“Development of the Capital Markets: The Kenyan Experience”

Ghana Capital Markets Conference 2013
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Mr. Paul Muthaura,
Ag. Chief Executive Capital Markets Authority
PRESENTATION OUTLINE

- Market Context
- Who we are
- Benefits to the Economy
- Structure of the capital markets
- Capacity Track Record
- Environmental considerations
- Ongoing Reforms and Developments in the Capital Markets Industry
## KENYAN ECONOMY AT A GLANCE VERSUS KEY BENCHMARK ECONOMIES

<table>
<thead>
<tr>
<th>COUNTRY</th>
<th>RATING STANDARD AND POOR'S (CURRENT)</th>
<th>POPULATION (MN)</th>
<th>GDP (USD BN)</th>
<th>PER CAPITAL INCOME (USD)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Brazil</td>
<td>BBB</td>
<td>194</td>
<td>1,830.4</td>
<td>9,390</td>
</tr>
<tr>
<td>Malaysia</td>
<td>A-</td>
<td>28.4</td>
<td>220.4</td>
<td>7790</td>
</tr>
<tr>
<td>South Africa</td>
<td>BBB+</td>
<td>50</td>
<td>304.6</td>
<td>6090</td>
</tr>
<tr>
<td>India</td>
<td>BBB-</td>
<td>1,224.6</td>
<td>1,553</td>
<td>1270</td>
</tr>
<tr>
<td>Kenya</td>
<td>B+</td>
<td>40</td>
<td>47</td>
<td>790</td>
</tr>
<tr>
<td>Indonesia</td>
<td>BB+</td>
<td>239.9</td>
<td>599.2</td>
<td>2500</td>
</tr>
</tbody>
</table>

Source: World Bank Development Data 2012 (Population adjusted to latest census figures for Kenya)
Overview Kenya’s Financial System

Ministry of Finance

CBK
- Money Markets
  - Comm. Banks
  - Forex Bureaus
  - Mortgage Company
- 6 Micro Finance Institutions
- Building Societies
- 2 Credit Reference (CRB)

CMA
- Capital Markets
  - Sec. Exchanges
  - CSDs
  - Credit Companies Rating
  - Stockbrokers
  - Investment Banks
  - Listed Companies
  - Fund Managers
  - Investment Advisors
  - Custodians
  - CIS
  - Venture Companies

IRA
- Insurance Companies
- Reinsurance Companies
- Insurance brokers, etc

RBA
- Retirement Benefits Schemes
- Registered Administrators
- Fund Managers
- Custodians

SASRA
- Registered Sacco Societies
- FOSA

CBK Act
Banking Act

Micro Finance Act

Capital Markets Act
CDS Act, Rules and Procedures
Public Offers regulations
Licensing Regulations

Retirement Benefits Act

Coop. Societies Act
THE OBJECTIVES OF CMA

The principle objectives of the Authority are:

1. The development of all aspects of the capital markets with particular emphasis on the removal of impediments to, and the creation of incentives for longer term investments in productive activities;

2. To facilitate the existence of a nationwide system of stock market and brokerage services so as to enable wider participation of the general public in stock market;

3. To create, maintain and regulate a market in which securities can be issued and traded in an orderly, fair, and efficient manner, through the implementation of a system in which the market participants regulate themselves to the maximum practicable extent;

4. To protect investor interests;

5. To operate a compensation fund to protect investors from financial loss arising from the failure of a licensed broker or dealer to meet his contractual obligations;

6. To develop a framework to facilitate the use of electronic commerce for the development of capital markets in Kenya.
COMPOSITION OF CMA’S BOARD OF DIRECTORS

- Ministry of Finance
  - The Chairman
    - Permanent Secretary, Treasury
    - Governor of Central Bank
    - The Chief Executive
    - The Attorney General
    - Six Financial Sector Experts
Our Mandate

CMA is an independent public agency charged with the responsibility of regulating and facilitating the development of orderly, fair and efficient capital markets in Kenya.

Our Vision

To be a world-class regulator of a vibrant capital market.

Our Mission

To promote market confidence, investor protection and access to financial services within the capital markets in Kenya and the region through effective regulation and innovation.
1922- Earliest recorded stock trading in Kenya (as a British Colony)
1954- Nairobi Stock Exchange established as an association-using call over system of trade (over coffee at the Stanley Hotel, Nairobi)
1989- CMA established through an Act of Parliament
1996- First Debt Instrument issued (corporate bond)
1998- Largest IPO in Sub-Saharan Africa issued (USD 300 million)
2011- Bond Turnover surpasses Malaysia
2013 April - Kenya records second highest equity returns in Dollar terms in the Globe of 30.86% (incidentally after Ghana with 55.99%-MSCI report)
WHERE WE WANT TO BE

- International Financial Center
  - Islamic Finance Capital
  - Leading Futures and Derivatives Market in Africa
  - Center of Knowledge in Capital Markets in Africa
- Gateway to Africa’s capital markets
  - Vision 2030 Flagship

Target? Next 5 Years
BENEFITS OF CAPITAL MARKETS TO THE KENYAN ECONOMY

- Provides equity and debt capital to entrepreneurs by mobilizing long-term savings - Attainment of the Kenyan Vision 2030 (middle income economy)

- Encourages broader ownership of productive assets by small savers to benefit from economic growth and wealth distribution - Retail investor empowerment through privatization, divestiture and other public offered securities

- Diffuses stresses on the banking system by matching long-term investments with long-term capital - Infrastructure financing

- Enhances corporate governance
Provides **exit mechanism** for entrepreneurs to unlock their investments—boosts Venture capital and private equity investment given confidence on exit options.

Improves efficiency of capital allocation through **competitive price discovery** and valuation of entities—Regulated securities exchanges—formal and OTC trading platforms—markets.

Gateway to Kenya for global investors and foreign direct investments (FDI)—where we want to be in 5 years.
### MARKET LICENSEES

<table>
<thead>
<tr>
<th>Licensed/approved Institutions</th>
<th>April 2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Securities Exchange (NSE)</td>
<td>1</td>
</tr>
<tr>
<td>2 Central Depositories (CDSC)</td>
<td>1</td>
</tr>
<tr>
<td>3 Investment Banks</td>
<td>12</td>
</tr>
<tr>
<td>4 Stockbrokers</td>
<td>10</td>
</tr>
<tr>
<td>5 Investment advisers</td>
<td>19</td>
</tr>
<tr>
<td>6 Fund Managers</td>
<td>21</td>
</tr>
<tr>
<td>7 Collective Investment Schemes</td>
<td>16</td>
</tr>
<tr>
<td>8 Authorized depositaries/Custodians</td>
<td>14</td>
</tr>
<tr>
<td>9 Credit Rating Agencies</td>
<td>2</td>
</tr>
<tr>
<td>10 Venture Capital Companies</td>
<td>1</td>
</tr>
<tr>
<td>11 Dealers</td>
<td>1</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>98</strong></td>
</tr>
</tbody>
</table>

In 1999 Kenyan Capital Markets only had 14 Stockbrokers, 1 Securities Exchange, and the Regulator (CMA)
Blueprints for Capital Markets Development in Kenya

- Capital Markets Authority Vision 2002-2005
- CMA Strategic Plan 2007-2009
- CMA Strategic Plan 2009-2012 (alignment with Vision 2030 and Medium Term Plan (MTP - I))
- CMA Strategic Plan 2013-2017 (under development)
- Capital Markets Master Plan 2013-2022 (under development)- Strategy development at industry rather than Authority level
Capital Markets in Kenya traditionally started with Equity and Bond

Product Structure

Equity market
- Ordinary Shares (<1954)
- Unit Trusts (2000)
- Islamic Unit Trusts (2011)
- REITs (2013+)
- Venture Capital/Private Equity (1999)

Debt market
- Treasury Bonds (1997)
- Corporate Bonds (1996)
- Commercial Paper (1996)
- County Bonds
- Asset Backed Securities

Derivatives market
- Futures and Options (2013)
- Commodity Futures (2013)
- Forward Contracts
- Currency Futures (2013)
- Financial Derivatives (2013)
  - Index Futures (2013)
  - Equity/Bond Futures (2013)

Primary and Secondary Market

Secondary Market

Now offers ABS, REITs, Futures and Derivatives, etc.
MILESTONES – MARKET PERFORMANCE

- Total Market capitalization (Equity and Bonds) as at April 30, 2013 was USD 26 billion: the highest in the country’s history

- Largest Equities Exchange in East and Central Africa
  - Nairobi Securities Exchange has 61 out of the 94 listed companies in the East African region
  - Nairobi Securities Exchange is the fourth largest market SSA (after South Africa, Egypt and Nigeria) in terms of equity market capitalization at USD 18 billion (as at April 2013)

- The Settlement Cycle is at T+3 matching an international standard yet to be implemented by even South Africa
The largest corporate bond raising in Nairobi was for Kshs 25 billion (> US$320 million)

15 corporates have accessed the bond market for more than Kshs 72 billion (> US$840 million) but drops to Kshs 47 billion if one exceptional is excluded

Between 2002-2012 GOK sought to raise Kshs 1.248 trillion in Gilts – bids of Kshs 1.8 trillion was received – year 2012 was Kshs 143 billion (US$1.7 billion)

KENGEN is set to raise Kshs 30 billion (USD 300 Million through the first Asset Backed Security in 2013


Issuances despite impact of recent international market instability:

Over Kshs. 63 Billion / USD 760 mln raised in the capital markets from IPOs, Rights Issues & Public Offers (2008 – 2013)
2012 was also a good year for foreign inflows. (figures as of March 2013)

Kenya’s Net Equity Flows in Kshs Millions

- Net Equity Flows (Kshs M)
- Month

- 2009
- 2010
- 2011
- 2012
- 2013*
JOURNEY: ENABLING ENVIRONMENT

- Stable Macroeconomic environment
  - Prudent management of monetary and fiscal policy (stable interest rate, inflation regime; stable exchange rate currency)
  - Reforms in the pension, insurance and cooperatives sector

POLITICAL STABILITY PARAMOUNT

Stable sovereign rating
Kenya GDP Growth Rate 2005-2012

GDP Growth Rate (%) vs Year

Growth Rate (%): 6, 6, 7, 4, 5, 5, 4, 4
Average 92-day T-Bill Rates 2005-2012

Year | Rate (%)
--- | ---
2005 | 8.44
2006 | 6.81
2007 | 6.8
2008 | 7.7
2009 | 7.38
2010 | 3.6
2011 | 8.73
2012 | 12.75

Av. 92-day T-Bill Rates
Kenya Shilling Exchange rate to the US Dollar 2005 - 2013

SOURCE: WWW.TRADINGECONOMICS.COM | OTC INTERBANK
Kenya inflation rate 2005 - 2013

KENYA INFLATION RATE
Annual Change on Consumer Price Index

SOURCE: WWW.TRADINGECONOMICS.COM | KENYA NATIONAL BUREAU OF STATISTICS
WHERE WE WANT TO BE

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Target? Next 5 Years
JOURNEY: ENABLING ENVIRONMENT

Robust and facilitative legal framework
- Recent amendments to the Regulatory Framework
- Move towards risk based supervision
- General Review of the overall framework ongoing
- Enhanced enforcement sanctions (penalties)
  - CMFIU established, penalties enhanced
- Enhanced Capacity in compliance and enforcement

- Strengthened of Corporate Governance functions of listed companies and market intermediaries (Corporate Governance and Business Conduct Regulations)
Robust and facilitative Policy and institutional framework

- Incentives: over 30 tax and policy incentives granted by the government. New products and services – venture capital, ABS, credit rating, underwriting.

Foreign investors can acquire up to 75% direct portfolio investment in equity.

- Modernisation of market infrastructure and practices – central depositories, automated trading systems creating room for linkages; state of the art surveillance system.

Broad range of products and services

- New products and services: Venture capital, ABS, REITs, credit rating, move towards establishing a regulated commodity futures market.
WHAT ARE WE ARE DOING AS CAPITAL MARKETS AUTHORITY
KEY REFORMS IN CAPITAL MARKETS

Capital Markets Master Plan (CMMP)
- Capital Markets Master Plan (CMMP) Steering Committee from a diverse mix of skills and expertise which will be expected to formulate the Capital Markets Master Plan within a period of 12 months
- Comprehensive Market Assessment already completed.

Implementation of framework of Demutualization of the Nairobi Securities Exchange
- The Nairobi Securities exchange is expected to be demutualized by July 2013. It is subsequently expected to self list

Framework for product development through effective oversight of empowered SRO’s
- Futures and Derivatives market development
- Key foundation for Bond Market reforms

Modernisation of market infrastructure and practices—
- Automated Trading and Depository System since 2006 (equity) and 2009 (Debt).
- State of art Surveillance System launched in June 2012
KEY REFORMS IN CAPITAL MARKETS

Regulatory Environment
- Introduction of Legal and Regulatory Framework inline with IOSCO Principles and international best practice
- Ongoing implementation of Risk Based Supervision by the Capital Markets Authority:
  - CMA is a Full Signatory of the IOSCO Multilateral MOU to play role in combating cross border market misconduct

Commodities/Futures
- The Authority is in the process of introducing a regulated Commodity Futures market following increased interest by potential local and international investor- First set of regulations (Futures Exchange Licensing, 2013) already on public exposure (May 1-31, 2013).
  - The Roll out of Derivatives and Commodities Futures Exchange by June 2013 informed by consultancy, capacity building tours to India, Mauritius, Brazil, USA, South Africa and presently Côte D’Ivoire
  - Derivatives trading of International Contracts in Currency, Interest Rate, Minerals/Mining in line with Authority’s drive to be an International Financial Center
REITS

- Introduction of Real Estate Investment Trust vehicles to leverage booming property industry
- Introducing Traditional REIT products for income generating rental properties
- Introducing unique Development REIT products to fund construction and development

Investor Education

- As a key objective of our strategic plan, investor education and public awareness remains and will continue to be at the top of the Authority’s development agenda.

Corporate Governance

- Establishment of a Corporate Governance Steering Committee.
GEMS

- Introduction of Listing Platform for SME and Venture Companies
- **Growth and Enterprise Market Segment (GEMS)**
- Modeled on TMX Venture Exchange, the JSE ALTEX and the London Stock Exchange AIMS market
- Provides a prime avenue for exit for growing Private Equity and Venture Capital investment industry
- Opportunity for entrepreneurs to diversify ownership and realize investment

Islamic Capital Market

- Accelerating the building of critical mass for the development of a significant **Islamic Capital Markets industry** thereby widening the range of available Shariah-compliant products and services.
- Government Infrastructure bonds and recent Diaspora Bond issuance had a Sukuk component
- Discussions with stakeholders to introduce Sukuk’s to attract Sovereign Wealth Funds from the Middle East ongoing
KEY REFORMS IN CAPITAL MARKETS

Bond Market Reforms

- A Bond Market Steering Committee was constituted to spearhead implementation of the bond market reforms.
- Two trading avenues for bonds creating a hybrid bond market
- The Over-the-counter (OTC) or off-exchange trading which is done directly between two parties;
- On exchange trading
- Proposal to introduce short selling submitted to MoF

The OTC model is expected to be fully operational by June 2013
CONCLUSION

- The macroeconomic environment continues and is further expected to improve with inflation and interest rates declining and real GDP growth improving.

- We expect further deepening and broadening of capital markets in Kenya: GEMS, REITS, ISLAMIC products, Futures market........

- Indications are good performance recorded in 2012 to 2013 and expected to continue in 2014 and beyond.
THANK YOU
OPEN DISCUSSION!

Website: www.cma.or.ke