

**THE NATIONAL TREASURY  
REVIEW OF FINANCIAL SERVICES AUTHORITY  
(FSA) BILL AND IMPROVING FINANCIAL SECTOR  
MARKET CONDUCT IN KENYA**

Summary of FSA bill for Insurance Industry  
meeting, 27<sup>th</sup> April 2016, Fairview Hotel,  
8.30am

# Taskforce rationale for FSA

1. Presidential Taskforce on Parastatal Reforms recognised the need to consolidate financial regulators in the securities, insurance, pensions and financial cooperatives sub-sectors
2. Rationale for consolidating CMA, IRA, RBA and SASRA:
  - increasing integration
  - convergence in financial services
  - blurring the lines between banking, insurance, capital markets and long-term pensions sectors
  - Reducing regulatory arbitrage
  - Addressing regulatory gaps
3. Reducing compartmentalised and fragmented industry oversight (silos)
4. *Because of prior delay, current phase is being done in extremely limited time and with urgency*

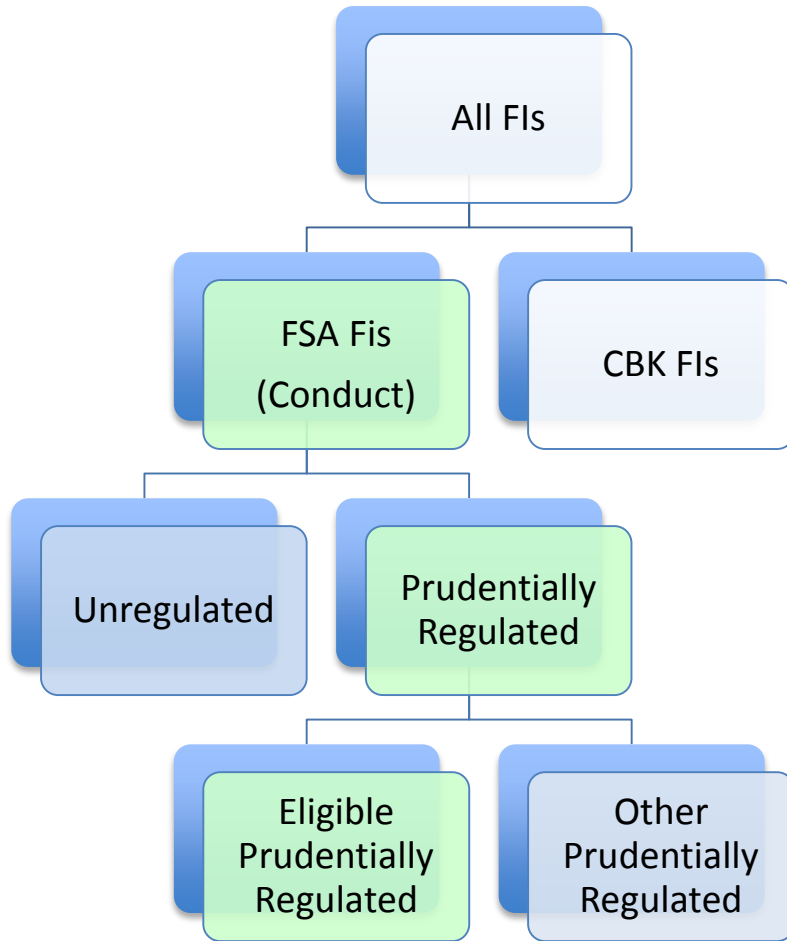
# Cost of Credit Committee

1. In 2014, H. E. Deputy President directed formation of Committee on Cost of Credit and Mortgage Finance
2. Led by CS Treasury, with participation of CS Health, CS Industrialisation, CBK Governor, and other experts
3. Wide ranging recommendations, but w.r.t. consumer protection:
  - Ensure disclosure of lending rates
  - Increase transparency in pricing of financial products
  - Develop financial services consumer protection framework
  - Develop financial education national strategy and framework
  - Develop unified oversight of credit provision
  - Develop approach to oversee unregulated credit sector
4. These recommendations added impetus to the work on holistic financial sector market conduct framework, including finalising the FSA legislation and market conduct framework to provide a strong legal and institutional framework

# Main Elements of the FSA Bill

1. Establish the FSA
2. Provide stronger prudential powers through:
  - General prudential rule-making powers
  - Access to the full suite of enforcement powers introduced here for conduct
  - Jurisdiction and regulatory powers over non-bank financial conglomerates
3. Provide powers to support conduct regulation:
  - Conduct rule-making power
  - Conduct license
  - Regulation of SROs
  - Information gathering
  - Inspections and investigations
  - Enforcement
4. Establish a Statutory Ombudsman Scheme (for customer complaints)
5. Establish a Customer Compensation Fund (with industry sub-funds)
6. Establish a Tribunal (for industry complaints)
7. Financial arrangements (industry funded)
8. Transitional provisions
9. Consequential amendments

# Key Relationships, definitions



- Financial institutions = all FIs minus CBK supervised FIs
- Prudentially regulated = existing 4 industries
- Eligible FIs = large prudentially regulated FIs (for conglomerates) i.e.,
  - Insurers
  - Saccos
  - Exchanges, clearing houses, depositories

Objective: no provider of a financial product or service should escape conduct regulation (unless by explicit exemption)

# Financial Products and Services

**3. PRODUCT:** a facility or arrangement through which a person:

- (a) makes a financial investment
- (b) manages financial risk
- (c) makes non-cash payments
- (d) provides credit under a credit agreement
- (d) regulations may prescribe
- (b) regulations may exempt

**4. SERVICE:** in relation to a financial product:

- (a) providing financial product advice
- (b) dealing in a financial product
- (c) making a market for a financial product
- (d) administering or managing
- (d) regulations may prescribe
- (e) regulations may exempt

## Part II: The FSA - Objectives

- a) promote and enhance the safety and soundness of prudentially regulated financial institutions;
- b) enhance and support the efficiency and integrity of financial markets;
- c) promote public confidence in and encourage the development of the financial sector;
- d) protect financial customers by—
  - (i) promoting fair treatment of financial customers by financial institutions; and
  - (ii) providing financial customers and potential financial customers with financial education programs, and otherwise promoting financial literacy and the ability of financial customers and potential financial customers to make sound financial decisions; and
- e) promote systemic stability in the financial sector; and
- f) subject to paragraphs (a) to (e) —support the economic policy of the Government, including its objectives for growth and employment.

# FSA Governance and Structure

Most characteristics of FSA align with the 2014 draft (which you would have seen):

- The Board (of 9) will be an oversight Board (responsibility in s17):
  - Governance
  - Strategy
  - Policy
  - Monitoring performance
  - Financial oversight
- Other responsibilities (e.g., issuing rules, licensing, enforcement actions, MOUs, etc) will reside with CEO, with advice from EXCO
- No legislated silos or organisational detail



# Part III: Rules

Objective is to give FSA (through CS) power to issue Prudential and Conduct Rules under this Act:

- rules are statutory instruments and will follow the SIA procedure (consultation etc)
- rules must align with FSA's objectives (Note: since most market integrity rules are in law (CMA) FSA conduct rules will be mainly for customer protection)
- CBK concurrence where a CBK-regulated entity is involved (conglomerates) and consultation where aimed at systemic stability

# Part IV: Conduct Licence

Objective is to give FSA power to license FIs that provide products or services, subject to carve outs (CBK) and a progressive roll-out:

- You need a licence to provide a product or service
- Licence will be perpetual
- Bill gives guidance to FSA on things to consider in licensing – more detail in rules/regulations
- Single licence model - classes of licence will be left to FSA
- FSA may vary, suspend, revoke, impose conditions, etc. and exempt
- Transitional provisions will provide a blanket exemption with FSA to determine roll-out (6 to 12 months)

# Part V: Self regulatory organizations (SROs)

- FSA may authorize SROs
- FSA may delegate specified regulatory powers or functions to an SRO
- An SRO so authorised is still subject to FSA oversight and delegation may be taken back
- SRO may issue directives to SROs
- SROs must advise FSA of disciplinary actions
- SROs receive same legal protections for actions not taken in bad faith as the FSA has

# Part VI and VII: SOs and Conglomerates

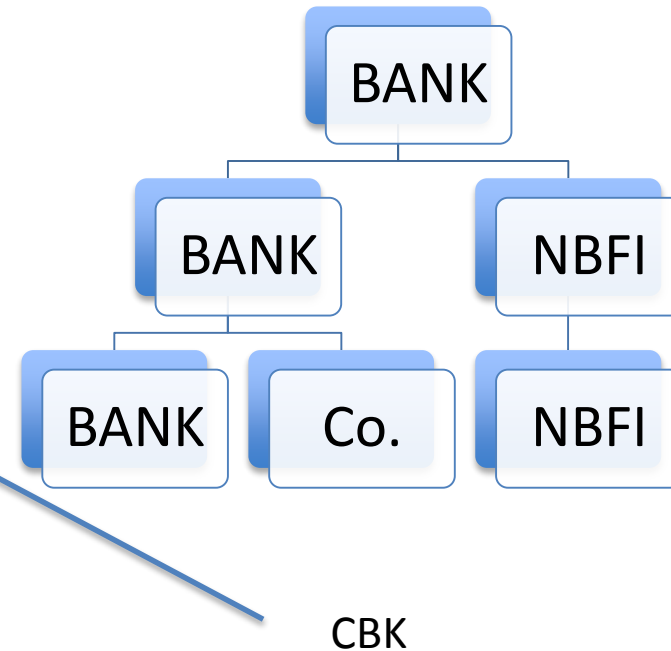
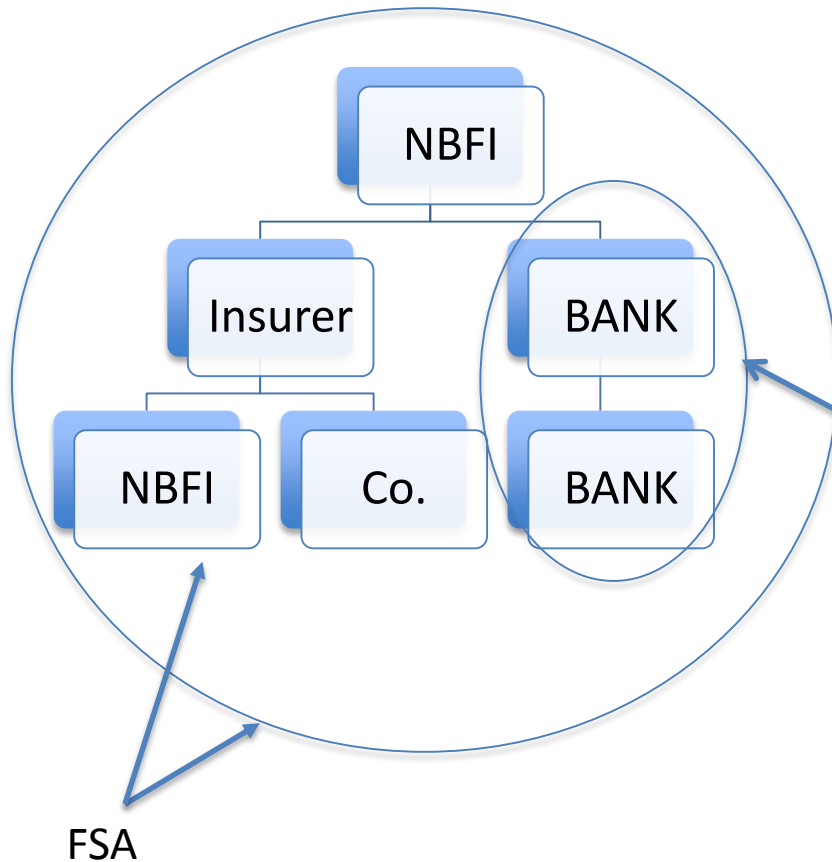
Objective is to give FSA power to regulate and supervise financial conglomerates that are headed by an entity that is not regulated by the CBK – and which include an eligible FI:

- Significant Owners of eligible FIs (ELIs) must be approved on the way up and down
- FSA designates conglomerates and scope for regulation – purpose is to protect the ELI
- FSA may license HCs and may require them to be a NOHC
- FSA can make rules for HCs and enforce them

# FSA and CBK: Conglomerates

FSA-regulated Conglomerate

CBK-regulated Conglomerate



And same for CBK-regulated conglomerates

# Part VIII: Information

- FSA can request specified information from anyone in order to assess compliance with law or to assist it to perform its functions
- Licensed FIs must comply

# Part IX: Inspections and Investigations

Objective is to give FSA power carry out routine on-site inspections and investigations:

- Sets out grounds for both actions
- Inspections are “friendly”
- Investigations are “on suspicion”
- An investigation requires a warrant and must follow procedure
- Persons need to be warned about self-incrimination under an investigation
- Protections for privileged documents
- Must not intentionally or negligently interfere or hinder
- It is an offense to destroy a relevant document

# Part X: Enforcement

This part gives FSA powers to issue directives, enforceable undertakings, debarments, and administrative penalties (paid to the compensation fund).

## Part XI: Statutory Ombudsman Scheme

- Ombudsman is independent entity, funded by industry
- Ombudsman Board, Chief Ombudsman and 2 others appointed by CS
- Ombudsman may make rules
- Customer must attempt to resolve with FI first
- Grounds for hearing a case:
  - Provider contravened the law
  - Provider breached contract
  - Provider treated customer unfairly
- Ombudsman decisions are binding on the FI but not on the customer
- Ombudsman may make rules



# Part XII: Compensation Scheme

- The Financial Sector Compensation Scheme provides a single administrative structure for five funds: one for customers of each of the four existing industry groups and one for conduct
- All fines are paid to the Fund
- Funds are also accumulated by taking a portion of the industry levies and licence fees
- A financial customer who suffers loss from a contravention of a financial sector law by a licensed person is entitled to recover from the relevant Compensation Fund
- Grounds for application:
  - Provider contravened the law
  - Provider breached contract
  - Provider is insolvent

# Part XIII: Tribunal

Objective is for Tribunal to review industry complaints against the FSA:

- This Part sets up Tribunal – Judicial Services Commission appoints and funds
- Grounds for review and process are set out in the definition of a reviewable decision –
  - Decisions by FSA against a particular person/entity (includes fines and debarments etc.)
  - Decisions relating to claims on the compensation fund
- S137 limits most decisions to - reject or set aside and return to FSA to reconsider
- Only in the case of administrative penalties is the Tribunal able to overturn the FSA's decision and substitute the decision of the Tribunal

# Part XIV: Finances

- This part establishes the FSA's financial arrangements
- Industry levies and fees will fund FSA, and the operations of the Ombudsman and the Compensation Fund
- The intention is to freeze levy rates for a period
- The final Part deals with the miscellaneous and transitional provisions

# Market conduct framework

1. Main purpose is to inform stakeholders about FSA's conduct responsibilities and how it will go about them – this is the FSA's key information document
2. FSA Board will likely hold a strategic planning session soon after it is formed – this draft is designed as a rough draft to assist the Board and senior management in preparing their own, fuller document

# Outline of the conduct framework

## Background and Context

1. Introduction
2. What conduct regulation is

## Main Tools of Conduct Regulation

3. Market Intelligence and analysis
4. Licensing
5. Conduct rules and guidance
6. Supervision for market integrity
7. Supervision for customer protection
8. Enforcement
9. Dispute resolution
10. Customer education
11. Stakeholder engagement

## Implementation

# Next steps

- Finalization of FSA Bill and Framework incorporating comments from industry stakeholder and the public, etc
- Public consultation in May 2016
- Finalization of all outputs early June 2016; final report by end of June 2016
- National Treasury is introducing the FSA Bill with the 2016/2017 budget in June 2016
- ***This will only be a first phase; further work could take 1-3 years***
- Phase II work could include finalizing review of underlying laws, new regulations and rules, including transition planning
- **If any, written comments to be sent to The National Treasury (Attn. Ag. Director, Financial and Sectoral Affairs Dept.) with copy to CEO of the respective regulator, to reach no later than 20<sup>th</sup> May 2016**