.dailyforex.com/forex-articles/2015/11/how-do-fed-rate-hikes-affect-the-us-and-global-economies/50918

[2] Read more on taper tantrum on the link https://www.imf.org/external/pubs/ft/sdn/2014/sdn1409.pdf

investors in listed companies (foreign shareholding at NSE as at Dec.2016 is 27.33%[3]) as well as reduced inflows within the Kenyan borders, who would be pursuing better returns in less risky US Treasury paper.

1.1 Sub-Saharan Africa and Regional Economic Performance and Forecast

According to World Bank, growth in Sub-Saharan Africa is estimated to have decelerated to 1.5 percent in 2016, the lowest level in over two decades, as commodity exporters adjusted to low commodity prices, with regional GDP per capita contracting by 1.1 percent. Angola and South Africa are some of the oil exporters whose growth was negatively influenced by the end of the commodities super cycle and resulting low commodity price levels.

However, activities in non-resource intensive countries; agricultural exporters and commodity importers generally remained robust.

Forecast: Commodity prices are expected to stabilize, but stay well below their levels of 2011, and rise above 3.5 percent by 2018, as policies in oil exporters continue to adjust fiscal adjustment needs remain large. Growth in the region is forecast to rebound to 2.9 percent in 2018.[4]

1.2 Kenya's Economic Performance and Forecast

Kenya's economic growth prospects remain uncertain following the expected general elections in August 2017, interest rate controls, shortfalls in revenue collection and rising public debt.

According to the World Banks ease of doing business report 2017, Kenya was among the ten countries reported to have the most improved economies in 2015/16 according to the areas tracked by the Doing Business Report with an overall ranking of 92, 21 points above its previous rank of 113. Key areas of improvement were as below;

	Topic	DB 2017	DB 2016	Change in Rank
1.	Starting a business	116	150	⇧ **34**
2.	Dealing with construction permits	152	155	⇧ **3**
3.	Getting electricity	106	127	⇧ **21**
4.	Registering property	121	122	⇧ **1**
5.	Protecting minority investors	87	112	⇧ **25**
6.	Trading across borders	105	107	⇧ **2**

Source: World Bank

2.0 Capital Markets Performance

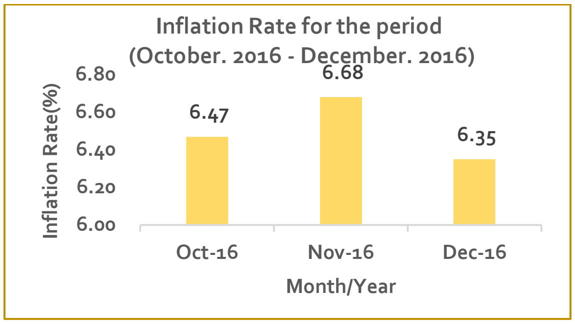
It is important to appreciate the trends in gross market data to establish their relationships before further analysis to observe how they affect overall financial stability.

2.1 Macroeconomic Statistics

[3] Source: Central Depository and Settlement Corporation(CDSC) Kenya

[4] World Bank Group Flagship report "Global Economic Prospects, Weak Investment in uncertain times, January 2017."

2.1.1 Inflation Rates



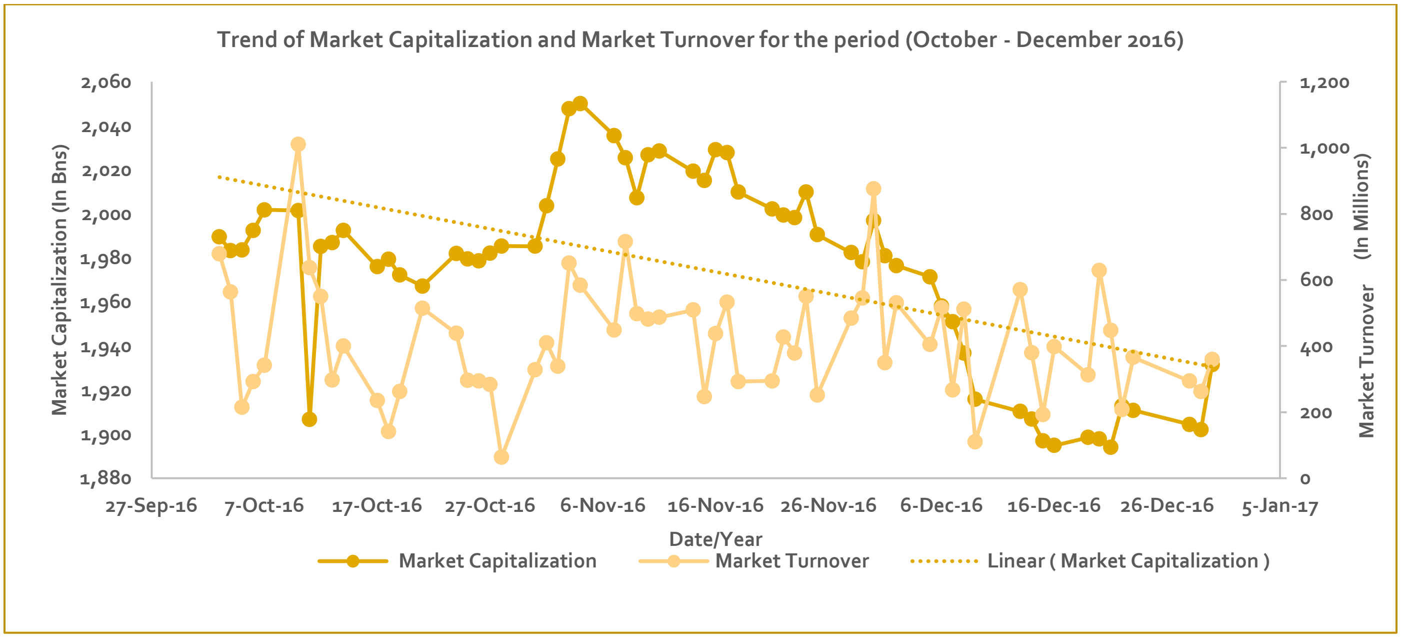
Source: KNBS

2.2 Market Turnover vs. Market Capitalization

The relationship between market turnover and market capitalization is important as the two indicators can be used to determine how liquid a market is –that is how frequently investors roll over their portfolio investments.

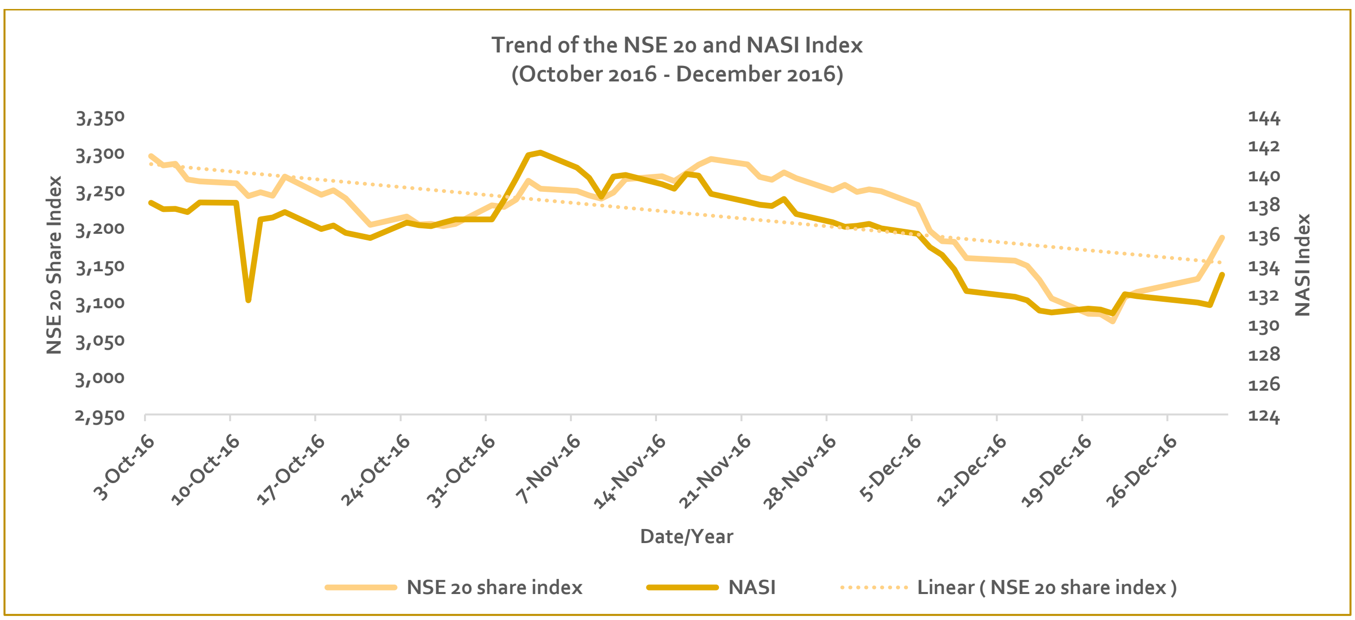
However starting the last week of November and feeding into the whole month of December, market capitalization remained below the Kshs.2 Billion mark. Of the sixty five listings at the Nairobi Securities Exchange, Safaricom recorded the largest market size accounting for 39.68% of total market cap as at 30th December 2016. Eighteen companies have a market share ranging between one percent and ten percent, with the remaining forty six accounting for less than one percent of total market cap confirming the dominance of the only company listed under the technology and telecommunications sector in Kenya's securities markets. Market turnover remained volatile in the period under review recording a low of KES. 63.07 Million and topping out at KES. 1,010 Million; both in the month of October.

Figure 1: Trend of Market Capitalization and Market Turnover for the period October – December 2016



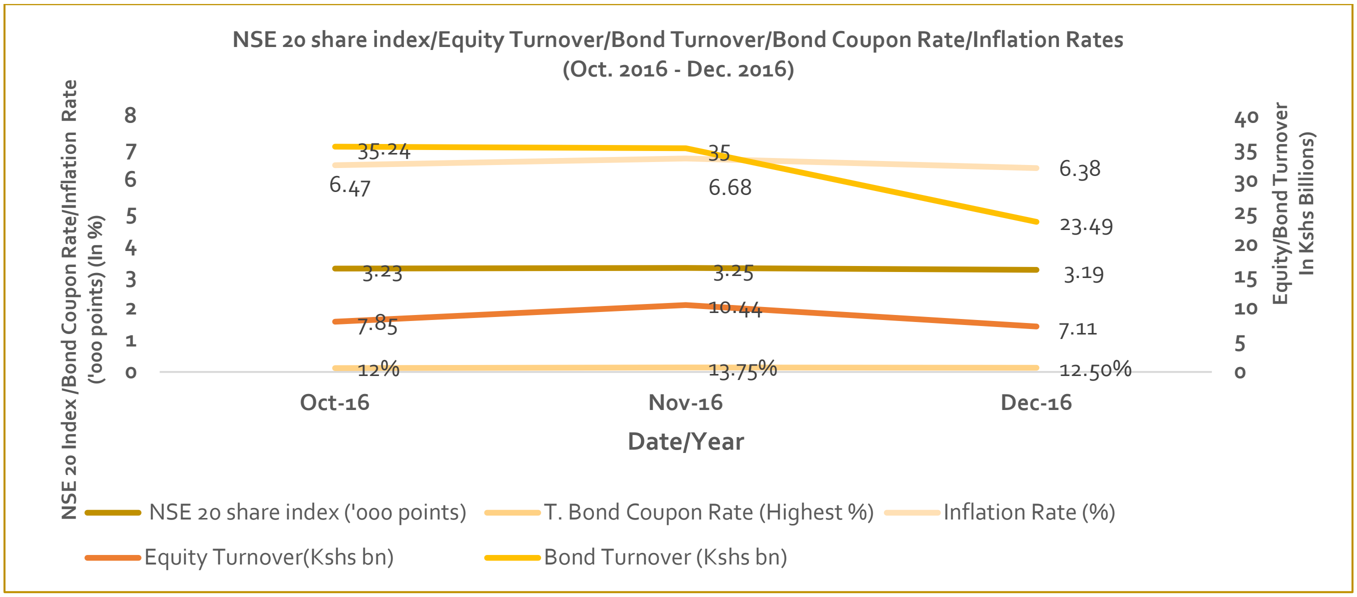
Source: NSE

Figure 2: Trend of the NSE 20 Share Index and NASI for the period October – December 2016



Source: NSE

Figure 3: Trends in interest rate and inflation rate vs Bond Turnover and Equities Turnover



Source: NSE/Capital Markets Authority

2.3 Performance of the bond and equities secondary market

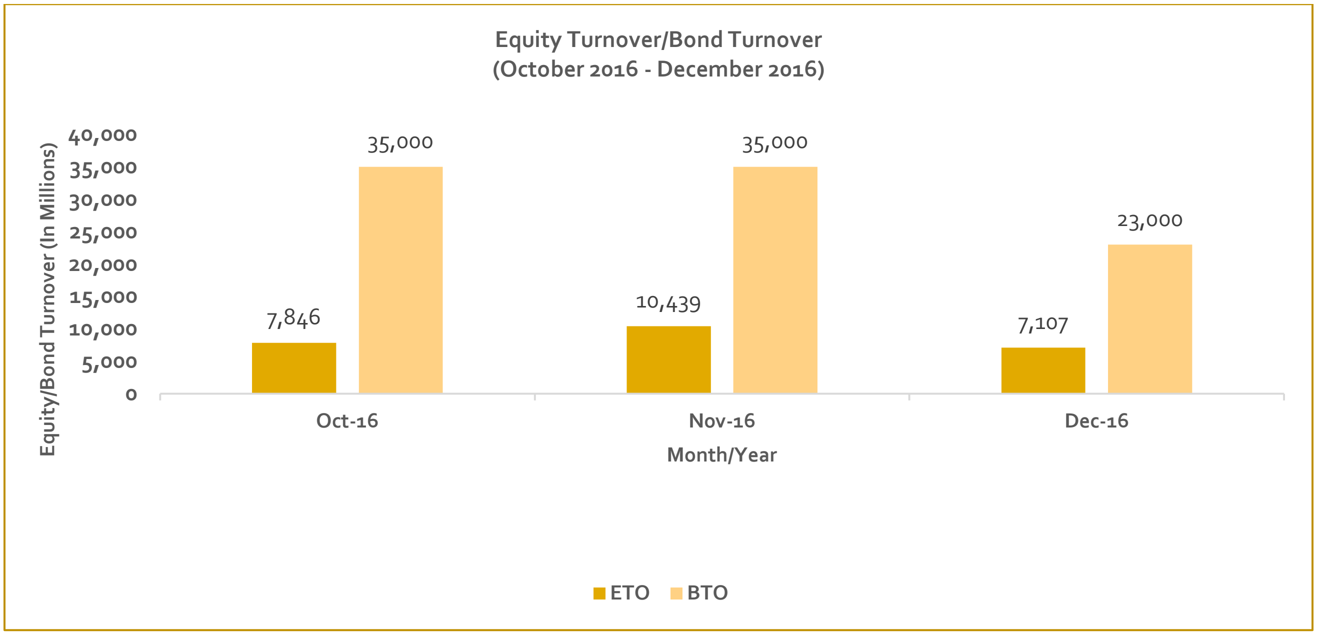
Performance of the indices equally depicted a downward trend in the fourth quarter of 2016 partially attributable to global events such as the US elections and the continued uncertainty following the Brexit Vote. Both Treasury Bonds and Equities turnover fell in December in spite of relatively stable inflation and coupon rates during the quarter as in Figure 3 below.

Additionally, investor caution in the lead up to an election year (2017) may have contributed to the poor performance of the indices as reflected by the negative compounded growth rates.

2.4 Equity Turnover and Bond Turnover

During the quarter, bond turnover remained higher compared to equity turnover recording 81.69%, 77.03% and 76.39 % of total market turnover in the months of October, November and December 2016, implying a shift by investors from equities to the bond market.

Figure 4: Equity Turnover and Bond Turnover for the period (October 2016 – December 2016)



Source: NSE

2.5 Performance of Listed Companies based on price movements

2.5.1 Top ten price gainers as at December 2016

	Counter	VWAP as at 30th Sep.2016	VWAP as at 30th Dec.2016	% Change
1	Kenya Airways	3.95	5.85	48.10%
2	Eaagads	20	27.25	36.25%
3	KenolKobil	11.3	14.9	31.86%
4	Eveready (E.A)	1.95	2.35	20.51%
5	Express Kenya	3	3.55	18.33%
6	Uchumi	3.35	3.95	17.91%
7	TPS Eastern Africa	17.55	20.5	16.81%
8	Kenya Re	19.8	22.5	13.64%
9	Mumias	1.15	1.3	13.04%
10	Nairobi Business Ventures	7	7.9	12.86%

Source: NSE/Capital Markets Authority

Kenya Airways: With the implementation of aggressive cost reduction and fleet optimization measures coupled with the review of the governance structure, with the appointment of Mr. Michael Joseph, former Safaricom CEO as the Chairman of the Kenya Airways board, investors have drawn positive expectations by opting to buy the share; hence the increased price.

Kenya Re: On 11th November 2016, Kenya-Re officially launched its Zambian Regional office which will be based in Lusaka City and will serve Namibia, Zambia, Zimbabwe, Botswana, Mozambique, Lesotho, Swaziland, Malawi and Angola with the intent of increasing reinsurance capacity for insurance companies in Africa. We believe that the rise in its share price could the impact of a possible re-allocation of funds after the bank interest rate cap and looking for an alternative stable financial sector holding.

2.5.2 Top ten price losers as at December 2016

		VWAP as at 30th Sep.2016	VWAP as at 30th Dec.2016	% Change
1	Deacons (EA)	9.95	6.05	(39.20)%
2	Sanlam Kenya	37	27.5	(25.68)%
3	Limuru Tea	650	530	(18.46)%
4	NMG	114	93	(18.42)%
5	E.A.Cables	7.2	5.95	(17.36)%
6	STANLIB FAHARI I-REIT	14	11.65	(16.79)%
7	Standard Group	19.5	16.5	(15.38)%
8	DTB(K)	139	118	(15.11)%
9	CIC	4.4	3.8	(13.64)%
10	Umeme Ltd	15.6	13.5	(13.46)%

Source: NSE

Umeme: In September 2016 Umeme Limited announced a 19.5% reduction in its Profit After Tax (PAX), attributing it to 'delays in recoveries for capital investments unaccounted for in the tariff methodology and normalization of the tax rate, which resulted in an effective tax rate of 32% compared to 9.1% in the first half of 2015. This coupled by the exit of its major shareholder Umeme Holdings Limited, a subsidiary of Actis Infrastructure 2 LP which owns 14.3% of the issued ordinary shares of Umeme are the most likely cause of the drop in its share prices, particularly given Actis substantial technical capacity support to the company . However, earlier in June 2016, during his delivery of the FY 2016/2017 Budget Speech, the Ugandan Minister of Finance had pronounced that the Government targets to double access to electricity among commercial and industrial users by 2040, by raising power generation with the completion of Karuma and Isimba dams. This may result in the growth of this company in the long-term

2.6 Performance of Market Intermediaries

The year was tough for market intermediaries' especially Stock brokers (SB) and Investment Banks (IB) taking into consideration the declining share prices of the top movers and the fixing of bank interest rate that affected the share prices of banks. Decline in turnover results in a commensurate decline in transaction fees which are calculated as a percentage of turnover, being a factor of volume and share price.

Investment Banks who usually acts as transaction advisers have also been affected because of decline in application of new issues by institutions especially banks. This is one of the most adverse effects of the delayed resolution of decision to place Chase Bank and Imperial Bank which were placed under receivership, and has resulted in great uncertainty over the fate of holders of Medium Term Notes issued by the Banks. This, is in addition to the moratorium declared on Fixed Deposit Accounts and Bank deposits (subject to maximum withdrawal limits set at Kshs. 1.5 million for Chase Bank Account holders and Kshs. 2.5 Million per Imperial Bank account holders), which altogether, locked up an estimated Kshs. 18.8 billion, in the Banks placed under receivership.

The cumulative primary impact due to the funds locked in by virtue of placing of these Banks remaining under receivership, is that investors are thereby not able to access their funds for purposes of investing in the capital market on the one hand whilst on the other hand securities issued by the banks are not available for trading. As a regulator acting in the interest of the public, the Authority continues to pursue possible interventions to secure bondholders' interest including advocating for the full implementation of Sec 29 (2) of Kenya Deposit Insurance (KDI) Act to ensure that the custodial accounts held in commercial banks and designated as trust accounts, continue to operate normally or are transferred to another custodian to allow normal operations even when the institution is under receivership or statutory management Fund Managers were also affected following decline in interest rates which in turn led to a slower growth of portfolio under management,

The Authority is banking on the reversal of the bearish trend, which is cyclic in nature for improvement in the profitability of its licensed market intermediaries, but also foresees them reviewing their business models to tap into new products and services relating to Derivatives, Real Estate Investment Trusts and Exchange Traded Funds.

3.0 Banking Industry Brief

Variable	2015 (Amounts in KES)	2016 (Amounts in KES)	Change
Total Volume	6,996,763,546	7,678,043,309	**681,279,763**
Total Value	209,197,297,217	147,178,325,246	**(62,018,971,971)**
Banking sector – Volume	2,333,261,702	1,864,551,070	**(468,710,632)**
Banking sector – Value	100,322,310,386	59,897,640,211	**(40,424,670,175)**
Banking Sector - % Total Volume	33.35%	24.28%	**(9.06)%**
Banking Sector - % Total Value	47.96%	28.93%	**(19.03)%**
Market Cap	2,049,000,000,001	1,931,000,000,001	**(118,000,000,000)**
Banking Sector Cap	662,957,794,711	498,647,492,870	**(164,310,301,840)**
Banking Sector - %Total Market Cap	32.36%	25.82%	**(6.53)%**

Source: NSE

The year 2016 saw the implementation of interest rate caps on banks effective September 2016; an item that re-opened discussions over the appropriateness of regulatory intervention in addressing market inefficiencies.

Analysis of the effect of the caps indicate a negative effect so far on the secondary equities market as tabulated below;

The Banking sector accounted for 47.96% of the total market value in 2015. During the subsequent year, the same industry accounted for 28.93% of the total market cap losing Kes.40 Billion or 19.03% by the end of December 2016. The erosion is still being witnessed with the current bear run in the market.

Further, the interest rate caps have limited access to credit by SMEs and other small businesses as banks result to loaning the government as it is less risky.

4.0 Current Capital Markets Stability Indicators (CMSIs)

1.0 Stock Market Volatility								
Equity Market Depth	**Quarter/Year**	**Statistics**				**Assessment of Risk Level (High – Medium – Low)**	**Performance Brief for the Quarter**	**Ongoing Intervention Measures**
NSE 20 Index Volatility	**Q4.2016**	**Oct**	**Nov**	**Dec**	**Q. Avg**	Low	In spite of the gradual decline in both the NSE 20 Index and NASI, volatility was relatively low compared to volatility levels recorded in previous quarters in the year (NSE prices were likely to deviate (from the mean by between 0.016% and 0.039% during the quarter ending December 31, 2016) as the index levelled out around its psychological 3000 points mark. Additionally, historical trends show that investor participation (both local and foreign) reduces as elections draw near.	To maintain the low volatility, the Authority has in consultation with stakeholders in the industry, developed draft policy and regulatory frameworks to support market making as plans are underway to introduce Securities Lending and Borrowing, and Exchange Traded Funds. The Authority believes that these market products and frameworks will help alleviate volatility by providing two way quotes and making securities available throughout trading sessions in the Securities Exchange(s)
		0.020%	0.026%	0.098%	**0.031%**			
	Q3.2016	**July**	**Aug**	**Sep**				
		0.211%	0.394%	0.148%	**0.152%**			
	Q2.2016	**April**	**May**	**June**				
		0.035%	0.219%	0.237% %	**0.140%**			
	Q1.2016	**Jan**	**Feb**	**March**				
		0.332%	0.113%	0.147%	**0.024%**			
NASI Volatility	**Q4.2016**	**Oct**	**Nov**	**Dec**	**Q. Avg**	Low		
		0.021%	0.012%	0.126%	**0.039%**			
	Q3.2016	**July**	**Aug**	**Sep**				
		0.065%	0.223%	0.067%	**0.030%**			
	Q2.2016	**April**	**May**	**June**				
		0.016%	0.108%	0.099%	**0.074%**			
	Q1.2016	**Jan**	**Feb**	**March**				
		0.313%	0.180%	0.180%	**0.016%**			
Quarterly Turnover Ratio	**Q4.2016**	**Oct**	**Nov**	**Dec**	**Q. Avg**	Medium	During the year Q4 recorded lower turnover ratios; a **47%** reduction compared with Q3. This is explained by the	The Authority is spearheading the introduction of new products to enhance liquidity such as Exchange Traded
		0.395%	0.523%	0.368%	**0.429%**			
	Q3.2016	**July**	**Aug**	**Sep**				

		0.664%	0.908%	0.856%	**0.809%**		depressed monthly turnover as NSE listed companies prices fell on reduced demand particularly by foreign investors. To a very large extent share prices of listed commercial banks and financial institutions who contribute to % of market turnover and market capitalization respectively following the interest rate cap policy effective September 2016.	Funds, Global Depositary Receipts/Global Depository Notes. This is in addition to having fully opened the listed equity companies at the Exchange. Initiatives like Direct Market Access and Securities Lending and Borrowing are also being forwarded by the Authority to increase market intermediary activity in the market further improving overall liquidity positions.
	Q2.2016	**April**	**May**	**June**				
		0.494%	0.479%	0.864%	**0.612%**			
	Q1.2016	**Jan**	**Feb**	**March**				
		0.674%	0.496%	0.646%	**0.605%**			
2.0 Foreign Exposure Risk								
Overall Foreign Investor Participation to Equity Turnover	**Q4. 2016**	**Oct**	**Nov**	**Dec**	**Avg**	**High**	Foreign investor participation in the quarter reduced by **11.55%** compared to Q3.2016. The NSE is largely driven by foreign investors and a reduction in foreign participation indicates a possible shift to the bond market or to other equity markets outside Kenya.	Through its Capital Markets Master Plan, the Authority provides multiple gateways for foreign investors to enter the market through new tailored products (Derivatives, ETF, and GDRs/GDNs), modernization of market infrastructure and world class policy and regulatory frameworks.
		67.07%	63.69%	74.10%	**68.29%**			
	Q3.2016	**July**	**Aug**	**Sep**				
		78.59%	69.85%	83.18%	**77.21%**			
	Q2.2016	**April**	**May**	**June**				
		65.86%	66.59%	56.41%	**62.95%**			
	Q1.2016	**Jan**	**Feb**	**March**				
		60.92%	43.18%	65.02%	**56.37%**			
		Oct	**Nov**	**Dec**	**Q. Sum**			

Net Foreign Portfolio Flow **(In KES Millions)**	**Q4.2016**	(125)	459	615	**949**	**High**	Net Foreign Portfolio levels reduced significantly by 84% in Q4.2016 when compared to Q3.2016 with October recording higher foreign sales than purchases.	Notwithstanding the uncertainties inhibiting growth in foreign investors participation, the Authority will ensure full implementation of the Capital Markets Master Plan recommendations on making the Kenyan capital markets globally competitive
	Q3.2016	**July**	**Aug**	**Sep**				
		974	3,703	1,343	**6,020**			
	Q2.2016	**April**	**May**	**June**				
		80	196	6,707	**6,983**			
	Q1.2016	**Jan**	**Feb**	**March**				
		(533)	281	(1,334)	**(1,586)**			
Market Concentration **(Top 5 companies by market cap)**	**Q4. 2016**	**Oct**	**Nov**	**Dec**	**Q.Avg**	**High**	The top five companies by market capitalization at the bourse accounted for **65.15%** of the market with Safaricom garnering the highest share. This makes performance of the exchange directly vulnerable to any shocks that affect the top five companies.	The Authority continues to conduct sensitization forums for SMEs and family businesses to consider listing on the exchange through the GEMS segment. This is aimed at ensuring that the market is not solely driven by large firms such as Safaricom.
		65.44%	65.37%	64.65%	**65.15%**			
	Q3.2016	**July**	**Aug**	**Sep**				
		62.82%	65.14%	65.33%	**64.43%**			
	Q2.2016	**April**	**May**	**June**				
		61.96%	62.61%	62.93%	**62.50%**			
	Q1.2016	**Jan**	**Feb**	**March**				
		60.39%	61.17%	61.81%	**61.12%**			
3.0 Government Bond Market Exposure								
Bond market turnover Concentration	**Q4. 2016**	**Oct**	**Nov**	**Dec**	**Q.Avg**	**High**	The Treasury bond market remains dominant in the Kenyan bond markets, accounting for **98.71%** during Q4.2016. The Authority in conjunction with other stakeholders is actively engaging Bond Market Steering Committee (BMSC)	The Authority in conjunction with the CBK and KDIC are actively pursuing both the Chase Bank and Imperial Bank cases to ensure confidence in corporate bonds is restored in the market.
		99.52%	98.34%	98.27%	**98.71%**			
	Q3.2016	**July**	**Aug**	**Sep**				
		99.73%	97.97%	98.28%	**98.66%**			
	Q2.2016	**April**	**May**	**June**				
		99.93%	98.66%	99.89%	**99.49%**			
	Q1.2016	**Jan**	**Feb**	**March**				
		99.48%	97.98%	99.61%	**99.02%**			

<table>
<tr><td></td><td></td><td></td><td></td><td></td><td></td><td></td><td>to identify mechanisms that would boost the level of corporate bond activity in the country but notes the delayed resolution of Imperial and Chase Bank remain significant stumbling blocks in the perception of the functioning of the corporate debt market.</td><td></td></tr>
<tr><td colspan="9">4.0 Investor Profiles (Equity & Bond Market)</td></tr>
<tr><td>Equity Market</td><td colspan="5"><table>
<tr><th>Category</th><th>No of Investors</th><th>No. of Shares Held</th><th>% of shares held</th></tr>
<tr><td>EC</td><td>254</td><td>730,900,499</td><td>0.85%</td></tr>
<tr><td>EI</td><td>7,521</td><td>202,614,074</td><td>0.23%</td></tr>
<tr><td>FC</td><td>685</td><td>17,387,472,758</td><td>20.15%</td></tr>
<tr><td>FI</td><td>8,077</td><td>909,307,935</td><td>1.05%</td></tr>
<tr><td>LC</td><td>41,572</td><td>24,422,833,318</td><td>28.31%</td></tr>
<tr><td>LI</td><td>1,200,268</td><td>42,621,076,461</td><td>49.40%</td></tr>
</table></td><td>High</td><td>Statistics on investor shareholding indicates that local investors account for 78.79% of shares held in the equity market with 21.21% being held by foreigners. However, shares held per foreign investor is 2,088,197 while per local investor is 54,399 indicating higher levels of participation by foreigners than local in acquiring shares.</td><td>The Authority recognizes the need to tap into retail investors in the country through actively engaging the public in investor education initiatives. This is done country wide through women groups, youth groups, university student organizations and professional bodies. The capital markets should be considered as an alternative channel of saving through which investors can earn returns.</td></tr>
<tr><td>Corporate Bond Market</td><td colspan="5"><table>
<tr><th>Category</th><th>No of Investors</th><th>Amount Outstanding in KES Bn</th><th>% of total outstanding</th></tr>
<tr><td>EC</td><td>11</td><td>180,600,000</td><td>0.23%</td></tr>
<tr><td>EI</td><td>11</td><td>39,900,000</td><td>0.05%</td></tr>
<tr><td>FC</td><td>4</td><td>855,672,500</td><td>1.08%</td></tr>
<tr><td>FI</td><td>109</td><td>511,866,005</td><td>0.64%</td></tr>
</table></td><td>High</td><td>98% of corporate bonds are held by local retail and corporate investors. The 93% holding by corporate investors poses some significant risks in the event</td><td>The Authority has made proposals to the National Treasury requiring commercial banks and other financial institutions to ring fence assets held in custodial accounts in</td></tr>
</table>

<table>
<tr><td rowspan="3"></td><td>LC</td><td>1,102</td><td>73,814,796,812</td><td>92.80%</td><td></td><td rowspan="3"></td><td rowspan="3">of default by the issuers as has been witnessed by the Imperial Bank and Chase Bank bond issues.</td><td rowspan="3">relation to bond issuers in case of failure of these institutions</td></tr>
<tr><td>LI</td><td>3,631</td><td>4,142,675,459</td><td>5.21%</td><td></td></tr>
<tr><td colspan="5">Source: CDSC
EC- East African Company; EI-East African individual; FC-foreign Company; FI-foreign individual; LI-local individual; LC-local Company</td></tr>
<tr><td colspan="9">5.0 Safety Net Infrastructure</td></tr>
<tr><td rowspan="8">ICF Coverage Ratio</td><td>Q4.2016</td><td>Oct</td><td>Nov</td><td>Dec</td><td>Q.Avg</td><td rowspan="8">Low</td><td rowspan="8">The Investor Compensation Fund for the quarter sufficiently covers investors' clients of investment intermediaries in cases where the investment intermediary is not able to perform its obligations as the balances as at December 2016 are able to cover up to 3.88 of the average daily market turnover in the quarter under review.</td><td rowspan="8">The Authority continues to ensure that market intermediaries strictly contribute their shares into the fund as per the required deadlines thus making sure that at any given time, the funds' balances are able to meet client investments in the market.</td></tr>
<tr><td></td><td>4.02</td><td>3.36</td><td>4.28</td><td>3.88</td></tr>
<tr><td>Q3.2016</td><td>July</td><td>Aug</td><td>Sep</td><td></td></tr>
<tr><td></td><td>2.24</td><td>2.01</td><td>1.94</td><td>2.06</td></tr>
<tr><td>Q2.2016</td><td>April</td><td>May</td><td>June</td><td></td></tr>
<tr><td></td><td>3.01</td><td>3.22</td><td>1.83</td><td>2.69</td></tr>
<tr><td>Q1.2016</td><td>Jan</td><td>Feb</td><td>March</td><td></td></tr>
<tr><td></td><td>2.16</td><td>2.86</td><td>2.25</td><td>2.43</td></tr>
<tr><td rowspan="7">SGF Coverage Ratio</td><td>Q4.2016</td><td>Oct</td><td>Nov</td><td>Dec</td><td>Q.Avg</td><td rowspan="7">Medium</td><td rowspan="7">SGF Ratio for the quarter averaged at 1.89 indicating the sufficiency of the fund to address any liability or loss to investors that is likely to result following default by securities dealers.</td><td rowspan="7">The Authority continuously monitors the guarantee fund balances held by the CDSC to ensure that at any given time the fund's value supersedes overall value of market activity. In addition, through its inspections to market intermediaries, the Authority monitors the financial position of the firms to ensure that they</td></tr>
<tr><td></td><td>1.95</td><td>1.63</td><td>2.08</td><td>1.89</td></tr>
<tr><td>Q3.2016</td><td>July</td><td>Aug</td><td>Sep</td><td></td></tr>
<tr><td></td><td>1.10</td><td>0.99</td><td>0.94</td><td>1.01</td></tr>
<tr><td>Q2.2016</td><td>April</td><td>May</td><td>June</td><td></td></tr>
<tr><td></td><td>1.45</td><td>1.60</td><td>0.91</td><td>1.32</td></tr>
<tr><td>Q1.2016</td><td>Jan</td><td>Feb</td><td>March</td><td></td></tr>
</table>

<table>
<tr><td></td><td></td><td>1.05</td><td>1.40</td><td>1.10</td><td>1.18</td><td></td><td></td><td>are in good standing and investors are protected from any adverse effects that could otherwise result.</td></tr>
<tr><td colspan="9">6.0 Asset Base of Fund Managers, Stockbrokers, Investment Banks</td></tr>
<tr><td>Assets Under Management by CMA Licensees</td><td colspan="5">
<table>
<tr><th colspan="4">As at 30th September 2016
(Amount in KES Millions)</th></tr>
<tr><th>CMA Licensee</th><th>Total Assets</th><th>Total Liability</th><th>Net Assets</th></tr>
<tr><td>Fund Managers</td><td>6,377.15</td><td>1,971.73</td><td>4,405.42</td></tr>
<tr><td>Investment Banks</td><td>9,532.53</td><td>2,357.50</td><td>7,175.04</td></tr>
<tr><td>Stockbrokers</td><td>4,390.80</td><td>1,598.70</td><td>2,792.10</td></tr>
</table>
</td><td></td><td>Total Assets Under Management by Fund Managers, Investment Banks and Stockbrokers as at 30th Sep. 2016 was 6.38 Billion, 9.53 Billion and 4.39 Billion respectively.</td><td>The Authority acknowledges the need to expand the financial services sector by licensing firms that wish to operate in any of its licensee businesses such as stockbroking, fund management, investment banks, collective investment schemes etc. However, there is need that these firms meet the minimum requirements for each financial service offered as outlined by the Capital Markets (Licensing Requirements ((General) Regulations 2002.</td></tr>
</table>

5.0 Market Infrastructure, New Products and Systems Stability

5.1 Operationalization of the Derivatives Exchange

The Capital Markets Authority in conjunction with the NSE, CDSC,CBK and other market participants have been on a journey to operationalize a functional derivatives exchange in the country. A robust project plan has since been launched. Key milestones achieved to date include;

- Rules, procedures and various contractual arrangements between market players are already in place;
- Systems have been deployed and are currently undergoing User Acceptance Tests before Market "Go-Live".
- A Risk Management framework has also been developed by the CMA to guide the market on the Authority's expectations in this regard.

In addition a robust enforcement manual is currently under development to ensure on-market integrity and build a culture of fair trading and compliance.

The Authority has received formal proposals by the Nairobi Securities Exchange on appropriate fees for Derivatives transactions and placed this on public exposure for the statutory 30 day period.

5.2 M-Akiba

Active efforts towards the launch of M-Akiba (a mobile phone-based trading platform for retail bonds in Kenya) were made during the year 2016 through continuous consultations with stakeholders. The Government of Kenya plans to issue M-Akiba Bond on a pilot basis to enable stakeholders determine what areas need to be refined in the model. The proposed tenure is 3 months and the product is to be issued to a closed sample of investors.

5.3 Other Market Developments

5.3.1 Islamic Finance

During the quarter, CMA was admitted as an Associate member of the Islamic Financial Services Board (IFSB). This development will further imprint Kenya's position as the next Islamic Finance hub and it is imperative that the Authority will influence the development of global standards and policies that take into consideration the level of development of this industry across the globe.

5.3.2 New Products and Innovations

5.3.2.1 ETF and GDR Applications

In the fourth quarter 2016, the Authority received formal applications for the listing of Exchange Traded Funds (ETF) and Global Depository Receipts (GDRs). The applications are currently in the final stages of review and should be forwarded for consideration in the next Compliance and Facilitation Committee.

5.3.2.2 Asset Backed Securities

Between 10th October and 14th October 2016, the Authority conducted extensive stakeholder engagements on Asset Backed Securities targeting policy makers, potential issuers and regulators. At least four potential ABS issuers have showed interest though no formal submissions have been made yet to date as most market players await publication of the official Policy Guidance Notes which are scheduled for board submission in due course.

To address low uptake of new products in the secondary markets, the Authority has and will continue to facilitate capacity building and stakeholder awareness initiatives aimed at enhancing the understanding and interest in these products.

6.0 CMA Investigations and Enforcement

6.1 Uchumi Supermarkets

In November 2016, the Authority sanctioned former Uchumi Supermarkets directors and managers including ex-chief executive Jonathan Ciano with penalties totaling Kshs. 21.7 million for their roles in failures in corporate governance oversight, financial reporting, managing conflicts of interest and misrepresentation and omission of key disclosure to investors during the rights issue held in 2014.

7.0 New Opportunities in the Capital Markets

7.1 Fintech and the Regulatory Sandbox

The Capital Markets Authority of Kenya (CMA) and the Australian Securities and Investments Commission (ASIC) on 21st October 2016 signed a Co-operation Agreement which aims to promote innovation in financial services in their respective markets. The agreement sets up a framework for co-operation between the CMA and ASIC in expanding the space of innovation in financial services and the Regulatory Sandbox.

7.2 Project Financing at County Level

In line with its efforts of providing alternative funding mechanisms for infrastructure at devolved level, the Authority is finalizing a policy framework to support the unique requirements for project financing through asset securitization, bearing in mind concerns over fiscal discipline and the restrictions under the Public Financial Management Act (PFMA).

This will augment the National Government transfers to county governments. Access to capital markets by county governments provide an array of benefits to Kenya's economy such as;

i. Allowing Central Government to substitute credit financing for state grants in support of local capital investment resulting to relieved pressure on state budget while supporting decentralization through promoting local investment choices; and

ii. Market-based lending to counties increases efficiency of local investment by making clear the true cost of capital. State capital grants, like subsidized loans from State agencies, reduce the apparent cost of capital, encouraging local governments to invest inefficiently; and

iii. Development of a municipal credit system which has the potential to allow local authorities to sustain or even increase their high levels of investment, while decreasing central government capital subsidies.

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